

**AUDIT REPORT ON**  
**THE HAWAII SMALL BUSINESS**  
**DEVELOPMENT CENTER**  
**HILO, HAWAII**  
**AUDIT REPORT NO. 8-7-F-004-005**  
**DECEMBER 24, 1997**

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**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20416**

<b>AUDIT REPORT</b>
<b>Issue Date: December 24, 1997</b>
<b>Number: 8-7-F-004-005</b>

**TO:** Andrew K. Poepoe, District Director  
Honolulu District Office

**FROM:** Peter L. McClintock  
Assistant Inspector General for Auditing

**SUBJECT:** Audit Report - Audit of the Hawaii Small Business Development Center

Attached is a copy of the audit report on the Hawaii Small Business Development Center (HSBDC). The report contains four findings with eight recommendations directed to your office. We found that the HSBDC (1) did not focus resources to provide counseling assistance to the small business community, (2) could enhance its program delivery and offset UH-Hilo program funding reductions by soliciting increased funding, (3) had some financial reporting inaccuracies and timeliness problems, and (4) had minor unallowable expenses because indirect cost rates were improperly applied and the calculation of in-kind rents was incorrect.

The findings included in this report are the conclusions of the Office of Inspector General's Auditing Division based upon the auditors' testing of the HSBDC operations. The findings and recommendations are subject to review and implementation of corrective actions by your office following existing Agency procedures for audit follow-up and resolution.

Please provide us your management decisions for the recommendations within 80 days. Record your management decision on the attached SBA Form 1824, Recommendation Action Sheet, and show either your proposed corrective actions and target dates for completion or an explanation of your disagreement with our recommendations.

Should you or your staff have any questions or wish to discuss the issues contained in the report, please contact Garry Duncan, Director of Field Operations, at (202) 205-7732.

Attachment

**AUDIT OF  
THE HAWAII SMALL BUSINESS DEVELOPMENT CENTER**

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## SUMMARY

The objectives of the audit were to determine if (1) resources were effectively used to provide counseling assistance to the small business community, (2) operations were in conformance with the Cooperative Agreement, and (3) expenditures were allowable. Generally, the Hawaii Small Business Development Center (HSBDC) activities conformed to the Cooperative Agreement and expenditures were allowable. Operations could be improved, however, by increasing counseling services and fund raising activities; preparing accurate, timely financial reports; and properly computing indirect and in-kind costs. The auditors found:

- Counseling services, while considered the major service, averaged only 15.6 percent of the total staff hours available because a disproportionate amount of staffing resources were devoted to non-counseling services, such as secretarial and administrative duties. Counseling services could be increased by reallocating staffing resources.
- Funding stability could be improved by applying for funds available from private and local government entities. Increased funding would allow HSBDC to use its resources more effectively to provide counseling assistance to the small business community.
- The reporting and approval requirements in the Cooperative Agreement were not always followed. Financial and performance reports were not prepared or were inaccurate and submitted late.
- Indirect costs were overstated by \$30,415 because incorrect rates were used and in-kind rents were not properly prorated. Conversely, the HSBDC did not claim allowable indirect costs of \$34,837 for matching funds.

We recommend that the District Director, Honolulu District Office, require the HSBDC to take the following actions:

- Submit a plan to increase counseling hours and reduce administrative time.
- Increase fund raising from private sector and local government entities.
- Ensure that accounting problems are corrected and timely reports are submitted to SBA.
- Ensure that SF269 reports show how program income was received and used to further program objectives.
- Prepare and submit semi-annual and annual performance reports in accordance with the Cooperative Agreement.
- Use correct negotiated indirect cost rates to allocate expenditures.

- Prorate in-kind rent costs.
- Compute allowable indirect costs for matching funds regardless of the amount of Federal funds received.

The District Director, Honolulu District Office, advised that the HSBDC State Director was directed to (i) analyze and develop a plan to maximize client service delivery to the small business community based on economic conditions and projected trends statewide, (ii) aggressively seek out appropriate fund raising and partnership activity, (iii) work closely to resolve all reporting compliance issues, and (iv) incorporate the cost rate recommended by the University of Hawaii study group.

The HSBDC State Director disagreed with the recommendation and several statements and conclusions in finding 1. The Auditee Response and OIG Evaluation section of the report (page 7) discusses these matters. The Director generally agreed with the other three findings and recommendations.

The findings included in this report are the conclusions of the Office of Inspector General (OIG) Auditing Division based on testing of the auditee's operations. The findings and recommendations are subject to review, management decision, and corrective action by your Office in accordance with existing Agency procedures for follow-up and resolution.

## **INTRODUCTION**

### **A. BACKGROUND**

The Small Business Development Center (SBDC) Program is a partnership between SBA and host organizations to provide small businesses quality assistance in promoting growth, expansion, innovation, productivity, and management improvement. These objectives are accomplished through counseling, training, and specialized support.

SBA funds the SBDC through cooperative agreements that link resources of the Federal, state, and local governments with those of colleges, universities, and the private sector. The SBDC network includes a lead center and various sub-centers. In order to qualify for assistance, matching funds must be provided equal to the total amount of the SBA grant. At least 50 percent of this match must be in the form of cash.

The SBDC program is governed by Title 13, Code of Federal Regulations (CFR), Parts 130 and 143; SBA Standard Operating Procedure (SOP) 60 16; an individual cooperative agreement; the annual program announcement; and Office of Management and Budget (OMB) Circulars A-21, A-87, and A-110.

The Hawaii Small Business Development Center (HSBDC) network was established in January 1990 to operate as a department of the University of Hawaii at Hilo (UH-Hilo). The state office (lead center) and its State Director are located on the UH-Hilo campus. Services are delivered through five sub-centers located in Hilo, Hawaii; Kihei, Maui; Lihue, Kauai; Leeward, Oahu; and Honolulu, Oahu. A Business Research Library, co-located with the Kihei sub-center, provides specialized research services. Five of the HSBDC's 15 employees are counselors, four of whom also serve as sub-center directors.

The 1995 budget was \$905,061, including \$433,455 in SBA funding. The HSBDC was also responsible for overseeing a Department of Defense \$5.4 million grant that provided agricultural research projects for the depressed sugar industry in Hawaii. The grant funded 140 percent of a counselor position, two secretarial positions, and 30 percent of an administrative assistant position.. Accounting support was provided by another University entity, the Research Corporation of the University of Hawaii.

### **B. AUDIT OBJECTIVES AND SCOPE**

The objectives of the audit were to determine whether (i) resources were effectively used to provide counseling assistance to the small business community, (ii) operations were in conformance with the Cooperative Agreement, and (iii) expenditures were allowable.

Operations of the HSBDC state office/lead center, each sub-center, and the Business Research Library were evaluated by flowcharting processes, examining internal controls,

analyzing management and staffing, assessing reporting requirements, comparing program goals and accomplishments, and quantifying fundraising efforts. To assist in evaluating operational effectiveness, we sent questionnaires to clients and interviewed small business community leaders familiar with the HSBDC operations. The audit covered operations from January 1, 1995, to December 31, 1995, and certain 1996 financial, counseling, and program operations. Fieldwork was conducted from January 9 through July 15, 1997, at the lead center and each sub-center. The audit was performed in accordance with Government Auditing Standards.

### **C. FOLLOW-UP ON PRIOR AUDITS**

There were no prior audits of this Small Business Development Center.

### **RESULTS OF AUDIT**

While HSBDC's counseling assistance to the small business community could be enhanced, financial and reporting activities generally conformed with the cooperative agreement, except for the accuracy and timelessness of required SBA reporting. Expenditures were generally allowable except that indirect cost rates were improperly applied and indirect costs and in-kind rents were incorrectly calculated.

#### **FINDING 1 Counseling Services could be Increased by Reallocating Staff Resources**

While counseling is expected to be the major service provided for small businesses, it averaged only 15.6 percent of staff hours available for counseling in fiscal years 1995 and 1996. This occurred because a disproportionate amount of staffing resources were directed toward non-counseling functions, such as secretarial and administrative duties, and advocacy. As a result, HSBDC did not fully achieve its program objective of providing counseling to the small business community.

#### **Program delivery to the small business community**

The HSBDC considers counseling the principal effort of its core program. SOP 60 16 states that SBDCs shall emphasize providing in-depth, high-quality assistance to small business owners or prospective small business owners. Counseling involves furnishing one-to-one assistance in complex areas that require specialized expertise, such as management, marketing, finance, accounting, capital formation, and human resource management.

#### **Use of staffing resources**

Despite its own standards, the HSBDC dedicated over 80 percent of total staffing resources to non-counseling functions. Our analysis, which excluded the staffing positions

funded by a Department of Defense/Department of Agriculture grant, showed that HSBDC's direct counseling hours totaled only 14.8 percent and 16.5 percent of the total available hours in 1995 and 1996, respectively. Furthermore, a September 1997 programmatic review conducted by the Program Operations and Liaison staff of the Office of the Associate Administrator, Small Business Development Centers, showed that the HSBDC ranked 52<sup>nd</sup> out of 57 SBDCs in counseling performed.

The following table shows the percent of direct counseling hours to total hours.

**Percent of Direct Counseling Hours Compared to Total Hours Available**

		<b>Counseling Hours</b>		<b>Non-Counseling Hours</b>				
a	b	c	d	e	f	g	h	j
Year	Total Staff	Direct	Training, Advocacy, Administration	Administration Hours	Research Assistant	Secretarial	Total Hours* (c through g)	Percentage of Direct Counseling (c/h)
1995	15.3	4,092	5,491	5,424	3,616	9,040	27,663	14.8%
1996	15.4	4,590	5,188	5,424	3,616	9,040	27,858	16.5%
Avg.	15.35	4,341	5,340	5,424	3,616	9,040	27,761	15.6%

\* Total hours based on 1,808 hours per year per employee

The table also shows that counselors were spending more hours on training, advocacy, and administration than on direct counseling (an average of 5,340 hours versus 4,341). The State Director stated that HSBDC exceeded its goals for cases worked and that start-up businesses were counseled through formal training sessions. We noted the number of cases serviced met established goals set by the HSBDC. The time dedicated to training, advocacy, and administration could not be determined because the number of hours spent performing these functions were not recorded separately. Although training is part of an SBDC's function, the SBDC Program Office does not consider training a substitute for counseling. Counseling cannot be effectively provided in a training environment because the training is not directed to a client's specific needs nor is it the one-on-one assistance that occurs in a counseling session.

### **Actions available to increase funds for counseling**

Increased funding for counselors is needed because 34 percent of the total HSBDC cash match for calendar years 1995 and 1996 was contractually encumbered to meet new requirements of the Business Research Library (BRL). These funds, therefore, could not be used for other purposes, such as funding new counselors.

Five of the 15 staff were secretarial positions that, in fiscal year 1996, accounted for 32.5 percent of the annual available staff hours (see the table). The remaining ten staff positions consisted of five counselor, three administrative, and two research positions.

#### **Secretarial versus Other Staff Resources**

<b>Description</b>	<b>Secretary</b>	<b>Admin.</b>	<b>Research Assistant</b>	<b>Counseling*</b>	<b>Total Staff</b>
<b>Total Staff</b>	<b>5.0</b>	<b>3.0</b>	<b>2.0</b>	<b>5.4</b>	<b>15.4</b>
<b>Total Hours</b>	<b>9,040</b>	<b>5,424</b>	<b>3,616</b>	<b>9,763</b>	<b>27,843</b>
<b>% Hours To Total</b>	<b>32.5%</b>	<b>19.5%</b>	<b>13.0%</b>	<b>35.0%</b>	<b>100%</b>

*\*Includes direct counseling, advocacy, training, and counselor administration*

The State Director stated that the physical separation of the Hawaiian islands and the nature of counseling required one secretary per counselor per sub-center, including Honolulu.

Present technology, such as electronic mail, fax machines, cellular telephones and call forwarding, however, provide options for improving counselor efficiency while reducing direct secretarial support. One possible scenario to make additional funds available for counseling service would be to (i) consolidate the secretarial functions in the Hilo sub-center and the HSBDC lead office, the Leeward and downtown Honolulu sub-centers, and the Maui sub-center and the Business Research Library ; and (ii) fund the Maui and Business Research Library secretary position using Library funds. Implementation of these actions would reduce the cost of secretarial services by about \$69,000 which could be used to fund additional counselors.

### **Counseling service to the Kona area**

In March 1996, the HSBDC budget was reduced and the State Director terminated the circuit rider counselor for the Kona area. The Kona area counselor position had the greatest number of hours charged to counseling in 1995. The Hilo sub-center director, who lived halfway between Hilo and Kona, was assigned the Kona area but provided counseling service

in Kona for only two days a month. Kona small business clients desiring counseling service more often had to drive over 200 miles round trip to Hilo.

With the elimination of the circuit rider, counseling hours in the Kona area in 1996 declined from 1,134 hours in 1995 to only 321 hours in 1996. This decline occurred during a period when local business and government officials reported that Kona was experiencing economic growth and many small businesses needed counseling services.

Implementation of the actions to increase counseling positions discussed in the preceding paragraphs should enable the HSBDC to assign a circuit rider to the Kona area without an increase in the present funding level.

### **The Leeward sub-center**

To implement an outreach strategy approved by SBA, the HSBDC hired a second counselor for Oahu and opened a new sub-center in Leeward, Oahu. When the Leeward sub-center opened, many of its clients were already served by the downtown Honolulu sub-center. These clients also had access to 66 private management consulting firms. Since none of the population pool was more than 32 miles from the downtown Honolulu sub-center, we questioned the necessity for opening a second sub-center only 12 freeway miles and about 20 minutes away from the downtown sub-center.

Based on our observations, the new Leeward sub-center neither increased the service area nor access to available services. As of May 31, 1997, the State Director was planning to add a secretary to the Leeward sub-center instead of consolidating operations on Oahu. Since the Leeward sub-center did not substantially expand services to new clients, the State Director should consider closing the sub-center and using those resources to meet higher priority counseling requirements.

### **Recommendations:**

1. We recommend that the District Director, Honolulu District Office, direct the State Director to submit a plan to increase counseling hours and reduce administrative time. Actions to assist in accomplishing this could include
  - reducing secretarial positions by consolidating secretarial functions,
  - re-establishing the Kona area circuit rider position,
  - consolidating the Leeward Oahu and downtown Honolulu sub centers, and
  - using the current Leeward counselor to provide small business counseling to the downtown Honolulu sub-center and the Kona area.

### **SBA Management Response**

The District Director agreed with the recommendations and directed the HSBDC State Director to (1) develop and incorporate reporting procedures which more accurately record counseling, training, research, and advocacy activities; and (2) analyze and develop a plan to maximize client service delivery to the small business community based on economic conditions and projected trends statewide.

The District Director also stated that the HSBDC is set up to satisfy Hawaii's unique needs and compares favorably with other SBDCs when counseling, training, advocacy and research are considered. He stated that the comparison of counseling hours to all other activities undertaken by the HSBDC misrepresented actual performance by under-reporting training hours and highlighted the need to develop a reporting system to credit work more correctly and consistently. Also, he stated that the one-to-one ratio of counselor to secretary is the current "model" for the HSBDC (see Appendix A).

### **Evaluation of SBA Management Response**

The District Director's actions are responsive to our recommendations. We believe, however, that the plan to maximize program delivery should include a review of the current staffing "model." A one-to-one counselor to secretary position may no longer be reasonable or supportable. Although the District Director stated that the HSBDC compared favorably with other SBDCs, no statistics were provided to support this position.

### **Auditee Response and OIG Evaluation**

The HSBDC State Director disagreed with the finding and recommendations and several statements and conclusions (see Appendix B). The response, however, did state that the HSBDC would address the need for greater client services to the small business community in the annual revision of its strategic plan. Based on additional factual information provided by the HSBDC, certain minor changes and deletions were made to the report. OIG evaluation of the responses is in italics.

- The Director, HSBDC agreed that counseling is an important part of program delivery but questioned whether counseling should be considered the primary method of program delivery.

*The HSBDC's performance standards indicated that counseling is the principal method of program delivery. The SBDC Program Office considers counseling to be the primary client service because it provides a solution to a small business client's specific problem. Oftentimes such problems are very complex and can be solved best through counseling. While training is an important part of client services and is useful in disseminating information that is not client specific, it does not provide the one-on-one solution that counseling provides.*

- The Director disagreed that the HSBDC had a total of 15 staffing positions. Instead, he stated that 13.54 full-time equivalent positions were available in fiscal year 1996.

*The information regarding the number of staffing positions and the hours spent providing counseling services was developed using the counseling records and staff interviews at the HSBDC. To determine the full time equivalent positions, we included all time charged to HSBDC activities divided by the total number of staff hours available for a year. Adjusting for holidays, vacation, and sick leave, we computed that the staff hours available per employee was 1,808. In addition, we excluded the time individuals charged to the Department of Defense grant from the hours available to the HSBDC. Based on the above assumptions and counseling records of the HSBDC, we calculated that the total staff hours available equaled 15.3 and 15.4 full time equivalent staff positions in 1995 and 1996, respectively. We were not provided the HSBDC records that the Director used to calculate the full time equivalent positions of 13.54 in 1996.*

- The Director stated that client service positions (including counselors and research staff) constituted about 52.6 percent and 52.4 percent of its total staffing positions in 1995 and 1996, respectively. Therefore, the HSBDC dedicated only 47.4 percent and 47.6 percent, respectively, to non-client service positions.

*We excluded research staff hours from the counseling hour calculations because their research efforts could not be defined as one-on-one counseling. In addition, the lack of any useable HSBDC records precluded quantifying the research staff hours for counseling calculation purposes. We therefore concluded that HSBDC classification of research staff hours as client service positions is not appropriate for counseling hour calculations.*

- The Director stated that direct counseling hours were 20.6 percent and 18.9 percent of all positions in 1995 and 1996, respectively, and the HSBDC was 51st out of 57 SBDCs in counseling hours in FY 1996. He added that the statistics used for comparison purposes were not comparable because the HSBDC maintained consistent definitions for statistical reporting purposes internally; however, these definitions may not be consistent with other SBDCs. He disagreed with the statement in the report that counseling services were low and considered counseling services to be appropriate given the other services provided and the strategy developed for Hawaii.

*Based on 13.54 staffing positions, the HSBDC computed direct counseling time for 1995 and 1996 was 20.6 percent and 18.9 percent, respectively. We consider the counseling percentages computed by the HSBDC to be low. Ranking SBDC's by counseling hours provides an indication, for nationwide comparison purposes, as to the level of effort an SBDC expends on counseling. The ranking of SBDCs for*

*counseling services provided was determined by using a standard measure - dividing the total number of hours charged to counseling by the total amount of Federal dollars received. Using this approach, the HSBDC ranked 52<sup>nd</sup> in providing counseling services for Federal fiscal year 1996. The HSBDC ranking indicated it is below the national average and needs to increase its counseling hours.*

- The Director stated that although the number of secretarial positions may appear high, the number is appropriate as a percentage of resources. Secretarial positions comprised 22.7 percent of the total position resources. The Director also stated that in addition to performing administrative functions, secretaries perform some client services. Reducing the number of secretaries would adversely affect the morale, efficiency and effectiveness of the HSBDC.

*We agree that the secretarial staff provides an invaluable service to the HSBDC. We believe, however, that with modern technology, the number of secretarial positions may be reduced without adversely affecting administrative support and the resources directed to providing client services. With advancement of such technology as word processing, electronic mail, voice mail, fax machines, and cellular telephones, many of the duties performed by a secretarial staff are now done by a non-administrative individual. For example, voice mail allows callers to leave messages which the counselor can retrieve and answer at his or her convenience when not available or out-of-town. Voice mail also allows call forwarding so that local or remote offices can receive and answer phone calls even though a secretary is not available to answer the calls or receive messages. With email and computers, counselors can also prepare final documents and send or receive mail without the services of a secretary. The scenarios described above should decrease the number of secretarial positions needed to support counselor positions.*

- The Director questioned the accuracy of the actions proposed to enable an increase in counseling hours within the current funding levels. The proposed actions were considered counter-productive for Hawaii. The HSBDC State Director stated eliminating two secretarial positions would not provide sufficient funds to hire one full-time counselor.

*Based on HSBDC payroll information for secretarial positions versus counselor positions, we determined that consolidating secretarial positions as described in the finding would provide sufficient funds to hire at least a part time counselor. The discussion in the finding suggesting that the number of secretarial positions be reduced was only one approach that the HSBDC might take to increase counselor positions within current funding levels. If the HSBDC implements the recommendation in Finding 2 to increase fund raising, additional counselors may*

*be hired and the current number of secretarial positions may be sufficient to support additional counselors.*

- The Director questioned the statement that the terminated counselor (Kona area circuit rider) was the most productive. Adjusting for travel time, the Kona area counselor was not as productive as claimed. If the Kona counselor's hours were adjusted for travel time, the number of hours spent providing counselor hours decreased to 897 from 1,134. Furthermore, if the Kona counselor's hours were adjusted for the average time spent by other counselors in administrative duties and advocacy, the number of actual counseling hours would decrease to 762. The Kona counselor had minimal or no administrative, supervisory, or outreach duties.

*The statement that the Kona counselor was the most productive was based on HSBDC counseling records. This counselor charged more time to counseling than any other counselor position. We were unable to verify the new HSBDC data and do not know what records were used to recalculate the counselor's performance. We recognize, however, that the number of clients served through counseling is also an indicator of productivity. To evaluate productivity, the number of clients served, the type of service provided, and the amount of time charged to counseling must be considered. Based on the HSBDC's response we changed the report to read the counselor with the greatest number of hours charged to counseling was terminated.*

- The Director disagreed that HSBDC should consider closing the Leeward sub-center. The Leeward sub-center was opened at the mandate of SBA to increase delivery of HSBDC services on Oahu.

*The delivery of increased HSBDC services on Oahu was the result of adding a counselor position. The goal of increasing program delivery could have been achieved without establishing the Leeward sub-center. The second counselor position could have been assigned to the Honolulu sub-center. Consolidation of the Leeward and the Honolulu sub-centers should not reduce the delivery of services but could reduce operating costs. Although SBA approved the HSBDC outreach strategy to add two more counselors to Oahu, it did not mandate the opening of the Leeward sub-center or any realignment of counselor resources.*

## **HSBDC ADDENDUM RESPONSE**

### **Finding 1: Counseling Services Could be Increased**

#### **Auditee Response and OIG Evaluation**

The HSBDC State Director, in an addendum to his response to the draft report, disagreed that the total counseling hours for the Kona area for 1996 was 321 hours. He stated the total was 653 hours, which represented an understatement of 103.4 per cent. The State Director also said the 321 hours covered only the period from January 1, 1996 to March 15, 1996 and should have included the 332 counseling hours provided by the Hilo center director during the period March 15, 1996 to December 31, 1996.

*The HSBDC State Director addendum response did not change the thrust of the finding and recommendation. The audit focused on 1995 operations and provided updated 1996 data based on documents provided the auditor by the HSBDC. The 321 hours reported for 1996 was based on counseling hour reports the HSBDC provided the auditors. The additional 332 hours claimed by the State Director was not identified on the HSBDC counseling hour reports as being provided to the Kona area. Accepting the fact that the total counseling hours for the Kona area in 1996 was 653 hours instead of 321, the number of counseling hours still decreased by 42 percent from the 1995 level of counseling services provided.*

### **Finding 1: Counseling Services Could be Increased**

#### **Auditee Response and OIG Evaluation**

The HSBDC State Director stated in his addendum response that the existence of 66 management firms on Oahu was immaterial to the program because the SBA program announcement prevented the HSBDC from competing or appearing to compete with the private sector. As a result, the HSBDC did not consult with companies which could afford the private consultants.

*The addendum response did not change the finding and recommendation contained in the audit report. The presence of 66 management consulting firms is not material to the finding. The finding focused on the appropriateness of opening a second center on Oahu only 12 miles and 20 minutes away from the Honolulu sub-center. The Leeward sub-center did not increase the service area or access to available services and was not mandated by SBA. The new sub-center represented an inefficient use of resources and increased HSBDC operating costs during a period when its budget was being reduced. Based on our observations, the goal of increasing program delivery could have been achieved without establishing a new office.*

### **FINDING 2 Program Funding from Private and Public Sources should be Sought**

The HSBDC was vulnerable to UH-Hilo funding fluctuations as demonstrated by fiscal years 1993 and 1995 UH-Hilo funding reductions. As a result, HSBDC's ability to

deliver program services to the small business community was hampered. Increased fund raising would allow the HSBDC to reduce the impact of UH-Hilo funding fluctuations.

### **SBDC program objectives are important to the business community**

The Cooperative Agreement states the program objectives are to strengthen the small business community, contribute to its economic growth and make assistance available to small businesses. The presidents of each islands' chamber of commerce, officers of various banks, and county officials throughout the State of Hawaii endorse the HSBDC. Several of these business and public officials agreed that the program provided a crucial adjunct to efforts to overcome the economic recession in Hawaii.

### **Funding reductions resulted in a proposed outreach strategy**

UH-Hilo funding reductions in fiscal years 1993 and 1995 resulted in staffing cuts, including layoffs of the associate state director, the administrative assistant, and the Kona area counselor. SBA began addressing these issues in an October 5, 1994, letter which recommended that the HSBDC implement fund raising from other sources such as the private sector. It was also suggested that the lead center relocate from UH-Hilo to Oahu where most of the potential funding sources were located. Subsequent memorandums in 1994 and early 1995 reiterated SBA's concerns. The State Director, the UH-Hilo Chancellor, one of Hawaii's U.S. Senators and Representatives, and community leaders opposed the relocation of the lead center to Oahu for the following reasons:

- The advances in telecommunications (such as cellular telephones, fax capability, and electronic mail) and the ease of travel from Hilo to Honolulu eliminated the need to be physically located in Honolulu, Oahu.
- The Hilo location was based on a desire by Hawaii's Congressional delegates to promote small business development in the rural areas of Hawaii.
- The HSBDC was needed on the outer islands, which are rural and have high unemployment rates, to assist in the development of small businesses and diversify the economy upon the demise of Hawaii's sugar industry.
- The support of the UH-Hilo, its host institution, would be lost by relocating to Honolulu, Oahu.

On March 3, 1995, HSBDC proposed a compromise outreach strategy to increase program funding by raising funds from the public and private sectors and increasing staff by two additional counselors on Oahu. On March 20, 1995, SBA approved this outreach strategy and recommended that (i) the HSBDC seek funding from other sources, such as the private sector, to expand and strengthen its program; and (ii) the UH-Hilo make no further cuts in its matching funds.

## **Outreach strategy activity not fully implemented**

Although the HSBDC met its outreach strategy fund raising goals for fiscal years 1995 and 1996, the funds were encumbered and could not be used to increase the number of counselor positions as required by the outreach strategy. All of the funds raised were contractually encumbered for new requirements represented by the Business Research Library. In December 1995, the State Director added a second counselor to Oahu, eliminated the Kona area counselor in February 1996, and, as of May 1997, had yet to provide the promised third counselor.

Contrary to SBA's recommendation that no further cuts occur in matching funds, the UH-Hilo chancellor informed the State Director to expect another funding reduction of \$25,000 for fiscal year 1998 (July 1, 1997 through June 30, 1998). With a similar reduction in the Federal cash match, the reduction could total \$50,000. The State Director told us if the funding cuts materialized, he would probably further reduce program staff and counseling services.

## **Potential fund raising efforts**

The HSBDC can avert reduced operations by increasing private and public fund raising. On Oahu, for example, we found funds were available from the following sources:

- The Bank of Hawaii stated it had \$2 million for community development with \$1 million available to organizations like the HSBDC. Application for such funding would be required.
- The First Hawaiian Bank and the City and County of Honolulu Housing and Community Development Department had funds available if the HSBDC would apply.

The State Director stated he would follow up on each lead.

## **Rationale for the lack of fund raising efforts**

The State Director said he had not attempted to raise funds from other sources, such as those mentioned above, because HSBDC did not have an Associate State Director. According to the State Director, filling the position of Associate Director would enhance his ability to raise funds.

## **Recommendation**

2. We recommend that the District Director, Honolulu District Office, direct the State Director to implement SBA's recommendation to raise funds from private sector and local government entities with initial fund raising efforts directed toward the sources identified during the audit.

### **SBA Management Response**

The District Director reported the HSBDC has taken action to address this recommendation by successfully raising additional funds for its operations. The District Director also directed the HSBDC State Director to continue to aggressively seek out appropriate fund raising and partnership activity.

### **Evaluation of SBA Management Response**

The District Director actions are responsive to our recommendation.

### **Auditee Response**

The HSBDC generally agreed with the finding and recommendation. The State Director stated that the recommendation was already being implemented prior to the audit exit conference, except for the sources identified during the audit. After the audit work was completed, the HSBDC State Director contacted the sources identified by the auditors which resulted in the raising of additional funds from the City and County of Honolulu. The HSBDC also met with the University of Hawaii president who agreed to restore funding and to transfer future year HSBDC funding to the larger state budget.

### **Evaluation of Auditee Response**

The HSBDC actions are responsive to our recommendation.

## **FINDING 3 Financial and Performance Reporting Needs Improvement**

HSBDC generally complied with the Cooperative Agreement, except for certain reporting and approval requirements. Financial and performance reports for fiscal years 1995 and 1996 were either not prepared or were inaccurate and untimely. According to the HSBDC and its accounting agent, the reporting and approval requirements were not followed because of data transfer errors, late submission of data, and unfamiliarity with reporting requirements. As a result, SBA did not have accurate, complete, and timely information to determine if Federal funds were used effectively and efficiently.

### **Financial Status Reports (SF 269)**

The Financial Status Report for 1995 was not submitted timely, contained inaccurate financial data, and omitted program income expense information. The Cooperative Agreement required the HSBDC to submit a final SF 269 report no later than 90 days after the end of a budget period. The 1995 final SF 269 was submitted seven months late, and the 1996 report was over three months overdue as of July 15, 1997. The reports were late because expenses were not finalized until nine months after the end of the calendar year.

The 1995 report contained inaccurate financial data on costs, recipient outlays, and indirect expenses. The inaccuracies occurred because the program income and expenses were commingled with project expenses. Other inaccuracies occurred because indirect costs were reported as outlays per the approved budget.

The Cooperative Agreement and 13 CFR §130.480 require all program income to be reported on the SF 269 in detail with a description of how it was used to further program objectives. As of the end of Fiscal Year 1996, a balance of over \$68,000 was carried in accumulated program income and not reported on the SF 269 reports.

The State Director said this occurred because 13 CFR §130.480 (c) did not specify which standard forms to use and the SF 269 did not explicitly request this information. In addition, it was believed that the total program income disclosure in the annual proposal satisfied the 13 CFR requirement. As a result, SBA was not aware that, by the end of 1996, over \$68,000 in program income was available which could have been used to expand services, such as counseling.

### **Performance reports**

The Cooperative Agreement and 13 CFR §130.820 (c) required that semi-annual and annual performance reports be provided to SBA that showed actual versus budgeted financial expenditures by cost categories. We were told that these financial reports were not prepared and submitted because the HSBDC was not aware of the requirement and the Program Announcement sections on performance reports were not cross-referenced to the SBA Notice of Award sections. As a result, SBA could not accurately monitor the financial performance of the HSBDC.

### **Recommendations:**

3. We recommend that the District Director, Honolulu District Office, require the State Director to:
  - A. Ensure the University of Hawaii accounting agent takes actions to submit timely data and correct data transfer and accounting problems.

- B. Ensure SF269 reports show how program income was received and used to further program objectives.
- C. Prepare and submit semi-annual and annual performance reports showing actual versus budgeted financial expenditures by cost categories in accordance with the Cooperative Agreement.

### **SBA Management Response**

The District Director agreed with the recommendations and reported the HSBDC State Director and staff had instituted several measures to facilitate more timely reports and compliance with the reporting requirements. The District Director also directed the HSBDC State Director to continue to work closely with the UH grants management personnel to resolve all reporting compliance issues.

### **Evaluation of SBA Management Response**

The District Director actions are responsive to the recommendations.

### **Auditee Response**

The HSBDC generally agreed with the finding and recommendations. The Director stated that all performance reports were accurate and filed on time, although he agreed that program income and expenses were inaccurately reported and acknowledged that the HSBDC failed to submit actual versus budgeted financial expenditures reports as required by the 1995 Cooperative Agreement. The Director met with the HSBDC accounting agent to ensure timely and accurate submission of reports. The Director stated the HSBDC complied with the program income and performance reporting requirements after the auditors brought this to his attention.

### **Evaluation of Auditee Response**

The HSBDC actions are responsive to our recommendations.

### **FINDING 4 Indirect Costs and In-kind Contributions Need Correction**

Expenditures were reasonable, allowable, and allocable with two exceptions - indirect costs of \$15,083 and in-kind costs for rent of \$15,332. Conversely, indirect costs of \$34,837 were not claimed as matching funds. Since the questioned costs were offset by unclaimed indirect costs, no refund of Federal funds is due. These exceptions occurred because the accounting agent used the wrong indirect cost rates and the HSBDC did not prorate its in-kind rent. The HSBDC believed it did not need to calculate indirect costs for non-Federal matching funds when the matching amount exceeded the Federal amount.

**Indirect cost rates**

The Federal government negotiates indirect cost rates for use on all UH-Hilo Federal agency grants, contracts and/or agreements. The rates are negotiated in accordance with cost principles mandated by OMB Circulars A-21 and A-88.

The HSBDC accounting agent used an incorrect rate to determine the Federal indirect cost rate. The accounting agent should have classified HSBDC operations into on-campus and off-campus. By using the On-Campus-Sponsored Training indirect cost rate of 23.66 percent to burden direct costs, indirect costs of \$15,083 were overstated. The correct indirect cost rates were 21.14 percent (On-Campus-Other Sponsored Activities) for the Lihue, Kauai sub-center and the Hilo, Hawaii lead center and 19.59 percent (Off-Campus-Other Sponsored Activities) for the other sub-centers. The following table itemizes the indirect costs questioned.

**Calculation of 1995 Indirect Costs Questioned**

<b>Amount Claimed</b>				
<b>Federal Funds</b>	<b>Sub-Center</b>	<b>Cost Category</b>	<b>Indirect Rate</b>	<b>Indirect Costs</b>
\$433,455	All	On-Campus - Sponsored Training	23.66%	\$102,555
Total Indirect Costs Claimed				\$102,555
<b>Amount Allowed</b>				
<b>Federal Funds</b>	<b>Sub-Center</b>	<b>Cost Category</b>	<b>Indirect Rate</b>	<b>Indirect Costs</b>
\$165,097	Hilo, Hawaii Lihue, Kauai	On-Campus -Other Sponsored Activities	21.14%	\$ 34,901
\$268,358	Other Sub-centers	Off-Campus - Other Sponsored Activities	19.59%	\$ 52,571
Total Indirect Costs Allowed				\$ 87,472
Indirect Costs Questioned				\$ 15,083

**In-kind rents - Honolulu**

Paragraph C4, OMB Circular A-21, requires in-kind rent to be prorated among the benefiting institutions. The Bank of Hawaii in-kind contribution for office space was not prorated between the downtown Honolulu sub-center and the other tenant, SCORE. The

HSBDC in-kind contribution was overstated by \$20,908. In addition, the HSBDC claimed an in-kind contribution of \$12,146 for the Maui Technology and Research Center office space. The fair market value of this space was \$17,722. Allowable in-kind contributions were thereby understated by \$5,576. As a result of the over and under statements, questionable in-kind contributions for the office spaces totaled \$15,332.

**Unclaimed costs**

OMB Circular A-21, paragraph C1, permits the HSBDC to claim indirect costs on UH-Hilo funds. The HSBDC did not claim \$34,837 in allowable indirect costs attributed to the state matching direct costs because the total matching funds of \$435,347 exceeded the Federal funds of \$433,455 received. The table itemizes the unclaimed allowable indirect costs for 1995.

**Unclaimed Allowable 1995 Indirect Costs**

<b>Description</b>	<b>Amount</b>
State Matching Direct Costs	<b>\$256,396</b>
Less: Equipment, Rental & Burdened BRL Costs	<b><u>88,902</u></b>
Net State Matching Direct Costs	<b>\$167,494</b>
Applicable Indirect Cost Rate:	
On-Campus - Hilo, Lihue (\$130,584 x 21.14%)	<b>\$27,606</b>
Off-Campus - Other Sub-centers (\$36,910 x 19.59%)	<b><u>\$7,231</u></b>
Allowable Indirect Cost Not Claimed	<b>\$34,837</b>

**Recommendations:**

4. We recommend that the District Director, Honolulu District Office, require the State Director to:
  - A. Use correct negotiated indirect cost rates to allocate expenditures.
  - B. Prorate in-kind rent costs.
  - C. Compute allowable indirect costs for matching funds regardless of the amount of Federal funds received.

**SBA Management Response**

The District Director stated the HSBDC accounting agent has taken steps to remedy the discrepancies and the University of Hawaii is currently evaluating data to determine the appropriate cost rates for the HSBDC activities. The District Director directed the HSBDC State Director to incorporate the cost rate recommended by the University of Hawaii study group.

### **Evaluation of SBA Management Response**

The District Director actions are responsive to our recommendations.

### **Auditee Response**

The HSBDC State Director agreed with the finding and recommendations. He reported the University of Hawaii incorrectly classified the HSBDC, and discussions are in process to correct the problem for FY 1997 and subsequent years. The HSBDC State Director stated program income and its uses in furthering HSBDC objectives has been implemented and in-kind rents will be prorated as recommended by the audit team. In-kind allowable indirect costs were not claimed because HSBDC's accounting agent could not agree on whether the costs could be claimed. HSBDC also stated that the requirement for SBA approval of contracts in excess of \$5,000 was eliminated beginning in FY 1996.

### **Evaluation of Auditee Response**

The HSBDC State Director actions are responsive to our recommendations. The recommendation to obtain SBA approval of contracts awarded in excess of \$5,000 was deleted.

**RESPONSE FROM**

**THE HAWAII SMALL BUSINESS DEVELOPMENT CENTER NETWORK**  
**A Partnership Program between the University of Hawai`i at Hilo and**  
**The U.S. Small Business Administration**

**TO THE DRAFT AUDIT REPORT ON THE**

**HAWAII SMALL BUSINESS DEVELOPMENT CENTER NETWORK**

**AUDIT REPORT NO. 8-7-F-004**

11/02/97

This Response, written in reply to the transmittal letter of 10/16/97 from Peter L. McClintock,

Assistant Inspector General for Auditing of the SBA's Office of Inspector General and received on 10/20/97, may not be abridged, abstracted, excerpted, summarized, synopsised or quoted, except in its entirety, without the prior written approval of the Hawai`i Small Business Development Center Network.

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## AUDITEE'S SUMMARY

The Hawai`i Small Business Development Center (SBDC) Network, established seven years ago, has built its program on an SBA base grant in 1995 and 1996 of \$433,455, which has been matched by the University of Hawai`i at Hilo and others. According to an economic impact study,<sup>1</sup> long-term clients of the Hawai`i SBDC Network in 1995 generated nearly \$14 million in incremental<sup>2</sup> sales, \$500,000 in incremental state and federal taxes, and \$6.5 million in debt and equity financing during a period in Hawai`i characterized by a stagnant economy at recessionary levels. Additionally, 90.9% of long-term clients indicated that services received were beneficial to them, rated the counselors at 91.6% regarding knowledge and expertise, and rated their counselors at 91.6% regarding the quality of their working relationship. Another study indicated that the annual economic impact of the Hawai`i SBDC Network was \$17,375,113.<sup>3</sup>

During 1995 and 1996, the years audited, the Hawai`i SBDC Network provided counseling to nearly 2,000 companies through its five centers statewide, conducted nearly 300 training events with approximately 5,600 attendees, and provided over 3,000 responses to research requests. Additionally, the Hawai`i SBDC Network professional staff worked actively throughout Hawai`i as advocates for economic development.

These are, then, the achievements of the Hawai`i SBDC Network and the context within which the SBA Office of the Inspector General conducted its audit in 1997.

In response to that audit, the Hawai`i SBDC Network makes the following claims:

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<sup>1</sup> Chrisman, James J., Ph.D. *The Economic Impact of Small Business Development Center Counseling*

*Activities in Hawaii: 1994 - 1995.* University of Calgary: November, 1996.

<sup>2</sup> Incremental impact includes only that which is above state economic indices and only that which occurred as a direct result of Hawai`i SBDC Network assistance.

<sup>3</sup> Hammes, David L., Ph.D. *The Annual Economic Impact of the Hawaii Small Business Development*

*Center.* University of Hawai`i at Hilo: May, 1997.

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- Objectives. Of the three objectives cited by the auditors, the one concerning the effective use of resources to provide counseling assistance to the small business community is too narrowly drawn to provide a meaningful evaluation by the auditors. The national SBDC Program defines its objectives and purpose in broadly based economic development terms, not just in counseling assistance. Under the Program's defined services, counseling is only one of nine services mentioned, none of which is given priority for achieving the SBDC Program's objectives and purpose. The Hawai`i SBDC Network's strategy encompasses four tactics: advocacy, counseling, research, and training. To examine one tactic--counseling--out of the context of all, misrepresents the whole. See pages 8 - 12 for a detailed response.
- Finding 1. The auditors state that counseling services could be increased by reallocating staffing resources and, presumably, *should* be increased because a disproportionate amount of staffing is devoted to non-counseling services. The Hawai`i SBDC Network has responded that (1) the objective to which the finding responds is too narrowly constructed, (2) that the finding lacks materiality, and (3) that the defining documents of the SBDC Program (a) do not give primacy to counseling over other tactics and (b) do not provide any standard or goal for counseling other than those goals negotiated annually with and approved by the SBA, goals which the auditors admit the Hawai`i SBDC Network has met or exceeded. The Hawai`i SBDC Network believes that the auditors have based their finding on an inappropriate and insufficiently examined criterion, that the criterion used is inconsistent with the published data, and that the Hawai`i SBDC Network nonetheless compares favorably with other states when using the published data. The balance of the auditors' observations are based on conjecture rather than upon evidence that is sufficient, competent, and relevant, as required by the GAO's *Government Auditing Standards*. See pages 13 - 29 for a detailed response. Based on the detailed response, the Hawai`i SBDC Network requests that Finding 1 and its recommendations be withdrawn.
- Finding 2. The auditors state that increased funding from private and public sectors would increase funding stability for the Hawai`i SBDC Network and allow for the more effective use of resources in counseling assistance. The Hawai`i SBDC Network believes that the auditors' observation is inappropriate as a finding (1) because it lacks materiality, (2) because no criterion exists upon which to base a finding, and (3) because it is unrelated to the audit objectives. The defining documents of the SBDC Program do not require fund-raising, have neither goals nor standards concerning fund-raising, and publish no statistics regarding fund-raising. If there were SBA goals or standards for fund-raising, the Hawai`i SBDC Network would rank high in any comparison or against any standard. In the current year, the Hawai`i SBDC Network has raised funds, in addition to the host institution's match, that are 173.9% greater

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than the SBA grant. Few SBDCs can meet that accomplishment. See pages 30 - 35 for a detailed response. Based on the detailed response, the Hawai`i SBDC Network requests that Finding 2 and its recommendations be withdrawn.

- Finding 3. The auditors state that the Hawai`i SBDC Network was not in compliance with certain reporting and approval requirements. We concur with the specific examples cited (except for the approval of contracts exceeding \$5,000), though not their generalized statement, and are now in compliance. See pages 36 - 39 for a detailed response.
- Finding 4. The auditors state that an incorrect indirect cost rate is being used and in-kind rent rates were not properly prorated. The Hawai`i SBDC Network cannot evaluate the auditors' conclusion regarding indirect cost rates because they have not included in the *Draft Audit Report* their justification. Based on functions performed and the principal setting of the Hawai`i SBDC Network, we believe the indirect cost rate in use is correct. We concur with the analysis of in-kind rent rates and are now in compliance. See pages 40 - 42 for a detailed response. Based on the detailed response, the Hawai`i SBDC Network requests that the subpart of Finding 4 regarding indirect cost rates be set aside.

The GAO "Yellow Book" states in paragraph 7.42 of the Generally Accepted Government Audit Standards (GAGAS): "When the comments [by responsible officials of the audited program] oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid, the auditors may choose to state their reasons for rejecting them. *Conversely, the auditors should modify their report if they find the comments valid.*" (Italics added)<sup>4</sup>

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<sup>4</sup> Comptroller General of the United States, Government Accounting Office. *Government Auditing Standards*. 1994 rev. para. 7.42.

## GENERAL RESPONSES

Following are general responses by the Hawai`i SBDC Network to the overall *Draft Audit Report* that do not fall within the specific findings and recommendations:

1. The Hawai`i SBDC Network believes that the *Draft Audit Report* results do not comply in certain respects to the GAO promulgated Generally Accepted Government Audit Standards (GAGAS) as published in the GAO "Yellow Book".<sup>5</sup> At paragraph 7.18, the GAO "Yellow Book" states: "Auditors should report significant findings developed in response to each audit objective. \2 In reporting the findings, *auditors should include sufficient, competent, and relevant information to promote adequate understanding of the matters reported and to provide convincing but fair presentations in proper perspective.* Auditors should also *report appropriate background information* that readers need to understand the finding." (Italics added.) At paragraph 7.41, the GAO "Yellow Book" states: "Advance comments should be objectively evaluated and recognized, as appropriate in the report." Note the following examples:

a. With respect to Finding 1, "Counseling Services Could Be Increased by Reallocation of Resources," and sub-finding of Finding 3, "Approval of Consultant Contracts," the Hawai`i SBDC Network provided in writing to the auditors sufficient and relevant information which we believe provided facts which should have precluded issuance of a Finding, but if included in the *Draft Audit Report* would have provided a fair background presentation for readers to understand the finding. Such advance comments were neither responded to nor addressed or included in the *Draft Audit Report*. The facts communicated in writing to the auditor were (i) that the goals and level of counseling (Finding 1) are required by the *SBA Program Announcement* to be negotiated between the SBDC State Director and the SBA District Director and are subsequently incorporated into the Cooperative Agreement. Such negotiations occurred, and counseling goals were established and incorporated into the Cooperative Agreements. Counseling goals were contractually met and exceeded. No mention of all of these facts is presented in the *Draft Audit Report* in the discussion of Finding 1. Further, despite the fact that a stated audit objective was to determine whether operations were in conformance with the *Cooperative Agreement*, and recognizing that

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<sup>5</sup> Comptroller General of the United States, Government Accounting Office. *Government Auditing Standards*. 1994 rev.

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the goals for counseling were in conformance with the *Cooperative Agreement*, Finding 1 postulates that insufficient counseling was undertaken by the Hawai`i SBDC Network.

b. Concerning Finding 3, "Approval of Consultant Contracts," the Hawai`i SBDC Network provided to the auditors upon request facts addressing this finding. They conveyed that through FY 1995, the requirement for prior approval of consultant contracts exceeding \$5,000 was not consistent with OMB Circular A-110, the provisions of which are incorporated into the *Cooperative Agreement*. Absent an approved deviation from OMB, the provisions of the Circular govern. Under the Circular, no prior approval is required for contracts exceeding \$5,000. For FY 1996 and subsequently, prior approval of contracts exceeding \$5,000 was eliminated in the *Cooperative Agreement*. Again, despite communicating this relevant information to the auditors, the *Draft Audit Report* does not address nor incorporate these circumstances.

2. The Hawai`i SBDC Network believes that the auditors should incorporate the recommendation of the GAO "Yellow Book," which states: "Auditors should report noteworthy accomplishments . . ." (7.43) "Such information provides a more fair presentation of the situation by providing appropriate balance to the report." (7.44) Such information, along with greater background information on the organization being audited, would provide third-party users of audit information with greater understanding and a reduced likelihood of misperceptions. The GAO "Yellow Book" states: "Being complete[, which is part of the fourth reporting standard for performance audits,] . . . also means including appropriate background information." (7.51)

3. The Hawai`i SBDC Network believes that the shaping of findings in performance audits to reflect only quantitative data, excluding qualitative data because it cannot be quantified or easily quantified, can distort the findings. For an example, see the response under Finding 1 to the subheading, "Use of Staffing Resources," paragraph 4.

## RESPONSES TO INTRODUCTION

### A. Background (*Draft Audit Report*, p. 1)

1. The *Draft Audit Report* states: "Five of the HSBDC's 15 employees are counselors . . . ." (*DAR*, p. 1, para. 4)

a. This statement is inaccurate. In 1995, there were 4.5 full-time equivalent (FTE) counselors out of a total of 11.0 FTE SBDC-only funded positions. Therefore, the counselors represented 41.1% of total employees, not the 33.00% claimed.

b. In 1996, there were 4.1 FTE counselors out of a total of 13.5 FTE SBDC-only funded positions. Therefore, the counselors represented 30.3% of total employees. However, the 3.0 FTE positions in the Business Research Library are client-service positions analogous to counselors, and should be included in this statistic in order to fully convey the Hawai`i SBDC Network's program delivery to clients. When included, there were 7.1 FTE client-service positions out of a total of 13.5 FTE SBDC-only funded positions, and the client-service positions represented 52.6% of total employees, not the 33.0% claimed.

2. The *Draft Audit Report* states: "One counselor position, 50 percent of two other counselor positions, and 30 percent of an administrative assistant position were funded by the [RETA-H] grant." (*DAR*, p. 1, para. 5)

a. This statement is inaccurate. In 1995, 3.7 FTE positions were funded through RETA-H (1.4 FTE counselor positions, 0.3 FTE administrative positions, and 2.0 FTE secretarial positions), not the 2.3 FTE claimed in the *Draft Audit Report*.

b. In 1996, 3.5 FTE positions were funded through RETA-H (1.9 FTE counselor positions, 0.3 FTE administrative positions, and 1.3 FTE secretarial positions), not the 2.3 FTE claimed in the *Draft Audit Report*.

### B. Audit Objectives and Scope (*DAR*, p. 1)

1. The *Draft Audit Report* states: "The objectives of the audit were to determine whether (i) resources were effectively used to provide counseling assistance to the small business

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community . . . ." (DAR, p. 1, para. 6)

a. This objective is too narrowly drawn to be an effective measure of an SBDC Program, and because it is so narrowly drawn the consequent evaluation leads to misperceptions about client-service delivery by the Hawai`i SBDC Network. Note the following statements from the SBDC Program's defining documents regarding the mission, objectives, and purpose of SBDC state/region programs:

"*Objective.* The SBDC Program creates a broad-based system of assistance for the small business community by linking the resources of Federal, State and local governments with the resources of the educational community and the private sector." (13 CFR 130.100)

"Purpose: The SBDC Program is designed to provide high quality business and economic development assistance to small businesses and prospective small businesses . . . in order to promote growth, expansion, innovation, increased productivity and management improvement." (SBA. *Small Business Development Center Program Announcement*, March 1997, p. 2)

"Program Objectives: The overall objective of the SBDC Program is to leverage Federal dollars and resources with those of the state, the educational community, and the private sector to:

- (A) Strengthen the small business community;
- (B) Contribute to the economic growth of the communities served;
- (C) Make assistance available to more small businesses than is now possible with present Federal resources; and
- (D) Create a broader based delivery system to the small business community."

(SBA. *Small Business Development Center Program Announcement*, March 1997, pp. 2-3)

The intent of these statements is clearly to define a program of broadly based economic development activity. Nowhere in these statements is *counseling* put forth as a higher priority than other types of assistance. In fact, *counseling* is not mentioned in the purpose or objectives of the SBDC Program. When *counseling* is referred to, it is but one of nine activities mentioned as services provided by an SBDC, and those

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nine services are neither prioritized nor meant to be inclusive. Note the following:

"SBDC Services: Services provided by a Small Business Development Center shall include, but not be limited to:

- (A) Furnishing one-to-one individual counseling to small businesses;
- (B) Assisting in technology transfer, research, and development, including applied research . . . .
- (C) Maintaining current information concerning Federal, State, and local regulations that affect small businesses and counsel small businesses on methods of compliance. . . .
- (D) Coordinating and conducting research into technical and general small business problems for which there are no ready solutions.
- (E) Providing and maintaining a comprehensive library that contains current information and statistical data needed by small businesses;
- (F) Maintaining a working relationship and open communications with the financial and investment communities, legal associations, local and regional private consultants, and local and regional small business groups and associations in order to help address the various needs of the small business community;
- (G) Conducting in-depth surveys for local small business groups in order to develop general information regarding the local economy and general small business strengths and weaknesses in the locality;
- (H) Maintaining lists of local and regional private consultants to whom small businesses can be referred; and
- (I) Utilizing and compensating qualified small business vendors . . . to provide services to small businesses.

(SBA. *Small Business Development Center Program Announcement*, March 1997, pp. 5-6)

Counseling is one tactic among others--such as advocacy, research, and training--for fulfilling the purposes and objectives of the SBDC Program. Research is referred to in the above defined SBDC services; training is specifically provided for in the Cooperative Agreement with set negotiated goals approved by the SBA; and the SOP 60 16 states regarding advocacy: "SBDC's also act in an advocacy role to promote local small business interests." (SOP 60 16, p. 5)

b. The question underlying the auditors' stated objective is, presumably, the

definition of the appropriate amount of counseling. No document provided to state/regional SBDCs states what constitutes an appropriate level of counseling. Rather, the *Program Announcement* provides that State Directors will *negotiate* the proposal with the SBA District Office, including goals for counseling, but as well for training. It further provides that the Office of SBDCs is responsible for "conducting the final review of the proposal programmatically and financially" (SBA. *Small Business Development Center Program Announcement*, March 1997, pp. 5-6) and "shall determine acceptability of SBDC proposals" (*Notice of Award*, page 4). With the issuance of the *Notice of Award*, there exists a Cooperative Agreement between the SBA and the host institution binding the state/regional SBDC to various provisions, including the negotiated goals for counseling. The appropriate level of counseling and the appropriate criterion for judgment of counseling, then, is that level negotiated with the SBA District Office and approved by the SBA Office of SBDCs. Regarding the level of achievement of the Hawai'i SBDC Network, the *Draft Audit Report* states: "We [the auditors] noted the number of [counseling] cases serviced met established goals . . . ." (*DAR*, p. 4, para. 1)

c. The reason that counseling goals are established in negotiations between the State Director of an SBDC and the SBA District Office, rather than being established at the Central Office of the SBA, is that a hallmark of the SBDC Program since 1985 has been that local conditions and needs at the state level should determine the strategy of an SBDC Program, including the balance and mix of advocacy, counseling, research, and training tactics. The SBA's SOP 60 16 states: "SBDC services *shall be tailored as closely as possible to meet the local needs* of small businesses and potential small business owners." (SOP 60 16, p. 12) (Emphasis added)

d. Since the SBDC Program consists of much more than counseling, an audit objective that focuses on counseling alone is too narrowly drawn and will not produce an evaluation that is reflective of a particular SBDC Program's accomplishments or failures and, in fact, may--as in the case of the *Draft Audit Report* on the Hawai'i SBDC Network--distort the effectiveness of the program. In effect, the auditors have failed to understand the program and have departed from the recommendations of the GAO "Yellow Book," which states: "Auditors should obtain an understanding of the program to be audited to help assess . . . the significance of possible audit objectives and the feasibility of achieving them." (Comptroller General of the United States, GAO. *Government Auditing Standards*. 1994 rev. para. 6.9).

e. A properly drawn objective would have been one that measured the effectiveness of all the tactics used--advocacy, counseling, research, training, and others--to achieve the negotiated goals and fulfill the strategy of the SBDC, given the adequacy of the strategy measured against the *local* conditions and needs of small businesses in the state. As this Response will show, such an objective would have produced a positive finding.

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f. And, if the auditors were to claim that it was not possible for them to create a properly drawn objective, then as the GAO "Yellow Book" recommends: "To preclude misunderstanding in cases where the objectives are particularly limited and broader objectives can be inferred, it may be necessary to state objectives that were not pursued." (Comptroller General of the United States, GAO. *Government Auditing Standards*. 1994 rev. para. 7.13)

## RESPONSES TO RESULTS OF AUDIT

**Finding 1: Counseling Services Could Be Increased by Reallocating Staffing Resources** (*DAR*, p. 3) "Counseling services average only 15.6 percent of the total staff hours available because a disproportionate amount of staffing resources were devoted to non-counseling services, such as secretarial and administrative duties. Counseling services could be increased by reallocating staffing resources." (*DAR*, Summary, p .i)

1. Finding 1, as stated in the bold type above, is of course true. In fact, it is a truism that could be stated about any state/regional SBDC. The question, surely, is not whether counseling services *could* be increased by reallocating staffing resources, but whether they *should* be. The Hawai'i SBDC Network (a) disagrees that counseling services should be increased by reallocating staffing resources and (b) disagrees that counseling services are disproportionate when based on an appropriate criterion.

2. Finding 1 does not establish materiality in the arguments and data presented in support of the Finding. Counseling goals, which are negotiated with the SBA District Office and approved by the SBA Office of the SBDCs, were met (*DAR*, p. 4, para. 1). There are no other goals or standards, and the auditors have cited none. The negotiated goals, which are incorporated into the Cooperative Agreement, are the only appropriate criterion for judgment. The GAO "Yellow Book" states: "In selecting criteria, auditors have a responsibility to use criteria that are . . . relevant to the matters being audited." (Comptroller General of the United States, GAO. *Government Auditing Standards*. 1994 rev. para. 6.11)

3. To establish that the Hawai'i SBDC Network's counseling hours are too low, which is the claim of the arguments and data presented by the auditors in support of Finding 1, requires in the absence of unmet goals that either (a) the other three primary tactics--advocacy, research, and training--be shown to be too high given the needs of the State of Hawai'i and the resources available to the Hawai'i SBDC Network or (b) total client service hours are too low given available resources or (c) the mix and balance of service tactics are inappropriate for the State of Hawai'i. This has not been done nor addressed by the auditors. Nor, have the auditors established (a) the SBA was remiss in approving the goals or (b) the process of negotiating goals established by the SBA in 1985 is improper.

4. Therefore, the Hawai'i SBDC Network is in disagreement with Finding 1. Note the following responses to the auditors' detailed analysis. These responses, we believe, will show that the audit has not fulfilled one of an audit's basic premises as stated in the GAO "Yellow Book": "Performance auditing contributes to providing accountability . . . in order to provide information to improve public accountability and facilitate decision-

making by parties with responsibility to oversee or initiate corrective action." (Comptroller General of the United States, GAO. *Government Auditing Standards*. 1994 rev. para. 1.13.h) We believe the finding is not only flawed, but distorts the performance of the Hawai'i SBDC Network and, therefore, cannot improve public accountability or facilitate proper decision-making.

**Program Delivery to the Small Business Community (DAR, p. 3, para. 3)**

1. The *Draft Audit Report* states: "The HSBDC considers counseling the principal effort of its core program." (DAR, p. 3, para. 3)

a. While the Hawai'i SBDC Network does consider counseling to be an important effort of its core program, it is not the only effort. The Mission Statement of the Hawai'i SBDC Network states: "We are a statewide organization whose mission is to stimulate the economy and help individuals and the broader community, through counseling, training, research and other activities." (*Strategic Plan: 1996 - 2001*, p. 5) Counseling is referred to as one among a number of *core competencies*.

b. The State Director has defined the tactics for achieving the SBDC Program's purpose and objectives to be advocacy, counseling, research, and training.

2. The *Draft Audit Report* states: "SOP 60 16 states that SBDCs shall emphasize providing in-depth, high-quality assistance to small business owners or prospective small business owners." (SOP 60 16, p. 13) (DAR, p. 3, para. 3)

a. The above quoted statement in the SOP 60 16 is immediately preceded by the following one: "Primary services to be provided shall include, but not be limited to, management and technical assistance through counseling and training. (SOP 60 16, p. 12) While the SOP 60 16 indicates counseling assistance is to be emphasized, which it is in the Hawai'i SBDC Program, it as clearly indicates training and advocacy (SOP 60 16, p. 5) and other tactics are to be used as well in order to achieve the purpose and objectives of the SBDC Program.

b. The word *assistance* is only rarely used in the SOP 60 16, 13 CFR 130, the *Program Announcement*, or the *Notice of Award* as a synonym for the word *counseling*. It is far more commonly used as a much broader term encompassing all services offered by SBDCs.

c. It should also be pointed out that the SOP 60 16 is not the best evidence. It was written in 1985, whereas 13 CFR 130 was adopted in 1995 and both the *Program Announcement* and the *Notice of Award* are revised annually. More importantly, the SOP 60 16 states: "[T]hese guidelines do not have the effect of regulations." (SOP 60 16, p. 4) Nor, do they have the effect of a contract such

as the Cooperative Agreement. There is no statement in these latter definitions of the SBDC Program that indicates counseling should be given priority over other client services.

### **Use of Staffing Resources (DAR, p. 3)**

1. The *Draft Audit Report* states: "The HSBDC dedicated over 80 percent of its total staffing resources to non-counseling functions." (DAR, p. 3, para. 4)

a. This statement is damning only if counseling is given primacy over all other types of economic development activities. As shown above, neither the national SBDC Program's defining documents nor the implementing ones of the Hawai'i SBDC Network support that contention.

b. If staffing positions devoted to all economic development activities (i.e., advocacy, counseling, research, and training) are considered, then 52.6% and 52.4% of all available staffing positions were client service positions devoted to economic development activities in 1995 and 1996, respectively. Therefore, the Hawai'i SBDC Network dedicated only 47.4% and 47.6%, respectively, to non-client service positions, not over 80% as might be inferred from the auditors' comments by third party users of this information.

2. The *Draft Audit Report* states: "Our analysis . . . showed that HSBDC's direct counseling hours totaled only 14.8% and 16.5% of the total available hours in 1995 and 1996, respectively." (DAR, p. 3, para. 4)

a. These figures are in error. The Hawai'i SBDC Network's analysis indicates that direct counseling hours of positions were 20.6% and 18.9% of all positions in 1995 and 1996, respectively. This error may flow from the ones made in the *Draft Audit Report's* computing of the number of FTEs in the RETA-H Program (see this Response, para. A.2 Background).

3. The *Draft Audit Report* states: "Furthermore, a September 1997 programmatic review conducted by the Program Operations and Liaison staff of the Office of the Associate Administrator, Small Business Development Centers, showed that the HSBDC ranked 55th out of 57 SBDCs in counseling performed." (DAR, p. 3, para. 4)

a. Analysis of this statement is difficult to perform since the SBA's Office of the SBDCs has refused, despite explicit requests, to provide the Hawai'i SBDC Network with either (i) a copy of the September 1997 Program Review (or an earlier September 1994 Program Review) or (ii) a copy of the comparison which an examiner of the Office of SBDCs purportedly put together and which is the basis for the above claim. Nevertheless, some statements can be made about this comparison:

i. The statistics upon which the comparison-ranking are based are not comparable. While state/regional SBDCs maintain consistent definitions for statistical reporting purposes internally within their states and regions, these definitions are not consistent among the state/regional SBDCs. Some include travel time, some may not; some include secretarial prep time, some do not; and some discount for multiple counselors at a client/counselor meeting, some do not. Any statistics of this type, therefore, must be used with caution. Note the following two factors, as well--both of which contribute to the non-comparability of the statistics.

ii. Counseling hours are a function, in significant part, of state SBDC strategy to meet local needs and situations. Therefore, a comparison ranking of counseling alone, while of some interest, should not be confused with nor by itself considered as evidence of the effective use of a Program's resources. It is conceivable under the SBDC Program that a state/region SBDC last in counseling hours is nonetheless effectively using its resources because of results achieved with other tactics in the arsenal of SBDC services. It is also conceivable that a state ranking first in counseling hours is ineffectively using its resources because one available tactic is emphasized to the exclusion of all others and, thus, the needs of the state's small businesses are not met.

iii. For small states, there exist *dis*-economies of scale. For instance, larger states frequently hire training directors to handle all training; whereas smaller states must assign training to the same individuals charged with performing counseling. Larger states frequently hire counselors who have no other significant duties and counsel 100% of their time; whereas smaller states must commonly assign many other duties to their counselors, such as advocacy, training, and administration. And, larger states defray administrative positions and costs over far more positions than smaller states.

iv. There is no indication that this comparison-ranking of counseling hours is adjusted for population. If it is not, then it reflects little more than that Hawai'i is among the smaller states in terms of population.

b. Based upon the statistics for state/regional SBDC counseling hours published on the Internet by the SBA, the claim that "the HSBDC ranked 55th out of 57 SBDCs in counseling performed" is inaccurate. Note the following:

i. Counseling Hours. Using the statistics published for Federal fiscal year 10/01/95 - 9/30/96, Hawai'i ranked 51st out of 57 SBDCs in counseling hours, not 55th out of 57 SBDCs.

Using the *most recent* statistics published by the SBA and available to the auditors, the Hawai'i SBDC Network ranked 46th out of 54 SBDCs in the

number of counseling hours, not 55th out of 57. (Published by the SBA at [//www.sba.gov/sbdc/intra/](http://www.sba.gov/sbdc/intra/) for the nine-month period from 10/01/96 through 6/30/97) Only 54 SBDCs were reported in these statistics.

ii. Counseling Hours Adjusted for Population. Using the same statistics for the period of 10/01/95 - 9/30/96 and adjusting for population (U.S. Bureau of the Census), the Hawai`i SBDC Network ranked 46th out of 54 SBDCs in the number of counseling hours divided by the state population. (The difference between 54 and 57 SBDCs occurs in this statistic because the State of Texas is divided into regions. Since the Hawai`i SBDC Network does not have immediate access to statistics for the separate regions of Texas, we have treated the regions as if a single state.) (Published by the ASBDC Research Network at <http://www.smallbiz.suny.edu>.)

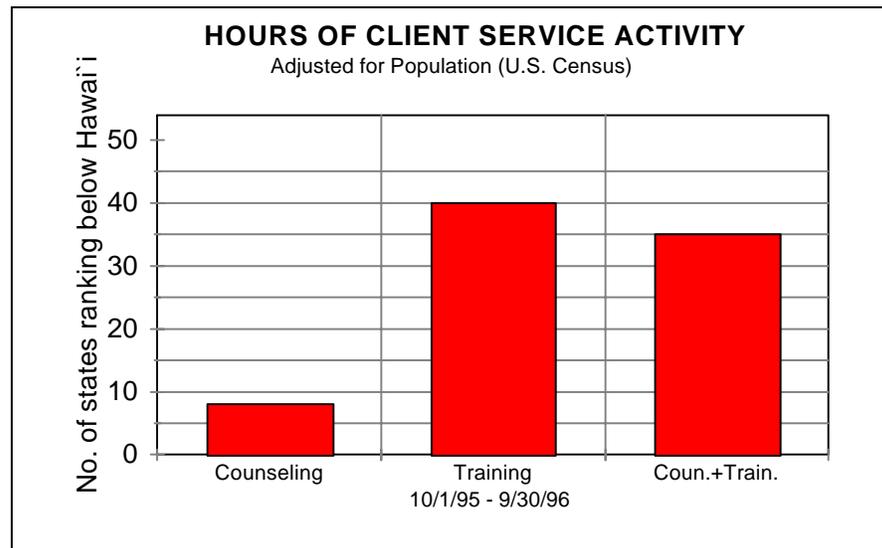
For the more recent nine-month period of 10/01/96 - 6/30/97 and adjusting for population, the Hawai`i SBDC Network ranked 39th out of 54 SBDCs. Ranking below Hawai`i's 39th place are states such as Arkansas (46), Arizona (48), California (52), Florida (51), Illinois (40), Indiana (47), Nevada (49), and New Jersey (50).

iii. Training Hours. In training hours delivered, the other area in which SBDCs report hours to the SBA, the Hawai`i SBDC Network ranked 33rd out of 54 SBDCs during the period of 10/01/95 - 9/30/96 in hours of training delivered.

iv. Training Hours Adjusted for Population. In training hours adjusted for population, the Hawai`i SBDC Network ranked 14th out of 54 SBDCs during the period of 10/01/95 - 9/30/96.

v. Counseling + Training Hours / by Population. If counseling hours and training hours are added and the sum is divided by population, then the Hawai`i SBDC Network ranked 19th out of 54 SBDCs during the period of 10/01/95 - 9/30/96. This counseling-training hours statistic, while not ideal, does provide a productivity comparison of state/regional SBDCs that accounts for differences in strategies based upon local differences among the states/regions. If one is attempting to judge productivity, it is arguably one of the best measures available, given the statistics currently collected by the SBA. Ranking below Hawai`i at 19th place are states such as Arkansas (20), Connecticut (25), Florida (33), Indiana (45), Maryland (46), Massachusetts (41), Missouri (36), New York (26), North Carolina (49), Pennsylvania (21), Rhode Island (34), and Washington (27).

The following graph illustrates the number of states ranking below the



Hawai'i SBDC Network in the counseling-training hours statistic.

c. In using the statistic from the September 1997 programmatic review, the auditors appear to have departed from the recommendations of the GAO "Yellow Book," which states: "If auditors intend to rely on the work of other auditors, they should perform procedures that provide a sufficient basis for that reliance." (6.15) "Auditors face similar considerations when relying on the work of nonauditors . . . ." (6.16) (Comptroller General of the United States, GAO. *Government Auditing Standards*. 1994 rev. para. 6.15 and 6.16) The GAO "Yellow Book" further states:

"When the auditors' tests of data disclose errors in the data, or when they are unable to obtain sufficient, competent, and relevant evidence about the validity and reliability of the data, they may find it necessary to

- a. seek evidence from other sources,
- b. redefine the audit's objectives to eliminate the need to use the data, or
- c. use the data, but clearly indicate in their report the data's limitations and refrain from making unwarranted conclusions or recommendations."

(Comptroller General of the United States, GAO. *Government Auditing Standards*. 1994 rev. para. 6.59)

4. The *Draft Audit Report* provides a table entitled "Percent of Direct Counseling Hours Compared to Total Hours Available" (p. 4).

a. The table is conceptually flawed. Rather than comparing *direct counseling hours to non-counseling hours*, which produces a distorted picture of the Hawai'i SBDC Network's use of resources by isolating counseling from the whole of client services delivered, the table should in fairness present a comparison of *client service hours to non-client service hours*. This was not done, presumably, because: "The time dedicated to training, advocacy, and administration could not be evaluated because the hours spent performing these functions were not recorded separately" (*DAR*, p. 4, para. 1). However, it is less than accurate to claim that "the time dedicated to training, advocacy, and administration could not be *evaluated* . . . ." What would be a more accurate statement is that these functions could not be *easily quantified* "because the hours spent performing [them] were not recorded separately." For the lack of easy quantification, the *Draft Audit Report* presents a distorted picture of the Hawai'i SBDC Network's delivery of client services. Third-party users of this information may well as a result infer an inaccurate assessment.

b. During the field audit, considerable time was spent by the Hawai'i SBDC Network staff working with the auditors to assess the contribution of training to productivity. Each training event for a two-year period (295 training events totalling 1,340 direct training hours) was examined. Based on this work, it is difficult to believe that an assessment of training activities relative to productivity could not have been made and included in the table.

5. The *Draft Audit Report* states: "The State Director states that although the counseling hours were low . . . ." (*DAR*, p. 4, para. 1)

a. The State Director does not concede the auditors' point that counseling hours are inappropriately low. On the contrary, the State Director believes (i) the counseling hours are appropriate, given the balance of advocacy, counseling, research, and training services, and (ii) the appropriate counseling criterion of SBA negotiated and approved case goals was met.

6. The *Draft Audit Report* states: "The State Director stated . . . that start-up businesses were counselled through formal training sessions. . . . Although training is part of an SBDC's function, we [the auditors] do not believe training can be considered a substitute for counseling." (*DAR*, p. 4, para. 1)

a. Many SBDCs, including the Hawai`i SBDC Network, focus some training events on reducing the need for low-level, repetitive counseling for individuals interested in starting a business. They do this in order to increase the efficient use of counseling resources by focusing them on high-level, unique counseling cases. In this sense, some training is a "substitute" for counseling in that it obviates the need for some counseling, but not that it is the same as counseling. The State Director's comments have been misunderstood.

b. SBA Internet-published statistics confirm the Hawai`i SBDC Network's success in this strategy. Nationally, 70.0% of all counseling cases involve start-up businesses. In Hawai`i, it is only 42.3%. (Published by the SBA at [//www.sba.gov/sbdc/intra/](http://www.sba.gov/sbdc/intra/) for the nine-month period from 10/01/96 through 6/30/97.) From this statistic, it may be reasonable to conclude that the Hawai`i SBDC Network's counseling is more efficient than that of many other states/regions.

c. If on the other hand, the Hawai`i SBDC Network had not used this means to increase its efficiency, then presumably and ironically there may have been no finding since counseling hours would have been higher, if less efficient.

7. The *Draft Audit Report* states: "We [the auditors] noted the number of cases serviced met established goals *set* by the HSBDC." (*DAR*, p. 4, para. 1) (Italics added)

a. It is true that the Hawai`i SBDC Network has met its established goals.

b. However, this statement is misleading and seems to reflect a misunderstanding by the auditors. Goals are not "set" by an SBDC. They are negotiated with the SBA District Office, approved by the Office of SBDCs, and incorporated into a Cooperative Agreement. The SOP 60 16 states:

"Services shall be provided pursuant to a negotiated cooperative agreement with full participation of both parties. (SOP 60 16, p. 4)

"The SBDC's (*sic*) have the responsibility and authority for: 1.  
Negotiating the annual Cooperative Agreement with the SBA . . . ."  
(SOP 60 16, p. 8)

**Actions Available To Increase Funds for Counseling (DAR, p. 4)**

1. The *Draft Audit Report* states: "Increased funding for counselors is needed because 34 percent of the total HSBDC cash match for calendar years 1995 and 1996 was contractually encumbered to meet new requirements of the Business Research Library (BRL)." (DAR, p. 4, para. 2)

a. This argument presumes (a) that counseling has primacy among client service tactics (which has been previously shown in this Response to not be the case) and (b) devoting 34% of the cash match (which is only 11.5% of the total Hawai'i SBDC Network funds in calendar years 1995 and 1996) to support another required client service tactic--that of research--is too high. There are no provisions or standards in 13 CFR 130, the *Program Announcement*, or the *Notice of Award* to support these presuppositions and, thus, no criteria upon which to base the judgment.

b. And, the SBA District Office and the SBA Office of the SBDCs approved this strategy and division of funds when it accepted the Hawai'i SBDC Network's proposals for the years 1995 and 1996. The auditors have presented no evidence the SBA was remiss in approving the strategy.

c. Two other points regarding this funding:

i. In the *Program Announcement's* description of the nine SBDC services to be offered to clients, the Business Research Library Specialty Subcenter's activities directly impact five of the nine defined SBDC services to clients. (SBA. *Small Business Development Center Program Announcement*, March 1997, pp. 5-6) The work the Business Research Library Specialty Subcenter does in delivering SBDC services is obviously central to the mission of the SBDC Program.

ii. In addition to the Business Research Library Specialty Subcenter's contribution to the mission of the Hawai'i SBDC Network, the state funds supporting the BRL were used beginning in 1995 as match. As a result, the Hawai'i SBDC Network matched all available federal funds in 1995 and subsequently. In fact, 1995 was the first year since 1991 in which all federal funds were matched by the Hawai'i SBDC Network.

2. The *Draft Audit Report* states: "Five of the 15 staff were secretarial positions that,

in fiscal year 1996, accounted for 32.5 percent of the annual available staff hours . . . . The remaining ten staff positions consisted of five counselor, three administrative, and two research positions." (*DAR*, p. 4, para. 3)

a. The figures above are incorrect. In fiscal year 1996, staff of the Hawai'i SBDC Network were distributed as follows:

<u>Position</u>	<u>FTEs</u>	<u>Percentage of Position Hours</u>	<u>Salary</u>	<u>Percentage of Position Resources</u>
<i>Secretarial</i>	4.59	33.9%	\$132,419	22.7%
Counseling	4.45	32.9%	240,924	41.3%
Administrative	1.50	11.1%	96,458	16.5%
Research	<u>3.00</u>	<u>22.2%</u>	<u>113,474</u>	<u>19.5%</u>
Total	13.54	100.0%	\$583,275	100.0%

b. While the secretarial positions, without further inspection, may appear high in number of positions, they are appropriate as a percentage of resources at 22.7%. Counseling and research positions, both client-service tactics, account for 60.8% of total staff funding resources in 1996.

c. Additionally, there appears to be an assumption that secretarial positions do not contain elements of client service. In fact, they do. While secretaries in the Hawai'i SBDC Network primarily engage in administrative work and work to increase the efficiency of the counseling staff, secondarily they work directly with clients by making referrals, locating information, and helping clients to effectively work with resource centers at each of the subcenters and at the Business Research Library Specialty Subcenter.

3. The *Draft Audit Report* states that by combining certain secretarial positions and reducing the number of secretarial positions by two, the cost of secretarial services could be reduced "by about \$69,000 which could be used to pay the salaries of one full-time and one part-time counselor." (*DAR*, p. 5, para. 2)

a. The underlying assumptions to this argument are that (a) 2.59 secretaries can do the work of 4.59 secretaries and/or (b) it is an effective use of resources for Center Directors to perform secretarial tasks. No evidence is presented to support these assumptions.

b. The auditors were provided with a copy of a seven-page document entitled *1996 Revised Budget Justification* which states the justification for the layoff of the West Hawai'i island (Kona) circuit-rider. It addresses the effect of the reduction of two secretarial positions as follows:

"To obtain a similar financial impact [to the layoff of the West Hawai'i circuit-rider position], it would be necessary to eliminate two secretarial positions. To do so would seriously decrease the efficiency of the Centers affected. In terms of negative impact upon the SBDC's clients, it is my [the State Director's] judgement that this action would cause considerably greater harm than the layoff of the business consultant for west Hawai'i because it would predictably lead (1) to decreased efficiency, effectiveness, and morale of Center Directors with a resulting decrease in client service and (2) to more costly service since Center Directors at higher salaries than secretaries would be forced to handle their own secretarial duties." (*1996 Revised Budget Justification*. 2/12/96, pp. 5-6)

c. Neither evidence nor weight of expertise is presented by the auditors to counter this argument.

4. The *Draft Audit Report* states that about \$69,000 from reductions in secretarial positions could be used to pay the salaries of one full-time and one part-time counselor. (*DAR*, p. 5, para. 2)

a. The savings from the two positions targeted for elimination in salary and fringe benefits would have been \$54,311 in 1996 and \$58,165 in 1997, not \$69,000.

b. The cost of a full-time counselor (including salary, fringe benefits, and travel costs for a circuit-rider position) would be approximately \$64,700. (See *1996 Revised Budget Justification*. 2/12/96, p. 3.) Obviously, the savings of \$58,165 would not even support one counselor position at \$64,700, let alone "one full-time and one part-time counselor."

### **Counseling Service to the Kona Area (*DAR*, p. 5)**

1. The *Draft Audit Report* states: "In March 1996, as part of the outreach implementation strategy to expand counselor services on Oahu, the State Director terminated the most productive counselor position, the circuit rider counselor for the Kona area." (*DAR*, p. 5, para. 3)

a. The statement that "the State Director terminated *the most productive counselor position*" is a tenuous claim. However, before exploring that issue further, it is important to clarify that the layoff was not made on the basis of productivity, nor could it have been. The factors involved are much more complicated than that, as was put forth in the document *1996 Revised Budget*

*Justification* and in a memorandum from the State Director to the auditors dated 1/16/97. Therefore, even if the claim were substantiated, it has no import beyond being ironic and unfortunate in its necessity.

b. However, the claim cannot be substantiated. As indicated previously in this Response, the auditors were provided with a copy of a seven-page document entitled *1996 Revised Budget Justification* which states the justification for the layoff of the West Hawai'i Island (Kona) circuit-rider. It states in part:

"Because of the 'circuit-rider' nature of this position wherein the consultant travels to the client rather than the client coming to the consultant, this position serves the fewest clients. Note the following:

of			Number of	Number of	Number
	<u>Position</u>	<u>Location</u>	<u>1995 Clients</u>	<u>Workshops</u>	
<u>Attendees</u>					
	Center Director	Hilo, Hawai'i	262	47	683
	Center Director	Honolulu	206	40	585
	Center Director	Maui	196	34	684
	Center Director	Kaua'i	182	36	881
	<i>Consultant</i>	<i>West Hawai'i</i>	<i>172</i>	<i>22</i>	<i>325</i>
	"				

(*1996 Revised Budget Justification*. 2/12/96, p. 5) (Italics added)

Note also that the number of training events (workshops) and the number of attendees at those events is much lower than those of the other positions--11.8% lower in training events than the average of the next three highest and 50.1% lower in attendees than the next three highest (excluding in each instance the highest).

c. The auditors' claim is based solely on a comparison of the number of counseling hours. If those hours are adjusted for travel time--travel time being negligible for all other positions--then the West Hawai'i circuit-rider position is seen to be less productive than claimed. See column "A" in the table below:

for			(A) No. of 1995 Counseling Hours	(B) No. of 1995 Counseling Hrs. Adj.
	<u>Position</u>	<u>Location</u>	<u>Adjusted for Travel</u>	<u>Adm.Duties &amp;</u>
<u>Advocacy</u>				

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 To *Draft Audit Report* No. 8-7-F-004

Center Director	Hilo, Hawai`i	1,037	1,037
Center Director	Honolulu	544	544
Center Director	Maui	729	729
Center Director	Kaua`i	627	627
<i>Consultant</i>	<i>West Hawai`i</i>	897	762

However, the circuit-rider position, unlike the center director positions, has nearly no administrative duties, no supervisory duties, nor any significant outreach responsibilities. These duties represent approximately 15% - 20% of the center directors' time, which reduces the circuit-rider position's hours to 762 (-15%) or 718 (-20%). See column "B" in the table above. If, then, the difference in training is also factored in, the claim that the position is the most productive is tenuous.

2. The *Draft Audit Report* states: "This decline [in counseling hours due to the elimination of the circuit rider position] occurred during a period when local business and government officials reported that Kona was experiencing economic growth and many small businesses needed counseling services." (*DAR*, p. 5, para. 4)

a. While local business and government officials may have reported that Kona was experiencing economic growth, the State of Hawai`i--and especially the Island of Hawai`i, including the western portion of the island--have been in the throes of a stagnant economy at recessionary levels since 1992. (See the Hawai`i Index of Leading Economic Indicators.) Nevertheless, it is certainly the case that Kona, like all areas of Hawai`i, has many small businesses needing advocacy, counseling, research, training, and other SBDC-type services.

3. The *Draft Audit Report* states: "Implementation of the actions to increase counseling positions . . . should enable the HBDSC (*sic*) to assign a circuit rider to the Kona area without an increase in the present funding level. (p. 5, para. 5)

a. This statement is not accurate as shown above in the discussion of the proposed savings and costs associated with adding a circuit-rider position in West Hawai`i Island.

b. More importantly, the conjecture of the auditors begs the question of whether their proposed action would be a wise management decision. As stated above, neither evidence nor weight of expertise is presented by the auditors to counter the Hawai`i SBDC Network State Director's fully developed and presented argument which concludes that such a decision would be counter-productive and inappropriate and, thus, unwise in the setting of Hawai`i.

c. In the State Director's memorandum of 1/16/97 to the auditors, he wrote:

"The decision to eliminate the position in west Hawai'i is in part the result, even if unintended, of an SBA mandate concerning the re-allocation of resources to Honolulu. It would be a considerable irony to create through a recommendation another mandate to correct the first one and, thus, perhaps setting up another unintended consequence that has a detrimental effect on SBDC clients. (Memorandum from Darryl Mleynek, State Director, Hawai'i Small Business Development Center Network, to Garry L. Duncan, Audit Manager, Office of the Inspector General, U.S. Small Business Administration. 1/16/97. p. 5)

### **Kona Counseling Position and the Leeward Subcenter (DAR, p. 6)**

1. The *Draft Audit Report* states: "The termination of the Kona counselor position allowed the HSBDC to assign a second counselor to a new sub-center in Leeward, Oahu." (DAR, p. 6, para. 1)

a. The auditors have reversed the sequence of events, and their conclusion is thus misleading. The second counselor position on O`ahu, in an agreement between the Hawai'i SBDC Network and the SBA referred to as the *Outreach Strategy*, was committed to by the SBA's Office of SBDCs on 3/20/95 in a letter signed by Johnnie L. Albertson, Associate Administrator, following an exchange of letters and phone calls among her, Cassandra M. Pulley, at that time the Deputy Administrator of the SBA, and the State Director.

In that letter, Ms. Albertson stated:

"I fully support your proposal to add two [her emphasis] consultants to the Honolulu subcenter thereby placing additional resources where the majority of the Islands' small businesses are located. I encourage you to fill both of these positions as expeditiously as possible.

". . . I do believe that you have formed a basis for resolving many of the concerns that the Agency has had with regard to Hawaii's SBDC. We will be most interested in seeing the results of your efforts . . . ."

The first of these two new counselor positions, which would be the second position on O`ahu, was required by the agreement with the SBA to be in place no later than 12/31/95. The search for a counselor began on 7/25/95, a counselor was hired on 11/16/95, and began working on 12/11/95. The decision to lay off the West Hawai'i circuit-rider was made in early February, 1996, and not

finalized until 2/12/96. Layoff notice was given on 2/15/96 and termination occurred on 3/14/96.

In the sequence of events, then, the most significant dates are 3/20/95 when the commitment by the SBA to hire a second counselor on O`ahu was made and 2/12/96 when the layoff decision was finalized. No termination of the West Hawai'i position was envisioned by the State Director of the Hawai'i SBDC Network on 3/20/95 or any date prior to that, nor up until shortly before the 2/12/96 date. Therefore, the assignment of "a second counselor" on O`ahu could not have been caused by the "termination of the Kona counselor position." (DAR, p. 6, para. 1)

b. The statement of the auditors is that the layoff was due to the decision of the State Director to hire a second O`ahu consultant. This conjecture was responded to by the State Director in a letter to the auditors dated 7/21/97, which addressed that very question as then posed to him by the auditors. He stated in part:

"The Outreach Strategy, which was a joint strategy developed by me [the State Director] with the concurrence of Andrew Poepoe [SBA Honolulu District Director] in response to Ms. Cassandra Pulley's request, consisted of what we believed to be the minimal commitment acceptable to the Washington office of the SBA that would resolve the issue over the location of the Lead Center. In that sense, I believe that the strategy to add a second consultant in Honolulu, although perhaps technically developed by me, was in fact mandated by the Washington office of the SBA. If the decision had been mine alone, I would not have added a second consultant in Honolulu while the budget for the Hawai'i SBDC Network was undergoing reductions." (Letter from Darryl Mleynek, State Director, Hawai'i Small Business Development Center Network, to Leon R. Cheney, Auditor, Office of the Inspector General, U.S. Small Business Administration. 7/21/97 pp. 3-4.)

The Hawai'i SBDC Network State Director understood the complexity of this *local* issue. Nevertheless, the SBA Office of SBDCs expected the second position on O`ahu to be created even if it meant moving "resources" from elsewhere in Hawai'i. The essence of their argument and expectations is contained in Ms. Albertson's phrase, "placing additional resources where the majority of the Islands' small businesses are located," and her position is revealed in the statement, "I encourage you to fill both of these positions as expeditiously as possible." An examination of the correspondence will substantiate that the State Director fought hard for his views in what became a contentious public issue, but was able only to deflect even worse consequences to the Hawai'i SBDC Network by effecting this compromise solution of hiring a second counselor on O`ahu.

2. The *Draft Audit Report* concludes the next presentation of the auditors' observations by stating: "Based on our observations, the new Leeward sub-center [satellite office] neither increased the service area nor increased access to available services. . . . Since the Leeward sub-center did not substantially expand services to new clients, the State Director should consider closing the sub-center and using those resources to meet higher priority counseling requirements. (*DAR*, p. 6, para. 2)

a. The purpose in opening the Leeward Satellite Office, as mandated by the SBA Office of SBDCs, was neither to expand the service area nor to increase *access* to services on O`ahu, as the auditors have incorrectly assumed, but rather was to increase the *delivery* on O`ahu of SBDC services, such as counseling. It has achieved that. Total client counseling hours on O`ahu in 1995 with one counselor were 544 hours and in 1996 with two counselors were 1,446 hours, an increase of 165.8% in counseling hours on O`ahu.

b. The particular location on O`ahu for the second counselor position was determined by three factors:

i. There existed no office space for a second counselor in the downtown Honolulu Business Information and Counseling Center (BICC) in which the first counselor was located.

ii. The State Director believed, given that a second location was necessary, that a leeward location in the approximate area of Waipahu would reach some percentage of clients who would not otherwise travel to a downtown location. Individuals familiar with local attitudes will understand that some small business people, even though the distance is only "12 freeway miles and about 20 minutes away," (*DAR*, p. 6, para. 1) will not venture into downtown Honolulu.

iii. Since the space for the Leeward Satellite Office was donated by the Bank of America, there were no additional costs associated with opening a second office in Waipahu, as opposed to having two counselors in one office in downtown Honolulu.

c. The auditors have privileged Kona over other areas of the State of Hawai'i. They refer to "closing the [Leeward] sub-center and using those resources to meet *higher priority counseling requirements*," presumably those in West Hawai'i (Kona). Yet, nowhere do they present evidence or weight of expertise to establish the need in Hawai'i for a higher priority of counseling to West Hawai'i. While a few residents of the Kona area have expressed their disapproval of the Hawai'i SBDC Network reducing service to that area, protests are political. The auditors may not understand that reduction of existing service to *any* area--even

that in leeward O`ahu--will produce similar political complaints.

d. For the auditors to suggest that the State Director close the Leeward Satellite Office is disingenuous since they know it means violating an agreement between the Hawai`i SBDC Network and the SBA Office of SBDCs. The GAO "Yellow Book" states: "Recommendations are most constructive when they . . . are addressed to parties that have the authority to act [and] are feasible . . . ." (Comptroller of the United States, GAO. Government Auditing Standards. 1994 rev. para. 7.23)

**Recommendations: 1A. Submit a plan to increase counseling hours and reduce administrative time.** (DAR, p. 6)

1. The Hawai`i SBDC Network disagrees with the recommendation as stated, because the finding upon which it is based is without merit.
2. Nevertheless, the Hawai`i SBDC Network will address the small business-based need in Hawai`i for greater client services in its annual revision of its strategic plan.
3. The Hawai`i SBDC Network believes it is unwise and counter-productive to decrease administrative time and strongly opposes this part of the recommendation.

**Auditee's Conclusion:**

1. The evidence presented in support of Finding 1 is neither sufficient, competent nor relevant upon which to base the finding. "Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditors' findings and conclusions." (Comptroller of the United States, GAO. *Government Auditing Standards*. 1994 rev., para. 6.46. See also para. 6.50) Furthermore, the objective to which the finding responds is too narrowly constructed, the finding lacks materiality, and the defining documents of the SBDC Program do not give primacy to counseling over other tactics and do not provide any standard or goal for counseling other than those goals negotiated annually with and approved by the SBA, goals which the auditors admit the Hawai`i SBDC Network has met or exceeded.
2. Finding 1 should be withdrawn. The GAO "Yellow Book" states: "When the comments [by responsible officials of the audited program] oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid, the auditors may choose to state their reasons for rejecting them. *Conversely, the auditors should modify their report if they find the comments valid.*" (Comptroller of the United States, GAO. Government Auditing Standards. 1994 rev., para. 7.42) (Italics added)

Hawai'i SBDC Network Response  
To *Draft Audit Report* No. 8-7-F-004

**Finding 2: Program Funding from Private and Public Sectors.** (*DAR*, p.7) "Funding stability could be improved by applying for funds available from private and local government entities. Increased funding would allow HSBDC to use its resources more effectively to provide counseling assistance to the small business community." (*DAR*, Summary, p. i)

1. While the Hawai'i SBDC Network generally agrees with the concluding opinions expressed by the auditors in Finding 2, it disagrees that their remarks should be elevated to a finding due to lack of materiality, of appropriate criteria, and of evidence which is sufficient, competent, and relevant upon which to reasonably base a finding.

Furthermore, the finding is not in response to an audit objective, and departs from the recommendations of the GAO "Yellow Book," which states: "[T]he elements needed for a finding depend entirely on the objectives of the audit." (Comptroller General of the United States, GAO. *Government Auditing Standards*. 1994 rev. para. 7.19)

2. The Hawai'i SBDC Network agrees that it was vulnerable to UH Hilo funding fluctuations and that program delivery was consequently affected adversely. And, of course, additional funds from whatever source would reduce the adverse impact.

3. The auditors omit mention of the SBA's efforts to also reduce funding for the SBDC Program during 1995 and 1996, although the SBA's failure in this objective mitigated most adverse effects to the Hawai'i SBDC Network. Nevertheless, increased funding from the SBA would also "allow HSBDC to use its resources more effectively to provide counseling assistance to the small business community." (*DAR*, Summary, p. i)

4. For a finding to be credible, criteria need to be established against which to make judgements. "Criteria are the standards used to determine whether a program meets or exceeds expectations." (Comptroller of the United States, GAO. *Government Auditing Standards*. 1994 rev, para. 6.11) There are within the defining documents of the SBDC Program no imperatives, negotiated goals, standards, or requirements concerning fund-raising. Therefore, there are no appropriate criteria for a finding.

5. The defining documents of the SBDC Program may make no reference to fund-raising because the costs of fund-raising are unallowable under OMB Circular A-110. "Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions, are unallowable." (OMB Circular A-21 J(22)(b))

6. If there were SBA goals for fund-raising, the Hawai'i SBDC Network would meet them. During the current year, the Hawai'i SBDC Network has obtained commitments for the following funds *in addition to* those derived from the SBA grant and UH Hilo match:

<u>Amount</u>	<u>Contract Period</u>	<u>Source &amp; Project</u>
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Hawai'i SBDC Network Response  
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\$343,500	8/01/97 - 7/31/98	Department of Defense funds received through the USDA for administration of the RETA-H Program <sup>6</sup>
167,000	8/01/97 - 12/31/98	State Department of Business, Economic Development and Tourism funds for services to recycling and remanufacturing small businesses. Includes funds from the EPA.
135,000	8/01/97 - 7/31/98	Maui County funds for the Business Research Library.
90,000	8/01/97 - 7/31/98	State Legislature funds for the Business Research Library. Received through the Maui Economic Development Board by way of the High Technology Development Corporation, both 501(c)(3)s.
<u>18,100</u>	8/01/97 - 7/31/98	City & County of Honolulu, Department of Commerce and Social Resources funds for a training program.
\$753,600		Total Cash Funding

a. The total cash funding of \$753,600 represents 173.9% of the SBA federal funding for Hawai'i. If comparisons were made by the SBA of fund-raising, funds raised as a percentage of federal funds would be the logical comparison.

b. In addition to this cash funding, the Hawai'i SBDC Network also receives substantial in-kind funding from the Bank of Hawaii and the Bank of America.

c. To our knowledge, statistics are not tabulated and released concerning what other states have achieved in obtaining funding beyond the SBA grant and host institution matching funds, but few other states/regions would exceed this amount as a percentage of SBA federal funds.

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<sup>6</sup> This \$343,500 in administrative funds are part of a 1997 grant for the RETA-H Program of \$4,763,889. Previous grants in this Program administered by the Hawai'i SBDC Network: \$4,711,320 in 1996, \$5,000,000 in 1995, and \$905,280 in 1993 for a total of \$15,380,489. No state/regional SBDC has administered a program this large, to the best of our knowledge.

7. As the above list shows, the Hawai`i SBDC Network recognizes the advantages to raising additional funds.

**SBDC Program Objectives Are Important to the Business Community (DAR, p. 7)**

The Hawai`i SBDC Network agrees with the comments made by the auditors in this section. In fact, the Network understands that most of the officials referred to in this section praised the SBDC's accomplishments in Hawai`i to the auditors, as did the clients surveyed.

**Funding Reductions Resulted in a Proposed Outreach Strategy (DAR, p. 7)**

1. The Hawai`i SBDC Network agrees with the summary of events in this section, except for the last paragraph (*DAR*, p. 8, para. 1).
2. It is noted that the auditors did not endorse the SBA's previous attempts to move the Hawai`i SBDC Network State Office (lead center) from Hilo to Honolulu, which we understand was an issue the auditors reviewed.
3. The *Draft Audit Report* states: "On March 3, 1995, *HSBDC* proposed a compromise outreach strategy to increase program funding by raising funds from the public and private sectors and increasing staff by two additional counselors on Oahu." (*DAR*, p. 8, para. 1) (*Italics added*)
  - a. While the compromise outreach strategy was technically proposed by the State Director of the Hawai`i SBDC Network, the proposal grew out of an expectation promoted by the SBA that such a proposal would resolve what had become a contentious public issue. For an extensive discussion of this issue, see the Response to Finding 1, "Kona Counseling Position and the Leeward Subcenter," pages 26 - 29.

**Outreach Strategy Activity Not Fully Implemented (DAR, p. 8)**

The *Draft Audit Report* states: "[T]he State Director added a second counselor to Oahu by eliminating the Kona area counselor . . . ." (*DAR*, p. 8, para. 2)

- a. No evidence is presented by the auditors in support of this statement. To the contrary, the Hawai`i SBDC Network did not add a second counselor to O`ahu by eliminating the Kona area counselor. It would be fair to state, however, the West Hawai`i Island circuit-rider was laid off in part because of the consequences of an SBA-mandated agreement. For an extensive discussion of this point, see the Response to Finding 1, "Kona Counseling Position and the Leeward Subcenter," pages 26 - 29.

**Potential Fund Raising Efforts (DAR, p. 8)**

1. The *Draft Audit Report* states: "The HSBDC can avert reduced operations by increasing private and public fund raising."

While this statement obviously rings true, it glosses over the full reality of fund-raising by SBDCs. Note the following points:

- i. When the federal government began to reduce funding to many business and social assistance programs, the competition for private and state funds increased dramatically.
- ii. Private and state funds, other than those from the host institution, are nearly always project-based. That is, the funds are encumbered for specific, defined projects and are not available for general operational purposes. This is precisely the point made by the auditors in their complaint about the funding for the Business Research Library Specialty Subcenter.
- iii. Private and state funds are short-term commitments--usually one year, occasionally two years.
- iv. The number of private sources for funding in a state as small as Hawai'i is quite limited.
- v. Frequently, private funding is limited to non-profit entities such as 501(c)(3)s.
- vi. Private and state funds, when obtained, increase the administrative load for the SBDC.

The effect of these realities in fund-raising is that private and state funding, other than from the host institution, may not increase an SBDC's stability significantly and may not avert reduced operations.

2. The *Draft Audit Report* states: "The State Director stated he was unaware of the funding sources [Bank of Hawaii, First Hawaiian Bank, City and County of Honolulu Housing and Community Development Department] and would follow up on each lead." (DAR, p. 8, para. 5)

- a. The State Director has long been aware of these funding sources. Two of them--the Bank of Hawaii and First Hawaiian Bank--have representatives on the Hawai'i SBDC Network's State Advisory Board and the third--the City and County of Honolulu--has provided the Hawai'i SBDC Network with an \$18,100

grant earlier in this year.

b. On 6/25/97 and 6/26/97, the State Director and SBA Project Officer met with representatives from First Hawaiian Bank and the Bank of Hawaii, respectively, to discuss future funding possibilities.

**Rationale for the Lack of Fund Raising Efforts (DAR, p. 8)**

1. The *Draft Audit Report* states: "The State Director said he had not attempted to raise funds from other sources, such as those mentioned above, because he lacked an Associate State Director and was reluctant to initiate fund raising efforts without the permission of the UH Hilo chancellor. As a subordinate of the chancellor, the State Director said he concentrated on program delivery and depended on the chancellor for fund raising." (DAR, pp. 8-9, para. 6)

a. The State Director, since his appointment in 6/94, has actively sought to raise funds. He did comment to the auditors that the creation of an associate state director position would enhance his ability to raise funds, but he did not use the lack of such a position to create the impression that he did no fund-raising. The evidence is the funds raised--\$753,600 in the current year. See the list above, page 32.

b. The State Director did comment to the auditors that when he was first appointed, the Chancellor had not given approval for fund-raising by the Hawai'i SBDC Network because he saw the SBDC as a competitor for funds. At the request of the State Director, the Chancellor reversed this position in 1994. At no time has the State Director ever depended upon the chancellor for fund-raising.

**Recommendation: 2A. Implement SBA's recommendation to raise funds from private sector and local government entities with initial fund raising efforts directed toward the sources identified during the audit.**

This recommendation has long been in the process of being implemented, with the exception of the particular sources identified during the audit, and even those have been part of recent fund-raising efforts.

**Auditee's Conclusion:**

1. Finding 2 has a lack of materiality, appropriate criteria, and evidence which is sufficient, competent, and relevant upon which to base a finding.

2. Finding 2 should be eliminated. The GAO "Yellow Book" states: "When the comments [by responsible officials of the audited program] oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid, the auditors may choose to state their reasons for rejecting them. *Conversely, the auditors should modify their report if they find the comments valid.*" (Comptroller of the United States, GAO. Government Auditing Standards. 1994 rev., para. 7.42) (Italics added)

3. The single, most important tactic to increase the stability of the Hawai'i SBDC Network's funding is to obtain full funding from the host institution. In a meeting on 8/05/97, the President of the University of Hawai'i System committed the University to providing full match funding in the current year and to do this in the future through a line-item in the State budget. This major achievement was the result of a strategy coordinated with the SBA District Director to obtain support from major leaders in the State for full funding for the Hawai'i SBDC Network. Letters were sent and phone calls were made to the President of the University of Hawai'i and the Acting Senior Vice President and Chancellor of the University of Hawai'i at Hilo. This was followed by several meetings between the State Director and the UH Hilo Acting Chancellor in preparation for a final meeting at which the commitment for full match funding was made by the President. In addition to the State Director and the SBA District Director and Project Officer, the Program Manager from the Office of SBDCs was in attendance at this meeting and, in fact, served as a catalyst for the scheduling of the meeting.

**Finding 3: Reporting and Approval Requirements.** (*DAR*, p. 9) The reporting and approval requirements in the Cooperative Agreement were not always followed. Financial and performance reports were not prepared or were inaccurate and submitted late. Approval for contracts exceeding \$5,000 was not obtained. The requirements were not complied with because the accounting agent did not detect data transfer and accounting system errors, and Notice of Award provisions were overlooked or misunderstood. (*DAR*, p. i)

1. The *Draft Audit Report* states: "Financial and performance reports . . . were either not prepared or were inaccurate and untimely." (*DAR*, p. 9, para. 3)

a. All performance reports were prepared and filed on time.

b. All performance reports were accurate, although all performance reports failed to include a section on financial expenditures from a management perspective, which is required by the *Notice of Award*, but is not mentioned in the detailed outline for performance reports in the *Program Announcement*. The SBA Office of SBDCs, in seven years of oversight responsibility, never brought this omission to the attention of the Hawai'i SBDC Network.

c. All financial reports were prepared and, other than final reports, were submitted on time.

d. The *Draft Audit Report* statement should be worded more correctly to read: Financial and performance reports did not include some required information (indirect cost rate, program income use, financial expenditures from a management perspective), contained some incorrect reporting (program income and expense commingled with expenditures, indirect cost details), and final reports were not submitted on time." Otherwise, the auditors' comment is overly generalized and may be misperceived by third party users of this information.

### **Financial Status Reports (SF 269) (*DAR*, p. 9)**

1. The *Draft Audit Report* states: "The Financial Status Report for 1995 was not submitted timely, contained inaccurate financial data, and omitted program income expense information." (*DAR*, p. 9, para. 4)

a. The Hawai'i SBDC Network concurs that the 1995 and 1996 final (but not quarterly) Financial Status reports were not submitted on time, and concurs that program income and expenses were inaccurately commingled with project expenses and indirect costs were inaccurately reported on the SF 269.

2. The *Draft Audit Report* states: "SBA was not aware that by the end of 1996 over

\$68,000 in program income was available . . . ." (*DAR*, p. 9, para. 6)

- a. The SBA was surely aware that program income was available, since program income balances were reported annually in the Hawai`i SBDC Network proposal and quarterly in the Hawai`i SBDC Network training reports.

**Performance Reports (*DAR*, p. 10)**

1. The *Draft Audit Report* states: "The Cooperative Agreement and 13 CFR §130.820(c) required that semi-annual and annual performance reports be provided to SBA that showed actual versus budgeted financial expenditures by cost categories." (*DAR*, p. 9, para. 6)

- a. While semi-annual and annual performance reports were submitted on time, inadvertently the Hawai`i SBDC Network did not implement the requirement in the *Notice of Award* to submit actual versus budgeted financial expenditures by cost categories from a management perspective. Once this oversight was brought to the attention of the Hawai`i SBDC Network in the course of the audit, these reports were filed for 1995 and 1996 year-end as soon as possible, and will continue to be filed as required.

- b. While the Hawai`i SBDC Network recognizes its responsibility to conform to the requirements of the award, it also notes under Standard Provision 2 of the award titled DELINEATION OF SBA INVOLVEMENT, subparagraph b., that SBA involvement included responsibilities to ensure Hawai`i SBDC Network activities conform to the requirements of the law, the *Program Announcement*, and the Cooperative Agreement. During the previous seven years, the absence of the required data was not conveyed to the Hawai`i SBDC Network.

- c. Issues such as this could be largely avoided if a single source of regulations were maintained or if the *Program Announcement* sections on performance reports, which are extensive, were cross-referenced with sections on performance reports in the *Notice of Award*.

**Approval of Consultant Contracts (*DAR*, p. 10)**

1. The *Draft Audit Report* states: "According to the terms of the Cooperative Agreement, HSBDC must obtain SBA approval before awarding contracts which are expected to exceed \$5,000." (*DAR*, p. 10, para. 3)

a. Since the implementation of OMB Circular A-110 (revised) in 1993, the procurement operations of the Hawai'i SBDC Network have been governed by these procurement standards. The requirement for prior approval of sole source contracts exceeding \$5,000 is not a provision of Procurement Standards of the Circular. The Hawai'i SBDC Network overlooked this ambiguity between the *Notices of Award* provision of (4e.) and the governing OMB Circular A-110 Procurement Standards. In retrospect, the Hawai'i SBDC Network feels that it was in substantive compliance since one of the two reasonable interpretations flowing from Federal Uniform Administrative Requirements (A-110) as promulgated by the OMB on the one hand and the SBA *Notice of Awards* on the other was followed. As a matter of note, the provision recited in Provision 4 of the 1995 *Notice of Award* was changed beginning in 1996 and, therefore, does not appear to require prior notification of agreements exceeding \$5,000.

b. As a further matter of note, OMB Circular A-110, Subpart A, paragraph 3 states that its provisions govern unless different provisions are provided for by Federal statute. Paragraph 4 of this subpart states that agencies may apply more restrictive provisions if approved by OMB. We are unaware of the 1995 *Notice of Award* provision 4 having been provided for by statute or receiving approval of OMB.

c. In conclusion, we acknowledge we were not in compliance with the Provision 4 for the reasons stated above. However, the ambiguity between this provision and OMB Circular A-110 appeared to remain, until the prior approval provision in the SBA *Notice of Award* document was eliminated in 1996 and subsequently.

### **Recommendations (DAR, p. 10)**

#### **3A. Ensure the University of Hawaii accounting agents take actions to submit timely data and correct the problem of commingling accounting data during data transfer.**

a. The Hawai'i SBDC Network has already taken steps to ensure timely submission by meeting on 9/30/97 with the SBA Project Officer, the Director of the University of Hawai'i Office of Research Services (ORS), and the UH ORS Fiscal Accounting Specialist to discuss removing barriers to timely submission of reports and related fiscal matters affecting the interface among the Hawai'i SBDC Network, the Research Corporation of the University of Hawai'i, and the University of Hawai'i Office of Research Services.

#### **3B. Report program income received and how it was used to further program objectives on SF 269 reports.**

a. The Hawai'i SBDC Network has complied with this recommendation since this compliance issue was raised by the auditors in May 1997. We appreciate the

assistance provided by the auditors in supporting the suggestions made by the Hawai'i SBDC Network to the UH Office of Research Services regarding the specifics of this requirement.

**3C. Prepare and submit semi-annual and annual performance reports showing actual versus budgeted financial expenditures by cost categories in accordance with the Cooperative Agreement.**

a. The Hawai'i SBDC Network has complied with this recommendation since this compliance issue was raised by the auditors in May 1997.

**3D. Obtain SBA approval before awarding contracts in excess of \$5,000.**

a. An ambiguity existed in FY 1995 and prior years, wherein the prior approval requirement in the Cooperative Agreement was outside the scope of OMB Circular A-110. SBA eliminated the prior approval requirement in FY 1996 and subsequently.

**Finding 4: Indirect Costs and In-Kind Contributions.** (*DAR*, p. 11) Indirect costs were overstated by \$30,415 because correct indirect cost rates were not used and in-kind rents were not properly prorated. Conversely, the HSBDC did not claim allowable indirect costs of \$35,408 for matching funds. Since unclaimed allowable costs offset the questioned costs, no refund is due. (*DAR*, p. i)

**Indirect Cost Rates (DAR, p. 11)**

1. The *Draft Audit Report* states: "[T]he HSBDC accounting agent used an incorrect rate to determine the indirect cost rate on Federal direct costs. The accounting agent should have classified HSBDC operations into on-campus and off-campus. Conversely, indirect costs of \$35,408 were not claimed as matching funds." (*DAR*, p. 11, para. 3)

a. No further sufficient, competent, and relevant information was included in this finding to enable a reader of the finding to understand the basis of the auditor's conclusion that an incorrect indirect cost rate was used (see para. 7.18 of the *GAO Government Auditing Standards*).

b. The University of Hawai'i fiscal year cited in the *Draft Audit Report* is 1995. For that fiscal year and prior years, the University of Hawaii system-wide office negotiated indirect cost rates with the OMB-assigned cognizant Federal agency. Multiple rates were negotiated including, but not limited to on- and off-campus Sponsored Instruction and Training and on- and off-campus Other Sponsored Activities. Since inception, the HSBDC has applied the on-campus Sponsored Instruction and Training rate in all award applications and resultant post award financial reporting. The basis for this application and reporting was two-fold: (i) the predominant characteristics of the functions being performed (training, counseling, research, and advocacy) were determined to coincide with the definition of Sponsored Instruction and Training set forth in OMB Circular A-21 and (ii) the principal setting of the Hawai'i SBDC Network State Office is located on-campus at the University of Hawai'i at Hilo.

c. Based on recent discussions with the UH system-wide office responsible for Indirect Cost studies, it has been determined they inadvertently or otherwise coded the Hawai'i SBDC Network activities under Other Sponsored Activities. The Hawai'i SBDC Network is presently in discussions with this Indirect Cost studies group and the Central Accounting Office and has provided them with appropriate data demonstrating that the principal functions performed under the SBA Cooperative Agreement coincide with the definition of the Sponsored Instruction and Training function set forth in OMB Circular A-21. Amendments to correct the above inadvertency are in process to correct this coding to Sponsored Instruction and Training for 1997 and subsequent years.

**In-Kind Rents - Honolulu (DAR, p. 12)**

1. The *Draft Audit Report* states: "OMB Circular A-21, paragraph C4, requires in-kind rent to be prorated among the benefiting institutions . . . . As a result of the over and under statements, questionable in-kind contributions for the office spaces totalled \$15,332." (DAR, p. 12, para. 1)

a. Although the Hawai'i SBDC Network questions sharing costs 50:50 with SCORE when they use space in the Leeward Satellite Office only one morning per week, the auditors' determination will be conformed to as a conservative proration of in-kind rental costs on O`ahu. We appreciate the detailed explanation provided by the auditors as to the proper proration and calculation of in-kind rental costs.

**Unclaimed Costs (DAR, p. 12)**

1. The *Draft Audit Report* states: "The HSBDC did not claim \$35,508 in allowable indirect costs attributed to the state matching direct costs . . . ." (DAR, p. 12, para. 2)

a. The Hawai'i SBDC Network concurs that indirect costs were not claimed on UH Hilo funds because the Hawai'i SBDC Network was told on two occasions by the University of Hawai'i that this was not allowed, even though the then Comptroller of the Research Corporation of the University of Hawai'i had advised us to do so.

b. Based on the arguments put forth in the *Draft Audit Report* requiring the application of on-and off-campus rates, the amount of indirect costs of \$35,508 calculated by the SBA auditors may be incorrect. They have not applied on- and off-campus rates to the UH Hilo funds. The correct amount based on the *Draft Audit Report* arguments should be \$34,837. See the *revised* table below:

Unclaimed Allowable 1995 Indirect Costs - Revised

<u>Description</u>	<u>Computational Amounts</u>	<u>Final Amount</u>
State Matching Direct Costs		\$256,396
Less: Equipment, Rental & BRL Costs		<u>88,902</u>
Net State Matching Direct Costs		\$167,494
<u>Description</u>	<u>Computational Amounts</u>	<u>Final Amount</u>
On-Campus Base - Hilo, Lihue	130,585	
Off-Campus Base - Other Subcenters	36,911	
On-Campus - OSA (rate = 21.14%)		27,606

Off-Campus - OSA (rate = 19.59%)	<u>7,231</u>
Total Indirect Costs Allowed	\$34,837

c. The use of Other Sponsored Activity (OSA) rates, rather than Sponsored Instruction and Training rates and of on- and off-campus rates in the above table, does not indicate the Hawai'i SBDC Network concurs with the auditors that such rates should be applied to SBDC funds.

**Recommendations (DAR, p. 12)**

**4A. Use correct negotiated indirect cost rates for allocating expenditures. (DAR, p. 12)**

a. The Hawai'i SBDC Network has initiated discussions with the University of Hawai'i Indirect Cost studies group at the Office of Research Services and the Central Accounting Office to correct the application of Other Sponsored Activity rates rather than Sponsored Instruction and Training rates to SBDC direct costs.

**4B. Prorate in-kind costs rents. (DAR, p. 12)**

a. The Hawai'i SBDC Network will adjust the proration of in-kind rent costs in accordance with the direction provided by the auditors.

**4C. Compute allowable indirect costs for matching funds regardless of the amount of Federal funds received. (DAR, p. 12)**

a. The Hawai'i SBDC Network will compute allowable indirect costs for matching funds.

### **OTHER AUDIT ISSUES**

The Hawai`i SBDC Network has noted that the auditors have issued no findings regarding other issues reviewed by them:

1. The appropriateness of the Rural Economic Transition Assistance - Hawai`i (RETA-H) Program as a Hawai`i SBDC Network administered program.
2. The appropriateness of the Business Research Library as a specialty subcenter of the Hawai`i SBDC Network.
3. The location of the Hawai`i SBDC Network State Office (Lead Center) in Hilo.
4. The appointment of the current State Director of the Hawai`i SBDC Network.
5. The definition of Program Income as currently in use in the SBDC Program.