

**AUDIT OF SELECTED ASPECTS OF
THE SERVICE CORPS OF RETIRED
EXECUTIVES PROGRAM**

AUDIT REPORT NUMBER 3-23

APRIL 11, 2003

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

AUDIT REPORT
Issue Date: April 11, 2003
Number: 3-23

To: Ellen Thrasher
Acting Associate Administrator for Business and Community Initiatives

Eugene Cornelius, Jr.
Assistant Administrator for Administration

Robert G. Seabrooks

From: Robert G. Seabrooks
Assistant Inspector General for Auditing

Subject: Audit of Selected Aspects of the Service Corps of Retired Executives (SCORE)
Program

As a result of a request from SBA's Office of Procurement and Grants Management (OPGM), we conducted a limited scope audit of the SCORE program. This memorandum provides the results of our audit related to SCORE's compliance with applicable rules and regulations and SBA's monitoring of its cooperative agreement with SCORE.

Background

SCORE, a nonprofit organization, is one of SBA's primary resource partners that provides services to the small business community through counseling, educational training workshops, and online assistance. Organizationally, SCORE consists of a national headquarters (National Score Office) in Washington, DC and 389 chapters located throughout the United States and its territories and possessions. The primary mission of the National Score Office (NSO) is to support the business counseling and workshop services that take place in the field and provide resources and marketing support for SCORE programs both locally and nationally. Chapters are unit members of SCORE, located outside the headquarters office, whose primary purpose is to provide professional training and counseling.

Annually, SCORE submits a budget and technical proposal for SBA's consideration and approval. Once approved, SBA enters into a cooperative agreement with SCORE. SCORE's cooperative agreement requires that they comply with Office of Management and Budget (OMB)

circulars, including A-110 and A-122, as well as requirements imposed by SBA. Accordingly, SCORE's operations and activities must abide by requirements governing the accountability and allowability of costs charged to the Federal cooperative agreement. SBA is responsible for monitoring and overseeing the ongoing SCORE operations for effective and efficient use of Federal funds.

The SCORE program received funding of \$3.75 million in Fiscal Year (FY) 2001 and \$5.0 million in FY 2002 from SBA's salaries and expenses lump sum appropriation. Each year there is a non-statutory earmark in the conference report for SCORE that specifies the desired amount of funding.

Objectives and Scope

The objectives of our audit were to (1) assess controls put in place by management to ensure appropriate use of Federal funds, (2) review SBA's role in monitoring the financial and performance aspects of the cooperative agreement award, (3) determine the scope and extent of SCORE's independent auditor's testing relative to its single audit, and (4) assess SCORE's FY 2002 proposed salaries for its three highest paid positions to determine if the proposed salaries were allowable and reasonable.

To accomplish the objectives, we interviewed officials from SBA and NSO and reviewed FY 2001 documentation related to management controls, financial and program records, and the independent auditor's working papers. Additionally, we reviewed SCORE's past and present compensation policies and practices and independent consultant data provided by SCORE to support their proposed FY 2002 salary levels. Further, we reviewed applicable laws, regulations, cooperative agreement provisions and SBA's and SCORE's internal policies and procedures.

The audit was conducted from January 2002 to October 2002 in accordance with Government Auditing Standards.

Summary of Results

NSO had an internal control structure in place to ensure appropriate use of Federal funds, except that NSO did not (1) report program income earned by its chapters on SBA Form 269, "Financial Status Report," as required by the terms and conditions of the Notice of Award, and (2) include its chapters' financial activities in its financial statements in accordance with financial accounting standards. Additionally, we determined that SBA's monitoring of the performance and financial aspects of the award should be strengthened. We did not determine whether the established salary levels for the three highest paid salaried positions for FY 2002 were allowable and reasonable because we found that SCORE's statutory authority does not explicitly address SBA providing funding to SCORE for its paid positions. Additionally, SBA has not developed supplemental policies to govern the creation and compensation of administrative positions.

Finding 1: NSO Did Not Report Chapter Program Income to SBA

NSO did not report program income earned by its chapters in FY 2001 to SBA. The Notice of Award required NSO to submit quarterly financial status reports to SBA on Standard Form 269, "Financial Status Report," which contains an area for the recipient to report program income. Program

income as defined by OMB Circular A-110, “*Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*,” Subpart A.2 (x) includes income earned by the recipient that is directly generated by a supported activity or earned as a result of the award and includes, but is not limited to, income from fees for services performed.

For FY 2001, SCORE’s chapters conducted approximately 5,600 workshops and seminars which SCORE’s records reflect generated \$1.08 million in gross income. This income, however, was not reported to SBA as program income during FY 2001. As a result, SBA was not aware of the amount of program income being generated by SCORE’s chapters and did not have this information available when making funding decisions during the year. To illustrate, SCORE requested and SBA approved \$50,000 in additional funding on two separate occasions during FY 2001 to cover chapter administrative expenses. SBA approved this additional funding without full knowledge of SCORE’s complete financial resources.

SCORE representatives stated they were unaware that chapter program income should be reported. They also stated, however, that all chapters are required to submit annual reports to NSO detailing their income and expenses so the information could easily be provided to SBA. As a result of our work, SBA became aware of this issue and emphasized in the FY 2003 cooperative agreement award that *all* program income is required to be reported to SBA, including but not limited to, fundraising and service fees. We consider SBA actions responsive to the issue and therefore, are not making any recommendations regarding program income in this report.

SCORE’s Response:

SCORE acknowledged that they did not report chapter revenue as program income on the quarterly financial reports submitted to SBA and agreed to report this revenue to SBA on an annual basis within 90 days of the end of a fiscal year. SCORE’s response is included in its entirety as Attachment 1.

SBA Management’s Response:

The Acting Associate Administrator for Business and Community Initiatives (Acting AA/OBCI) stated that appropriate changes have been made in the FY 2003 cooperative agreement requiring SCORE to report program income within 90 days of the end of a fiscal year. The Acting AA/OBCI’s response is included in its entirety as Attachment 2.

The Director of OPGM stated that the Office of Administration reviewed the draft audit report and did not have any comments.

Office of Inspector General’s Evaluation of Responses:

The comments provided by SCORE and the Acting AA/OBCI indicate agreement with the finding. However, program income reporting requirements should align with financial status reporting

requirements. Accordingly, if financial status reports are required quarterly per the Notice of Award, chapter revenue should be reported quarterly in the appropriate area of SBA Form 269, "Financial Status Report."

Finding 2: NSO's FY 01 Financial Statements Excluded Complete Chapter Related Financial Information

SCORE's FY 2001 financial statements prepared by NSO did not include complete chapter related financial information. As a result, SCORE's financial statements (1) were incomplete which affected their reliability and relevancy, (2) did not contain complete information for SBA to assess program performance, and (3) provided incomplete financial information for the purpose of assessing SCORE's compliance with applicable requirements under OMB Circular A-133, "*Audits of States, Local Governments and Non-Profit Organizations.*"

SCORE's FY 2001 Financial Statements Were Incomplete Which Affected Their Reliability and Relevancy

Although NSO's Chief Executive Officer (CEO) recently provided a written certification to SBA acknowledging that NSO and its chapters are one legal entity, the chapters' financial activities were not included in SCORE's FY 2001 financial statements. The Single Audit Act of 1984, as amended, and OMB Circular A-133 require that the audit of NSO's activities be organization wide. In addition, the Financial Accounting Standards Board (FASB) requires financial statements of an organization to be complete.

Completeness also affects the reliability and relevancy of financial statements. *FASB* Concept No. 2, "*Qualitative Characteristics of Accounting Information,*" states in order for financial statements to be considered reliable they must be complete in the sense that nothing material is left out of the information that may be necessary to insure it validly represents the underlying events and conditions of the organization. Completeness also affects financial statements relevance as the relevance of information is adversely affected if an important piece of information is omitted. SCORE's chapters are a material component of SCORE's operation and therefore, omission of related financial information made the financial statements incomplete and affected their reliability and relevancy.

Incomplete Financial Statements Limited SBA's Ability to Assess Program Performance

Incomplete information in SCORE's FY 2001 financial statements impacted SBA's ability to assess program performance. As described in *FASB* Concept No. 4 "*Objectives of Financial Reporting by Nonbusiness Organizations,*" the general objectives of financial reporting for nonbusiness (including nonprofit) organizations are to provide information useful for resource providers to:

- make rational decisions about resource allocation decisions;
- assess an organization's services and ability to continue to provide those services;
- assess management stewardship and performance; and
- understand an organization's economic resources, obligations, net resources and the effects

of transactions, events, and circumstances that change those resources and interests in them.

Accordingly, because information related to a significant portion of SCORE's operation was omitted from its FY 2001 financial statements, SBA was not receiving complete data to make informed decisions regarding SCORE's financial resources. To illustrate, SCORE requested and received \$50,000 in additional funding on two separate occasions from SBA during FY 2001 to help defer administrative expenses of its chapters, although NSO's records showed an aggregate balance of approximately \$2.3 million at the end of FY 2001 in the chapters' accounts. In the absence of financial information about SCORE's chapters' economic resources and obligations, SBA's ability to understand why additional funding was needed and make an informed budget decision was hindered.

SCORE Provided Incomplete Financial Information for Purposes of the Single Audit

Annually, SCORE is subject to a single audit in accordance with OMB Circular A-133. As part of that audit, the independent auditor assesses SCORE's compliance with laws, regulations, and requirements of contracts and grants applicable to its major Federal programs. Additionally, the auditor assesses the organization's internal control over compliance that could have a direct and material effect on a major Federal program.

An auditee has certain responsibilities with respect to the single audit that are outlined in OMB Circular A-133, Section 300. Those responsibilities include the responsibility to prepare appropriate financial statements and ensure the audit was performed as required. SCORE did not fulfill those responsibilities because it excluded pertinent chapter financial information from its FY 2001 financial statements that were provided to the independent auditor who conducted the single audit. As a result, the single audit did not cover the entire operations of the auditee and SBA cannot be assured that SCORE is in compliance with applicable requirements.

Recommendation:

- 2A. We recommend that the Acting AA/OBCI, in conjunction with the Assistant Administrator for Administration, work with NSO to ensure compliance with FASB reporting requirements.

SCORE's Response:

SCORE stated that a legal opinion provided by their attorney supports the decision not to include chapter finances in the audit process. SCORE also stated that given this opinion and the estimated additional audit cost of roughly \$150,000 per year to appropriately audit 389 chapters, they believe SCORE should not be required to include an audit of its chapters in its annual paid audit. Further, SCORE believes that providing annual information to SBA on chapter revenue should overcome the concern raised related to reliability, relevancy and the ability of SBA to assess program performance.

SBA Management's Response:

The Acting AA/OBCI concurred with the recommendation subject to certain changes being made. The proposed changes include a suggestion that the recommendation be jointly addressed to the Acting AA/OBCI and the Assistant Administrator for Administration.

Office of Inspector General's Evaluation of Responses:

SCORE's response indicates disagreement with finding 2 and the Acting AA/OBCI's comments indicate agreement with finding 2. With respect to the Acting AA/OBCI's suggested changes to the recommendation, we considered the changes and revised the recommendation as appropriate.

With respect to the inclusion of chapter related financial information in SCORE's financial statements, we continue to support our position on this matter and believe our recommendation is valid. SCORE's attorney's application of Statement of Position (SOP) 94-3 in this matter and resulting conclusion that the SCORE Association is not required to consolidate the chapters in the Association's financial statements, appears to be flawed. SOP 94-3 interprets FASB No. 117, *Financial Statements of Not-for-Profit Organizations*. The SOP states that it applies only to those situations when there are separate and different not-for-profit organizations that are related to one or more other not-for-profits in numerous ways including control and economic interest. In this case, extensive discussion of these factors becomes irrelevant, because as recently as October 25, 2002, SCORE's CEO certified that based on previous legal advice from its attorney "it is clear that SCORE chapters are not independent legal entities based on their unit membership in the SCORE Association." Since the chapters are not independent legal entities, they cannot be "separate and different not-for profit organizations." Therefore, it does not appear that SOP 94-3 applies in this situation.

With respect to the cost and administration burdens expressed related to auditing 389 chapters, we would agree that it is not cost effective or practical in many instances to collect and examine the entire population of data available. Instead, it is often necessary to draw a sample of information from the population that can be tested to provide the auditor reasonable assurance that the chapter financial information and related assertions in the financial statements are not materially misstated.

Finding 3: SBA's Monitoring of SCORE Should be Strengthened

SBA's monitoring of SCORE should be strengthened by ensuring that financial data is measured against actual performance results. For example, SBA could have discovered that SCORE was not reporting program income earned by its chapters (see Finding 1) had it compared the financial and performance information provided by SCORE. SCORE consistently reported no program income on its financial status reports while its performance reports emphasized the number of workshop attendees during the reporting period for which fees are customarily charged. Monitoring is the process by which the financial and performance aspects of a cooperative agreement are continuously assessed to ensure federal funds are properly spent and program goals and objectives are met. Monitoring is a cooperative function between the grants management officer from OPGM and the technical representative from the responsible program office. It includes the review of audits, financial status reports, performance

reports, and other written documents.

SBA has a process in place whereby OPGM designates a technical representative to monitor the award to assure compliance with the technical requirements of the cooperative agreement including the review and approval of a recipient's progress and financial reports, and other items required for approval. With respect to SCORE's award, we found that, in practice, the designated technical representative focused on the performance aspects (e.g. ensuring counseling and training goals were met) of the cooperative agreement award and performed only a cursory review of the financial reports and payment requests before approving and forwarding them to OPGM. The program officials stated this occurred because of a verbal agreement with OPGM that they would handle the financial aspects of the award, while the program office handled the performance aspects of the award. OPGM officials did not recall such an agreement and stated that the program office's responsibilities were clearly outlined in the technical representative's appointment letter.

OMB Circular A-110 encourages agencies whenever appropriate and when the output of programs or projects can be readily quantified, to relate quantitative data to cost data for comparison of unit costs. Accordingly, in order to accomplish this objective as well as the general objectives of monitoring cited previously, SBA should more clearly relate financial information contained in financial reports to the performance data in performance reports.

Recommendation:

- 3A. We recommend that the Assistant Administrator for Administration, in conjunction with the Acting AA/OBCI, ensure there is a clear understanding of the role of each office in monitoring the SCORE cooperative agreement award and design monitoring procedures that integrate reviews of performance and financial data.

SBA Managements' Response:

The Director of OPGM stated that the Office of Administration reviewed the draft audit report and did not have any comments. The Acting AA/OBCI concurred with the recommendation and indicated that the respective program manager and grant office manager have been working more closely together on various SCORE issues. Additionally, the Acting AA/OBCI stated that the program manager received grants training in FY 2001 and will receive Contract Officers Technical Representative training.

Office of Inspector General's Evaluation of Response:

The comments provided by the Director of OPGM are not responsive to the recommendation and Office of Administration actions to address the finding and recommendation will be evaluated during the audit resolution process. The Acting AA/OBCI's comments are responsive to the finding and recommendation.

Finding 4: SBA Does Not Have Express Authority to Provide Funding for Paid SCORE Administrative Positions

SBA provided funding for a SCORE paid headquarters staff for several years although the authorizing legislation did not address SBA providing funding to SCORE for its paid positions. Furthermore, SBA did not have supplemental policies governing the creation and compensation of paid administrative positions for the SCORE program. As a result, (1) it is unclear if Congress intended Federal funds to be used for this purpose, and (2) there is a lack of clear agency guidance to determine the allowability and reasonableness of SCORE's compensation policies and practices for the paid administrative positions.

Per discussion with SCORE's CEO, SBA has provided funding to SCORE for paid positions for approximately 25 years. The first paid positions were clerical in nature and over time several new paid positions were added. SBA historically approved funding for the non-volunteer positions based on what they believed was reasonable compensation. In FY 2002, however, SBA no longer believed that the proposed salaries for SCORE's three highest paid positions were reasonable and denied SCORE's proposed salary levels for these positions. OPGM funded the positions at FY 2001 levels and requested that the Office of Inspector General determine the reasonableness of the proposed salaries. SCORE's approved compensation budget for FY 2002 was \$982,300, which comprised twenty percent of SCORE's overall budget. This amount was provided to pay the salary and fringe benefits for thirteen full-time and one part-time position including a CEO, Vice President of Finance and Administration, and Vice President of Corporate Relations.

Section 8(b)(1)(a) of the Small Business Act (The Act) states that SBA is authorized to establish, conduct, and publicize, and to recruit, select, and train volunteers for volunteer programs including SCORE. The Act further states that the Administration may maintain at its headquarters and pay the expenses of a team of volunteers subject to the conditions and limitations as the Administration deems appropriate. Additionally, language in the authorizing legislation states that SBA will be responsible for providing clerical and stenographic services, publicizing the availability of the program, and maintaining a team of volunteers at headquarters to assist in the administration of the program.

OMB Circular A-122, Section 7(c), states that compensation is considered reasonable for an organization predominately engaged in federally-sponsored activities to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved. SBA's internal policies and procedures do not address salary reasonableness.

Based on the foregoing, the legislation does not address SBA providing funding to SCORE for its paid positions although the program's operations have evolved to include a paid executive and administrative staff which SBA has funded for several years. In addition, it is difficult to apply OMB Circular A-122 to a unique organization such as SCORE, and as a result, the criteria could be interpreted and applied differently by different users. SBA also has not developed its own internal guidance to clarify how SCORE non-volunteer positions are to be compensated. Therefore, there is no clear agency guidance to assist OPGM in determining the allowability and reasonableness of SCORE's proposed compensation amounts each year. Due to the uncertainty of the authorizing legislation, ambiguity of applicable OMB criteria, and lack of internal agency guidance, we did not determine

whether the FY 2002 proposed salary levels for the three highest paid salaried positions were allowable and reasonable.

Recommendation:

- 4A. We recommend that the Acting AA/OBCI determine the source of authority that permits SBA to provide funding for NSO paid staff. If SBA is authorized to pay a non-volunteer staff, then the Acting AA/OBCI, in conjunction with the Assistant Administrator for Administration, should develop and implement an appropriate compensation policy and limits for such staff. If SBA is not authorized to pay a non-volunteer staff, then SBA should work with SCORE to seek a legislative solution that would authorize SBA to pay a non-volunteer NSO staff and include compensation limits.

SCORE's Response:

SCORE stated that while express authority to provide funding for paid SCORE administrative positions is not specifically mentioned in legislation, they believe Congress is completely aware of the use of appropriated funds for this purpose and is supportive. In addition, SCORE stated that they had met with the appropriate legislators and committee staff to propose amendments to the Small Business Act that would clarify this matter.

SBA Management's Response:

The Acting AA/OBCI concurred with the recommendation subject to certain changes being made. The proposed changes included a suggestion that the recommendation be jointly addressed to the Acting AA/OBCI and the Assistant Administrator for Administration. The Acting AA/OBCI also commented that the evolution of the SCORE program had outpaced its enacting legislation and stated that the program office would work with SCORE to attempt a solution to update legislation to reflect changes in the program and current policies.

Office of Inspector General's Evaluation of Responses:

SCORE's and the Acting AA/OBCI's comments indicate agreement with the finding and recommendation. With respect to the Acting AA/OBCI's suggested changes to the recommendation, we considered the changes and revised the recommendation as appropriate.

* * *

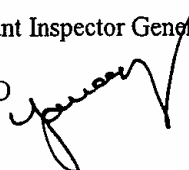
The findings included in this report are the conclusions of the Office of Inspector General's Auditing Division. **The findings and recommendations are subject to review, management decision, and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.**

Please provide us your management decision for each recommendation within 80 days. Your management decisions should be recorded on the attached SBA Forms 1824, "Recommendation Action Sheet," and show either your proposed corrective action and target date for completion, or explanation of your disagreement with our recommendations.

Should you or your staff have any questions, please contact Robert G. Hultberg, Director, Business Development Program Group at (202) 205-7577.

Attachments

To: Robert G. Seabrooks, Assistant Inspector General for Auditing

From: W. Kenneth Yancey, Jr., CEO 

Date: March 26, 2003

Re: Response to Limited Scope Review of the Service Corps of Retired Executives Program

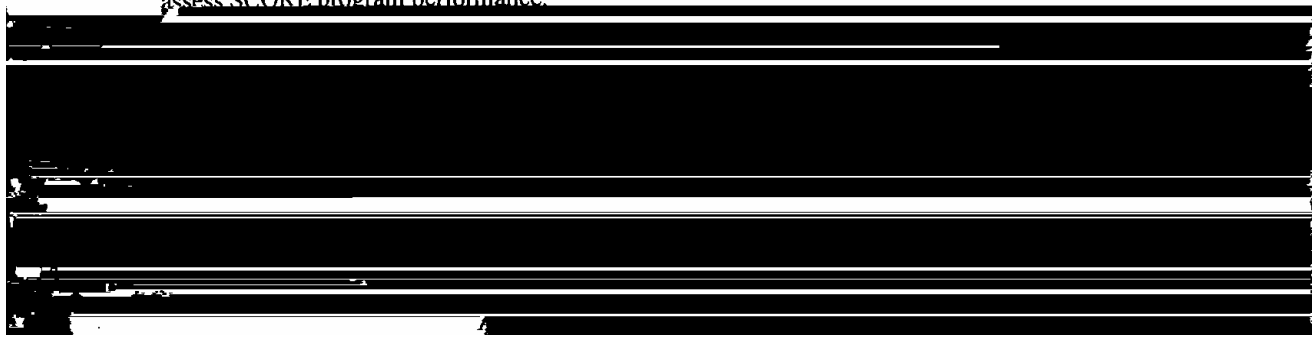
Thank you for providing us with the results of the "limited scope review" of the SCORE program recently concluded by the SBA Office of Inspector General. After discussions with SCORE Chairman of the Board Carl Trautmann, I will respond to the findings as they are presented.

Finding 1. NSO did not report chapter program income to SBA.

As stated, the National SCORE Office did not report chapter revenue as program income on its quarterly financial reports to the SBA. SCORE has agreed that SCORE chapter revenue will be reported to the SBA on an annual basis within 90 days of the end of a fiscal year.

Finding 2. NSO's FY01 Financial Statements Excluded Complete Chapter related Financial Information.

SCORE's FY01 financial statements do not include an audit of chapter financial activities. The attached legal opinion from SCORE attorney Ken Silverberg of Nixon Peabody supports the decision not to include chapter finances in the audit process. Given this opinion and the estimated additional audit cost of roughly \$150,000 per year to appropriately audit 389 chapters located from Maine to Guam, we believe that SCORE should not be required to include an audit of its chapters in its annual paid audit. The agreement to provide annual information to the SBA on chapter revenue should overcome the concern raised related to reliability, relevancy and the ability of SBA to assess SCORE program performance.



SCORE will be receptive to future enhancements of the SBA's efforts to better monitor SCORE both from a programmatic and financial standpoint.

Finding 4. SBA does not have express authority to provide funding for paid SCORE administrative positions.

While express authority to provide funding for paid SCORE administrative positions is not specifically mentioned in legislation, we believe Congress is completely aware of the use of appropriated funds for this purpose and is supportive. This awareness comes from both House and Senate testimony by SCORE staff, budget submissions which include a salaries and benefits line item, and additional meetings and correspondence with legislators. Since this issue was brought to SCORE's attention, we have met with the appropriate legislators and committee staff to propose amendments to the Small Business Act that would clarify this matter.

In the absence of internal SBA guidance on the issue of compensation for the top three paid positions in SCORE and particularly the CEO position, the SCORE Association Board of Directors followed OMB Circular A-122 and the IRS rules that relate to excess benefit transactions in not-for-profit organizations to establish compensation. The IRS rules require the retention of an independent consultant, the completion of a salary survey of similar positions in similar organizations and the exclusion of the CEO from the process. In addition to being in compliance with OMB Circular A-122 and IRS rules, the resulting compensation falls within the salary administration process, grades and ranges that SCORE has used for over 10 years. SCORE will work with the AA/B&CI to develop and implement appropriate compensation policy and limits for SCORE staff.

Thank you for the effort that went into this review and for the kind cooperation of the IG audit staff. If you have any questions regarding this information, please do not hesitate to contact me.

cc: Ellen Thrasher, AA/B&CI
Jane Butler, DADA/ED
SCORE Board of Directors



NIXON PEABODY LLP
ATTORNEYS AT LAW

Attachment 1
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December 2, 2002

W. Kenneth Yancey, Jr.
Executive Director
SCORE Association
409 3rd Street, SW
Washington, DC 20024-3213

RE: Application of Accounting Rules to Chapters

Dear Ken:

After our recent meeting with Bob Billig, SCORE's outside accountant from RSM McGladrey, Inc., Bob provided me with paragraphs 10,610.11 – 10,610.20 of an AICPA publication entitled *AICPA Technical Practice Aids*. He advises that these are the applicable portions of an SOP, or Statement of Position, issued by the AICPA and effective for financial statements issued after December 15, 1994. Paragraph 15 indicates that the SOP is an interpretation of Financial Accounting Standards Board Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. The SOP excerpt itself is not identified by a number.

As we agreed, I have reviewed the rules in this SOP excerpt in light of the relationship between the SCORE Association and its chapters. My conclusion is that the Association is not required to consolidate the chapters in the Association's financial statement, since their relationship is covered either by paragraph 12 of the SOP, which makes consolidation optional, or by paragraph 13 of the SOP, which "precludes consolidation." Instead, the disclosures of FASB Statement No. 57 are probably required, although your lack of information concerning chapter treasury funds limits what you can be required to disclose.

These conclusions are based on my understanding of how SCORE conducts its business, according to our various conversations with you, our review of the SCORE Bylaws, the SCORE Operating Manual, and the SCORE Chapter Membership Agreement. They are consistent with the letter we provided you on October 25 captioned "Funding To Chapters."

Chapter Assets

The SCORE Association is a nonprofit corporation, without capital stock or shares, chartered under the District of Columbia Non-Profit Corporation Act. The Bylaws provide that the Association will, in part, accomplish its purposes through the use of chapters, which are subordinate units of SCORE (*see* Article IV of the Bylaws). The Chapter Membership Agreement is the exclusive agreement between the Association and the chapter and its members. The Agreement's purpose is to demonstrate the intent of the chapter members to comply with the SCORE Operating Manual and Code of Ethics and Conduct.

The Operating Manual provides detailed rules governing the relationships between the Association and its chapters. In Chapter 6, the Operating Manual discusses the permitted uses of "chapter funds" and clearly acknowledges the existence of another category of chapter assets known as "treasury funds." Chapter funds are provided from the Association and at all times belong to the Association. If the chapter closes for any reason, chapter funds must revert to the Association.

Treasury funds can arise from donations of funds, property or services from outside sources, or from the conduct of chapter events and activities which generate an excess of revenue over expenses. Chapters do not account to the Association for their treasury funds, and may use treasury funds for any lawful purpose. The Operating Manual states that a chapter "may own or have an interest in monetary funds or property, such as equipment, furnishings, publications, leases or supplies" which are not chapter funds (*see* Chapter 11 of the Operating Manual). If the chapter closes for any reason, the responsible district director is charged with the duty to "secure, control and dispose of the chapter's records, monies and property for continued SCORE uses."

The difference between the operative terms of Chapter 6 and Chapter 11 is quite significant. Chapter 6 states unequivocally that chapter funds belong to the Association. By contrast, Chapter 11 delegates to the district directors the duty of the orderly winding up of a chapter in dissolution, including guidelines on how the director is to dispose of treasury funds. Read together, it is clear that the Association claims no ownership interest in donated property, treasury funds or property acquired through the expenditure of treasury funds. Its representative is merely directed to assume control of them to the extent possible, and use them for SCORE purposes.

The Accounting Rules

Although the Association neither elects nor appoints the officers of its chapters, its relationship with the chapters “could indicate that (its) resources and activities are controlled” by the Association as that term is defined for accounting (although not necessarily for legal) purposes. Paragraph 16, section A-7 of the SOP excerpt refers to an “oversight relationship,” which somewhat (but not exactly) resembles the Association’s relationship with its chapters:

“Oversight relationship – A national charter establishes conditions, such as financial relationships or an accreditation process, for a separate entity’s use of a national name or participation in the activities of a national organization.”

From this reading, I conclude that the Association’s relationships “could indicate” control, but the SOP excerpt does not state with certainty that they are control. Lacking this certainty, I next reviewed the context in which the word “control” appears.

Consolidation of the chapters with the Association would be required under paragraph 10 of the SOP excerpt if the Association had “direct or indirect ownership of a majority voting interest” in the chapters. It does not.

Consolidation would be required under paragraph 11 if the Association had both an economic interest and “control through a majority ownership interest by ownership of other than a majority voting interest.” Footnote 5 indicates that such a “majority ownership interest” might be manifested by the ownership of stock, ownership certificates, membership certificates, joint venture interests or partnership interests. The Association has no such interest.

Consolidation is permitted but not required under paragraph 12 if the Association had both an economic interest and control through another means, such as an oversight relationship. In the absence of consolidation, the disclosures required under FASB #57 are required.

Consolidation is precluded under paragraph 13 if the Association had either control or an economic interest, but not both. In such cases, the FASB #57 disclosures are required.

Applying The Accounting Rules

It is very clear that the Association possesses neither a majority voting interest nor a majority ownership interest in the chapters. As such, neither paragraph 10 nor 11 applies, nor is consolidation required. Under even the most liberal definition of “control,” the relationship could only fall within paragraph 12 or 13. The determination of whether your relationship is covered under paragraph 12 or 13 depends on the presence of an economic interest. And either way, FASB #57 disclosures are required.

The analysis can stop at this point. It is clear that consolidation is not required. At most, it may be permitted at the Association’s option. You have opted against such consolidation, which

you are fully entitled to do. Assuming now, for the sake of discussion, that the Association has either "control" or an "economic interest," FASB #57 disclosures are required.

The Association knows that the chapters have treasury funds, but does not know the extent of those funds, or their sources or uses. This lack of knowledge makes disclosure of the treasury funds impossible. All that could be disclosed is:

- the extent of chapter funds; and
- the fact that chapters own treasury funds which are not reported to the Association and are not assets of the Association.

These disclosures, along with whatever else is required by FASB #57, are the appropriate disclosures for any remaining possible situation, other than a situation in which it is concluded that the Association has neither "control" nor an "economic interest." Although it might technically be possible to argue that the Association has neither, making such an argument for the sole purpose of resisting footnote disclosures could be viewed as an attempt to withhold reasonable disclosures from the readers of the financial statements. As such, I would suggest that the prudent course of action is making the disclosures in the footnotes.

If any of this requires further clarification, please do not hesitate to contact me.

Sincerely yours,

Kenneth H. Silverberg



MEMO

Office of Business and Community Initiatives

TO: Robert G. Seabrooks
Assistant Inspector General for Auditing

FROM: Ellen Thrasher *ET*
Acting Associate Administrator,
Office of Business and Community Initiatives

SUBJECT: Response to Draft Limited Scope Review of the Service Corps
of Retired Executives (SCORE) Program

DATE: April 4, 2003

In September 2001, SBA's Office of Procurement and Grants Management (OPGM) requested clarification from the Office of the Inspector General on what constituted appropriate compensation levels of senior National SCORE Organization (NSO) staff. The Office of Business and Community Initiatives, (OBCI), the program office responsible for technical oversight and performance of program deliverables, has given considerable thought to the recommendations set forth in the limited scope review report and offer, in some instances, revised language which we believe necessary for responsiveness and clarity. Thank you for the opportunity to comment on the review results.

Finding 1: SCORE Did Not Report Chapter Program Income to SBA

OBCI response: Concur with the OIG that it considers SBA actions responsive to the issue and are not making any recommendations regarding program income for this report

Appropriate changes have been made in the Fiscal 2003 Cooperative Agreement, requiring SCORE to report program income within 90 days of the end of a fiscal year.

OBCI supported the annual reporting of program income which it solicited with a memo to



The reason for this request for annual reporting refers to the administrative burden placed on SCORE volunteers, whose main purpose is to counsel and train clients. The SCORE Program's unpaid volunteers have been required to respond to the incrementally increasing reporting requirements of OMB, GPRA, and the Congress without the administrative infrastructure necessary to support these requirements.

Finding 2: NSO's FY 01 Financial Statements Excluded Complete Chapter Related Financial Information

IG Recommendation 2A: We recommend that the Associate Administrator of Business and Community Initiatives instruct NSO to include in its financial statements complete financial information for its chapters to ensure the statements comply with FASB reporting requirements.

OBCI Response: Concur with changes to recommendation language as follows: We recommend that the Assistant Administrator for Administration, and the Associate Administrator of the Office of Business and Community Initiatives, work with the NSO to ensure compliance with FASB reporting requirements.

The SCORE program rated the highest of all SBA Entrepreneurial Development Programs in the 2002 Program Assessment Rating Tool (PART) evaluation conducted by the Office of Management and Budget (OMB). The questions relating to financial management practices received an unqualified "Yes" from OMB. The PART evaluation disclosed that... "Strong financial management controls and procedures are in place. Quarterly financial reports are readily available. External CPA audits are conducted annually." Further, the PART stated that "The program does not have any severe management deficiencies. SBA's CFO reviews the program annually to ensure that the proper cost controls are in place." Administrative functions to the SCORE program are vested in the NSO. Chapters and districts are funded on a direct reimbursement basis. Unlike other SBA grantees such as the Small Business Development Center Program and the Women Business Center program, who avail themselves of the services of a substantive accounting administrative infrastructure of, respectively, universities and independent not-for-profit organizations, SCORE which is comprised of volunteers who donate time specifically to counsel and training small businesses and does not maintain full time administrative staff at the district/chapter level.

SCORE does, however, have controls and procedures in place for financial related activity at the chapter and district levels, as designated in the SCORE Standard Operating Manual. Specifically, these are as follows: Chapter 5: "Total Expense Reimbursement System," Chapter 6: "Sources and Uses of Chapter Funds", Chapter 12: "Statutory, Legal and Insurance Issues" pages 52-53, "SCORE's Tax Exempt Status," Tax Filing", "State and Local Taxes," and "Group Exemption and Employer Identification Numbers." Job descriptions for the CEO, and SCORE District Director and Assistant District Director clearly delineate financial and budgetary responsibilities.

From a programmatic point of view, the paperwork burden placed on SCORE volunteers for frequent reporting at the chapter level would dilute SCORE's primary mission to train and counsel small business owners, negatively impact chapters in attracting, recruiting and training volunteers, and saddle volunteers with an administrative burden for which they are not prepared to donate their time and efforts.

With reference to the example cited of SCORE receiving the additional \$50,000 of SBA funds in FY 01, it was then SBA's policy to provide SCORE chapters with an annual administrative stipend to help defray chapter costs. The funds would be distributed by SCORE directly to the chapters at the direction of and based on a formula created by OBCI. The formula took into account the number of clients counseled and trained by each chapter. Since the increase of the SCORE appropriation to \$5 million in FY 02, this SBA funding has been discontinued, as SCORE now takes funds from its own appropriation and administers the disbursements in the same manner.

The Office of Procurement and Grants Management, the SBA office directly responsible for the financial compliance of SCORE, will provide their separate opinion with reference to the Single Audit Act of 1984, and Financial Accounting Standards Board (FASB) requirements, and the completeness of SCORE's financial statements. However, we are confident that OPGM's response will include consideration of the cost and paperwork burden placed on SCORE volunteers, the legal opinion for non-inclusion of individual chapter audits by NSO attorney Ken Silverberg; and the projected difficulty and cost to independently audit 389 geographically dispersed and structurally diverse chapters.

Finding 3. SBA's Monitoring of SCORE should be strengthened.

IG Recommendation 3A: We recommend that the Assistant Administrator for Administration, in conjunction with the Associate Administrator for Business and Community Initiatives ensure there is a clear understanding of the role of each office in monitoring the SCORE cooperative agreement award and design monitoring procedures that integrate review of performance and financial data.

OBCI Response: Concur

OMB's PART evaluation of the performance monitoring of SCORE was a positive "yes" response: "According to the agreement that the SCORE Association and SBA make each year, monthly, quarterly and yearly data is collected. The information is put into management reports.... Weekly face-to-face meetings between the program and the Agency, weekly memo updates, quarterly reports, and the presence of the SBA Manager at board meetings and annual national meetings informs the Agency about grantee activities."

The day-to-day monitoring of the SCORE Cooperative Agreement is undertaken jointly by the SCORE National Program Manger within OBCI and the Grants Office Manager within the OPGM. Both parties consult prior to negotiating with the NSO for deliverables to include in the technical proposal and the monitoring of the award and work closely and harmoniously to ensure compliance. The National Program Manager sought and received grants training in FY 01: ("Introduction to Grants and Cooperative Agreements for Federal Personnel" and "Introduction to Monitoring Grants and Cooperative Agreements.") Together over the period that they have worked together, the present Program Manager and Grants Office Manager have influenced the SCORE proposal to expand from a two-page Statement of Understanding to a substantive document with timelines, milestones and technical deliverables. Quarterly reports are reviewed by the National Program Manager prior submission to the Grants Manager. They meet on the average monthly, exchange emails and confer on a regular basis. In the FY 03 technical proposal both agreed to include the provision that the VP Finance and Administration or equivalent senior staff undergoes grants training, and this condition was included in the Notice of Award.

Because monitoring of the SCORE grant is divided between the technical and financial program areas, however, it will be in the best interests of the National Program Manager to receive Contract Officers Technical Representative (COTR) training which is usually provided internally at the SBA and is directly applicable to the monitoring of the SCORE Cooperative Agreement.

Finding 4: SBA Does Not Have Express Authority to Provide Funding for Paid SCORE Administrative Positions.

IG Recommendation 4A: We recommend that the Associate Administrator for the Office of Business and Community Initiatives (AA/B&CI) determine the source of authority that permits SBA to provide funding for NSO paid staff. If SBA is authorized to pay a non-volunteer staff, then the AA/B&CI should implement policy that establishes compensation limits for such staff. If SBA is not authorized to pay a non-volunteer staff, then the AA/B&CI should seek a legislative amendment that would authorize SBA to pay a non-volunteer staff and include compensation limits.

OBCI Response: Concur with changes to recommendation language as follows: We recommend that the Associate Administrator for the Office of Business and Community Initiatives (AA/OBCI) determine the source of authority that permits SBA to provide funding for NSO paid staff. If SBA is authorized to pay a non-volunteer staff, then the AA/OBCI and AA/Administration should jointly develop and implement appropriate compensation policy and limits for such staff. If SBA is not authorized to pay a non-volunteer staff, then SBA will work with SCORE to seek a legislative solution authorizing SBA to pay a non-volunteer staff and include compensation limits.

Although there is historical precedent, in the absence of express legislative authority, to provide funding for paid SCORE administrative positions, the evolution of the SCORE program has outpaced its enacting legislation. We will work with SCORE to attempt a solution to update legislation to reflect changes in the program and current policies. However, it should be noted over a 25 year period there has been paid SCORE staff. This has been a transparent process - a 1985 GAO Audit commissioned at the request of the Ranking Minority Member of the Senate Small Business Committee rendered this clearly in its 1985 report: "The.....appropriated funds are also used for the salaries and expenses of the Executive Director and SCORE's twelve other paid employees." In recent years, the NSO assumed, at SBA's request, administrative functions associated with the national program.

NOTE: On page 2, the report states that "The SCORE Program received funding of \$3.75 million in Fiscal Year (FY) 2001 and \$5.0 million in 2002 from SBA's salaries and expenses lump sum appropriation." This statement is incorrect. Funding for the SCORE Program appears as a line item in the SBA budget, and is earmarked by Congress each fiscal year.

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