



**U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL**

ADVISORY MEMORANDUM

Report Number 12-22

DATE: September 28, 2012

TO: Jonathan I. Carver
Chief Financial Officer, Office of the Chief Financial Officer

SUBJECT: The SBA's Ratification Process Could Lead to Possible Anti-Deficiency Act Violations

This Advisory Memorandum presents an issue that we identified during our on-going audit of *the Small Business Administration's (SBA) Unauthorized Commitments*. On May 9, 2012, we verbally notified procurement officials at the Denver Finance Center of our concerns. Specifically, the SBA (or the Agency) identified four unauthorized commitments¹ associated with an expired contract for postage meters in Fiscal Year 2011. Further, we determined that the SBA ratified these unauthorized commitments without determining whether unobligated funds were available when the unauthorized commitment initially occurred. Without such a determination, these ratifications appear to be invalid under Federal Acquisition Regulations (FAR) and U.S. Government Accountability Office (GAO) guidance, and may put the SBA at risk for an Anti-Deficiency Act violation. We did not determine how widespread this deficiency was, but wanted to provide SBA management with an early notification of this issue so the Agency can expeditiously implement corrective action, if needed.

The objective of the overall limited scope audit on unauthorized commitments was to determine the extent and reasons unauthorized commitments occurred at the SBA. As part of this audit, we selected 293 unauthorized commitments for review based upon the total dollar value and total number of the invoices per vendor. We included ratified invoices as well as invoices in various stages of the ratification process. The Office of Inspector General (OIG) Counsel Division conducted a legal assessment to determine whether the ratifications met the FAR standards required for ratification, including proof that funding was available on the date of the unauthorized commitment. This advisory memorandum discusses the results of our review for one of the selected ratification files and the associated vendor.

During the course of our audit, we identified an internal control weakness with the SBA's ratification process. Specifically, the SBA's ratification template did not comply with the FAR. According to SBA managers, this ratification process has been in use since February 2011, and they intended to continue using it to ratify all of the unauthorized commitments identified by the Acquisition Division personnel at the Denver Finance Center. However, when we notified Acquisition Division management about the weaknesses in its ratification template in May 2012, it updated the template in an attempt to ensure adequate controls are in place.

¹ An unauthorized commitment represents an agreement to procure goods or services that is made without requisite authority.

We conducted our audit in accordance with generally accepted government auditing standards from December 2011 to August 2012. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Background

Legal Standard for Ratification

The FAR defines ratification as the act of approving an unauthorized commitment² by an official who has the authority to do so. According to FAR 1.602-3(c), there are seven requirements to ratify an unauthorized commitment.³ This memorandum primarily discusses the requirement for agencies to demonstrate that “funds are available and were available at the time the unauthorized commitment was made.”⁴

In addition to the FAR guidance for ratifications, GAO opinions indicate that ratifications must determine that appropriated funds existed at the time of an unauthorized commitment. Specifically, the GAO defines ratification as “the equivalent of a previous authorization that relates back to the time when the ratified act was done.”⁵ Another GAO opinion found that a particular ratification was proper under the FAR, in part, because “funds were available to pay for the work at the time the commitment was made.”⁶ Therefore, federal government agencies must have had sufficient and unobligated appropriated funds—not otherwise apportioned—at the time the unauthorized commitment occurred in order to ratify the contract properly.⁷

The SBA Ratification Process

Shortly after the Acquisition Division was reconstituted as a component within the Office of the Chief Financial Officer at the Denver Finance Center, the Division established a Ratification Team. This Ratification Team is composed of employees designated to resolve the SBA’s unauthorized commitments identified by the Acquisition Division. This team developed a template in February 2011

² Federal Acquisitions Regulations Subpart 1.602-3 defines an unauthorized commitment as an agreement between a vendor and the government representative that is not binding solely because the government representative who made the commitment lacked the authority to enter into that agreement on behalf of the government. Under FAR 1.602-1, contracting officers lack authority to enter into a contract if by doing so they exceed limitations imposed by the procuring agency or enter into a contract that does not comply with all applicable legal requirements. This would include receiving products or services from a vendor without a valid agreement that complies with the FAR.

³ Federal Acquisitions Regulations Subpart 1-602.3(c)(7) of the FAR also provides that a ratification of an unauthorized commitment must be in “accordance with any other limitations prescribed under agency procedures.” Accordingly, we reviewed SBA’s SOP 00 11, which governs procurement actions. We note that SOP 00 11, much of which has not been updated in 1986, appears to be out of date. For example, the section addressing ratification (Chapter 14, Section 226-228) does not mention FAR section 1-602.3.

⁴ 48 C.F.R. § 1.602-3(c)(6)

⁵ Government Accountability Office, Report B-237654, *Federal Highway Administration Purchase of Commercial Insurance*, February 21, 1991. Government Accountability Office, Report B-259926, *Mr. Dan J. Carney, Controller Federal Bureau of Prisons*, March 31, 1995. The FAR allows contracting officers to ratify unauthorized commitments that are otherwise proper contracts after the officer determines that such a contract or commitment could have been authorized at the time of the award.

⁶ Government Accountability Office, Report B-306353, *Architect of the Capitol-Contract Ratification*, October 26, 2005.

⁷ 31 U.S.C. § 1511(a), An appropriation generally identifies the sums an Agency is authorized to obligate. Office of Management and Budget Circular A-11, at § 20.3, An apportionment is a plan, approved by the Office of Management and Budget (OMB), to spend appropriated funds. 31 U.S.C. § 1512(a), Apportionments are administrative divisions of an appropriation designed, among other things, to ensure agencies have a predictable source of funds and do not spend money at a rate likely to cause a deficiency or need for supplemental appropriation.

to be used in all ratifications in order to streamline the process and time required for each ratification.⁸ The template discussed the seven requirements identified in the FAR⁹ for a ratification and included agency procedures¹⁰ that dictated that a Determinations and Findings (D&F) be created for each ratification. The D&F must describe the history of the unauthorized commitment and include a recommendation from the Contracting Officer on whether or not it should be ratified. In addition to the D&F, the ratification files included legal and funding reviews, and statements from the vendor and SBA employees involved with the unauthorized commitment.

Results

Deficiencies May Exist in the SBA's Ratification Process

As of May 2012, the Acquisition Division had identified 417 unauthorized commitments incurred by the SBA. Normally, an agency would ratify one invoice at a time; however, due to the large number of unauthorized commitments, the SBA Ratification Team bundled together invoices for ratification based upon the vendor and the associated expired contract, if applicable. Acquisition Division data showed that 30 vendors submitted invoices to the SBA for products and/or services that were provided without a binding agreement. Of these 417 unauthorized commitments, 145—valued at \$581,877.99—had been ratified using a process that could possibly lead to possible Anti-Deficiency Act violation(s).

In order for an unauthorized commitment to be ratified, an agency must prove that “funds are available and were available at the time the unauthorized commitment was made.”¹¹ However, the Ratification Team only determined that funds were currently available to ratify the unauthorized commitment, and not if funds were available when the unauthorized commitment occurred. Because the Ratification Team used the same template and the same process for all ratifications prior to its update in May 2012, we are concerned that the deficiencies we have identified in the selected ratification file may have occurred in other ratifications. However, since we raised concerns, the SBA has begun a process of reviewing all ratifications made between February 2011 and May 2012 to determine if those ratifications met all seven requirements outlined in FAR 1.206-3(c), to ensure that funds existed at the time the unauthorized commitment occurred. We believe this process presents a possible risk for the SBA because seven Continuing Resolutions occurred in fiscal year 2011.

Establishing the availability of funds at the time of the unauthorized commitment is essential to ensuring that the SBA does not violate the Anti-Deficiency Act. Such a violation could occur when ratifying unauthorized commitments in one of two ways: (1) obligating funds in excess of an appropriation; or (2) obligating funds in excess of an apportionment.¹² In the first instance, the SBA could theoretically violate the Anti-Deficiency Act by ratifying the unauthorized commitment, and paying the vendor, when it had already obligated the fiscal year funds for other purposes at the time of the commitment. The second possible violation may occur if the unauthorized commitment obligates funds in excess of any apportionment from the Office of Management and Budget. Additionally, a violation of the Anti-Deficiency Act exposes responsible employees to administrative disciplinary actions and potential

⁸ This ratification template was updated more recently in May 2012, as previously noted in the memorandum, to address concerns we raised with the Acquisition Division to include the additional safeguards to ensure that each ratification complied with the requirements for ratification outlined in FAR 1.602-3(c).

⁹ 48 C.F.R. § 1.602-3(c), Limitations.

¹⁰ SBA Procedure No. A-2: Ratifications. February 18, 2009.

¹¹ 48 C.F.R. § 1.602-3(c)(6)

¹² 31 U.S.C. §§ 1341(a)(1)(A), 1517(a).

criminal charges.¹³ Further, agencies must report violations of the Anti-Deficiency Act at either the appropriation or apportionment level to the President and Congress.¹⁴

For the selected ratification file discussed in this memorandum, the unauthorized commitments occurred when the agency received postage meter services after the contract had expired. The contract for postage meter services expired on September 30, 2010, but the SBA continued to receive postage meter services for all of fiscal year (FY) 2011 without an active contract. These services resulted in four unauthorized commitments with a total value of \$14,832.00 in FY 2011.

Our Counsel Division completed a legal assessment of this ratification file and determined that the file did not provide sufficient evidence to support the ratification of the unauthorized commitments. The funding determination in the ratification file did not show that the SBA determined that unobligated funds were available when the unauthorized commitment initially occurred. The Chief Financial Officer stated that the FY 2011 funds were set aside at the beginning of the fiscal year to cover previous and future unauthorized commitments. However, procurement officials stated that FY 2011 funds were set aside in September 2011. Additionally, the documentation in the file only provided evidence to show that funding from FY 2011 was set aside at the end of the fiscal year. For example, the funding determination in the D&F stated that an SBA finance official “has confirmed that funds are available.” Additionally, the funding letter showed that:

Near the conclusion of the FY 11 budget year the OCFO made a determination and estimate of all unauthorized commitments remaining for the year. An accrual and obligation for \$1.9M was made at that time. Ratifications appropriately related to FY 11 are processed against these funds that were set aside for this specific purpose. There are sufficient funds to cover this current ratification in the amount of \$14,832.

A primary source of evidence the Acquisition Division could use to prove funds were available at the time an unauthorized commitment occurred is the SBA Form 2—*Requisition for Supplies, Services and Federal Assistance*. The SBA Form 2 is signed by an SBA budget or finance official to prove that appropriated funds were available at the time of the unauthorized commitments, or a requisition, for supplies, services, or federal assistance.¹⁵ Our review confirmed that the file did not include a Form 2 supporting the availability of funds at the time of the original unauthorized commitment for the postage meter contract. Additionally, the official statements from the employee who made the unauthorized commitment and his/her supervisor explained:

We received funds in our FY 11 budget to cover this expenditure but the Form #2 for this service was not processed due to a misunderstanding/miscommunication on how it was to be processed during a Continuing Resolution.

Because the ratification file for postage meter services did not contain any documentation to prove availability of funds at the time the services were received, the ratification of this unauthorized commitment appears invalid. Specifically, without a determination that appropriated funds were

¹³ 31 U.S.C. §§ 1349, 1350, 1518, and 1519.

¹⁴ 31 U.S.C. §§ 1351, 1517(b).

¹⁵ According to SBA SOP 00 11, this form is “the foundation on which the entire procurement action at SBA build” along with Imprest Fund Form 1165. SOP 00 11 Chapter 1, Paragraph 1(b)(June 16, 1987). When used as designed, an SBA budget officer initials SBA Form 2 prior to presentation to a warranted contracting officer, ensuring contemporaneous availability of appropriate funds for the requisition. SOP 00 11 Chapter 2, Paragraph 8(b)(1)(April 6, 1994).

available at the time of the unauthorized commitment, the SBA cannot ratify an unauthorized commitment properly in accordance with the FAR.¹⁶ Proper ratification of contracts under the FAR is significant because the Government may only record an obligation when it is supported by documentary evidence of a binding agreement.¹⁷

Conclusions

The ratification process used between February 2011 and May 2012 may have made the SBA vulnerable to possible Anti-Deficiency Act violation(s), since it did not require evidence that funding was available at the time the unauthorized commitment was made. While we did not determine the extent of the deficiencies, we notified SBA management of this issue in May 2012 and again in August 2012 so that the Agency could implement corrective action(s), as needed. As a result of these discussions with SBA management, the agency updated its ratification template to ensure that funds existed at the time the unauthorized commitment was made for all ratifications made since May 2012 and all future ratifications. Since raising our concerns with management, the SBA is in the process of reviewing the ratifications made between February 2011 and May 2012 to ensure that they comply with all the requirements outlined in the FAR.

Recommendations

We recommend that the Chief Financial Officer:

1. Continue to review remaining ratification actions that have been taken using this template to determine if they contain similar deficiencies, and undertake appropriate corrective action to ensure that all ratifications approved by the SBA are valid under the FAR.
2. Review and determine if any Anti-Deficiency Act violations occurred in the previously ratified unauthorized commitments.

Agency Comments and Office of the Inspector General Response

On August 28, 2012, we provided a draft of this advisory memorandum to the Chief Financial Officer (CFO) and the Deputy Chief Financial Officer for comment. On September 13, 2012, the CFO submitted formal comments, which are included in their entirety in Appendix I. The CFO stated that he concurred with the findings of the advisory memorandum and will follow the recommendations listed in the memorandum. A summary of management's comments and our response follows.

Recommendation 1 - Continue to review remaining ratification actions that have been taken using this template to determine if they contain similar deficiencies, and undertake appropriate corrective action to ensure that all ratifications approved by the SBA are valid under the FAR.

Management Comments

The CFO stated that his office has started to review the remaining ratification actions ensuring that all the ratifications are valid under the FAR. The OCFO also has reviewed the month-end balance of funds

¹⁶ 48 C.F.R. § 1.602-3(c)(6)

¹⁷ 31 U.S.C. § 1501(a).

for fiscal year 2011 and has reasonably determined that the agency had enough funds to cover the unauthorized commitments. Additionally, he stated that the Acquisition Division now uses the revised ratification template that complies with the FAR.

OIG Response

We consider management's comments responsive to the recommendation.

Recommendation 2 - Review and determine if any Anti-Deficiency Act violations occurred in the previously ratified unauthorized commitments.

Management Comments

The CFO stated that the agency cannot go back to the exact time when the unauthorized commitment took place, but the OCFO staff has reviewed the month-end balance for each month of Fiscal Year 2011. Based upon the review of the month-end balance of funds, the OCFO states that it can reasonably determine that the agency had enough funds to cover the unauthorized commitment. Additionally, according to the CFO, because the agency has an annual budget authority of approximately \$600 million for operations, it is almost impossible to have insufficient funding to cover nominal dollar amounts.

OIG Response

We consider management's comments non-responsive to the recommendation. The FAR requires that in order to execute a ratification, an analysis be performed to verify that funding was available at the time of the unauthorized commitment, not a range of time. Furthermore, Title 31 U.S.C. Section 3512, "*Executive agency accounting and other financial management reports and plans,*" requires agencies to establish internal accounting and administrative controls that reasonably ensure that obligations and costs comply with applicable law. It also requires that accounting controls reasonably ensure revenues and expenditures applicable to agency operations are recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared. In order to comply with these requirements, the SBA needs to have controls in place that reasonably ensure that funding was available at the time of the unauthorized commitments.

The SBA's response raises concerns that existing accounting and administrative controls do not reasonably ensure obligations and costs comply with applicable law. In addition, the FAR requires agencies to demonstrate that funds are available and were available at the time the unauthorized commitment was made. During fiscal year 2011, the SBA was funded through a total of seven Continuing Resolutions and each of the 417 unauthorized commitments must be matched to the existing appropriation at the time that the unauthorized commitment occurred. Therefore, merely performing a month-end analysis to determine whether funds were available, rather than an assessment of whether funds were available on the date that the unauthorized commitment occurred, does not reasonably ensure compliance with the FAR. While we agree that generally the SBA will have funds to pay for their commitments, the SBA cannot guarantee that funding is available at any point in time—particularly during multiple continuing resolutions. We believe that verifying the availability of funds at the time of the unauthorized commitment is crucial to ensure that Anti-Deficiency Act violation(s) did not occur.

Actions Required

Please provide your management decision for each recommendation on the attached SBA Form 1824, Recommendation Action Sheet, within 30 days from the date of this report. Your decision should identify the specific action(s) taken or planned for each recommendation and the target date(s) for completion.

We appreciate the courtesies and cooperation of the Small Business Administration during this audit. If you have any questions concerning this report, please call me at (202) 205-7390 or Riccardo R. Buglisi, Director, Business Development Programs Group at (202) 205-7489.

/s/
John K. Needham
Assistant Inspector General for Auditing

Appendix 1: Agency Comments



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

TO: John K. Needham
Assistant Inspector General for Auditing, Office of Inspector General

FROM: Jonathan Carver /s/
Chief Financial Officer, Office of the Chief Financial Officer

DATE: September 13, 2012

SUBJECT: OCFO's Response to OIG's Draft Advisory Memorandum on SBA Ratification Process dated August 28, 2012

OCFO concurs with this Draft Advisory Memorandum. Specifically, OCFO will follow the two recommendations listed in the report. OCFO has started to review remaining ratification actions ensuring that the ratifications are valid under the FAR, and the Acquisition Division uses the revised ratification template that complies with the FAR. Although we can't go back to the exact time when the unauthorized commitment took place, we reviewed the month-end balance for each month of FY2011. Based on the review we can reasonably determine the agency had enough funding to cover the unauthorized commitments. Moving forward, the Acquisition Division will individually review each invoice instead of in a "batch process" due to the rapidly decreasing number of ratifications. Given SBA's annual budget authority of approximately \$600 million for operations (Salaries and Expenses), it is almost impossible to have insufficient funding to cover nominal dollar amounts. Although we make all attempts to budget to the penny, there will almost always be remaining funds because of deobligations, in addition to the various other reasons the designated funding may not be spent.