

**REVIEW OF THE
SMALL DISADVANTAGED BUSINESS
CERTIFICATION PROGRAM**

AUDIT REPORT NUMBER 5-04

NOVEMBER 4, 2004

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**U.S. Small Business Administration
Office of Inspector General
Washington, DC 20416**

AUDIT REPORT
Issue Date: November 4, 2004
Number: 5-04

TO: Albert B. Stubblefield
Acting Associate Administrator for Business Development

FROM: Robert G. Seabrooks
Assistant Inspector General for Auditing

SUBJECT: Review of the Small Disadvantaged Business (SDB) Certification Program

The Office of Inspector General (OIG) completed an audit survey of the SDB Certification Program to determine whether SBA is properly evaluating the qualifications of applicant firms for certification or re-certification (hereafter referred to simply as “certification”) as SDBs. We found significant problems with SBA’s evaluation processes and supporting systems. Based on the results of the audit survey, we determined that a full audit of the program is not warranted at this time because those results would not likely change if we reviewed a larger sample of application files. This report presents the results of our review.

BACKGROUND

SBA administers two assistance programs for small businesses owned by socially and economically disadvantaged individuals, the Minority Small Business and Capital Ownership Development Program ([8\(a\) Program](#)), and the SDB Certification Program. While the 8(a) Program offers a broad scope of assistance to firms owned by socially and economically disadvantaged individuals, SDB certification strictly pertains to benefits in federal procurement. Section 8(a) firms automatically qualify as SDBs, but other firms may apply for SDB-only certification.

SBA certifies small businesses as SDBs if they meet specific social disadvantage, economic disadvantage, ownership, control, and size eligibility criteria. SDBs must meet all 8(a) eligibility requirements, with few exceptions. SDBs do not, for example, have a “potential for success” requirement and their owners have a higher adjusted net worth dollar limit for program entry. Once approved, the firm is added to an on-line registry of SDBs maintained in the Central Contracting Registry (CCR), where it is eligible for price evaluation adjustments of up to ten

percent when bidding on Federal contracts in certain industries. The program also provides evaluation credits for prime contractors who achieve SDB subcontracting targets. This helps Federal agencies achieve the government-wide goal of five percent SDB participation in prime contracting. The certification period is for three years at which point the SDB may apply for re-certification for another three years. According to the CCR, there were 2,918, non-8(a) SDBs as of March 9, 2004.

OBJECTIVE, SCOPE AND METHODOLOGY

The survey objective was to determine whether SBA is properly evaluating the qualifications of SDB-only applicant firms (i.e., those that are not also 8(a) firms) for certification as SDBs. We completed a survey rather than a comprehensive audit of the program. As part of the survey, we interviewed SBA employees/contractors, and reviewed government laws, regulations, policies and procedures pertaining to the SDB Certification Program. We also reviewed Office of Hearing and Appeals (OHA) cases for guidance in evaluating certain eligibility criteria.

Based on data provided by the program office, we randomly selected ten SDB-only application files from the 970 companies approved for certification in Fiscal Year (FY) 2003 and reviewed each file to determine whether criteria were met for the five eligibility elements of social disadvantage, economic disadvantage, ownership, control, and size. Based on data generated from the SDB application tracking system, we queried SBA's loan accounting data base to determine whether any of the 2,612 owners of SDB's receiving SDB-only certification from FY 2001 through FY 2003 defaulted on SBA loans and reviewed the relevant SDB certification file for every identified defaulted loan.

The scope of our survey was limited in the following three ways: (1) we could not review some of the files included in our initial sample because SBA could not locate them; (2) we could not compare the financial condition of the applicant to the financial profiles of small businesses in the same primary industry classification because SBA did not have current peer business performance comparison data; and (3) we could only make very limited use of the SDB application tracking system since an official acknowledged that it was inaccurate.

We performed audit survey work from March to July, 2004 in Washington, D.C. The survey was conducted in accordance with Government Auditing Standards.

SURVEY RESULTS

Eligibility reviewers in SBA's Office of Certification and Eligibility (OCE) did not adequately consider whether owners of companies applying for SDB certification were economically disadvantaged. Contrary to regulations, eligibility reviewers were also certifying companies as SDBs when their owners had defaulted on government obligations. As a result, at least two of the ten SDBs in our sample should not have been certified. An additional firm that indicated a Federal delinquency on its SBA Form 1010 without providing an explanation may

need to be de-certified once a follow-up is done. Moreover, the owners of seven other companies certified from June 2001 to April 2004, but not in our sample, had defaulted on SBA loans. Companies inappropriately obtaining SDB certification could receive Federal contracts which would otherwise be awarded to eligible SDBs. Additionally, we found (1) data integrity problems with an SDB application tracking system and (2) inadequacies in file safekeeping, as program officials could locate only two-thirds of the files requested for review by auditors.

SBA Management generally agreed with Findings 1, 3, and 4, and with the exception of Recommendation 1C, agreed with all the recommendations contained in those findings. For Recommendation 1C, they did not want to de-certify the firm found unqualified for program participation based on the owner of the firm's total assets without further investigation. SBA management agreed with the language of Finding 2's title and the recommendations in that finding, but disagreed with the finding's premise. Specifically, they disagreed that regulations prohibit applicants with prior Federal loan defaults from participating in the SDB Certification Program. Management's response to the draft report is included as Attachment 1.

Finding 1: Criteria for Determining the Economic Disadvantage of SDB Owners were not Properly Applied.

Of the four criteria to be considered when determining economic disadvantage for owners of companies applying for SDB certification, OCE did not analyze two and inadequately considered a third. OCE officials stated they made their economic disadvantage determination based on whether the individual's adjusted net worth was under \$750,000 and on "a totality of the circumstances" for assets and income. While adjusted net worth is the sole economic disadvantage criterion for which the Code of Federal Regulations (CFR) sets a fixed dollar limit for SDB certification, the CFR requires that SBA consider the three other criteria (total assets, two years' personal income, and business peer performance comparison). Since only adjusted net worth has a fixed dollar limit, OCE reviewers primarily focused on that criterion, and gave insufficient consideration to the other three. OCE reviewers were not comparing the financial performance of each applicant company with that of its peers since officials appeared unaware that the CFR required this criterion be considered when determining economic disadvantage.

The fair market value of all assets was not analyzed when determining economic disadvantage.

None of the reviewed OCE certification analyses contained a discussion of total assets when determining whether each company's owner was economically disadvantaged. According to 13 CFR 124.104 (c), which lists the factors to be considered when determining whether an individual is economically disadvantaged, SBA will examine the fair market value of all assets, whether encumbered or not, in considering factors relating to the personal financial condition of any individual claiming disadvantaged status.

Importantly, an OHA ruling, *Pride Technologies, Inc.* (1996), found that SBA acted properly in denying a firm's entry into the 8(a) Program (and hence, into the SDB Program) based on the business owner's total assets exceeding \$4.1 million, among other factors. This OHA ruling also stated that as long as one of the reasons SBA used for denying economic

disadvantage, e.g., total assets, is upheld, the denial will be sustained. Moreover, the SDB Training Manual (p.7) indicates that high total assets are one of the “red flag” factors affecting economic disadvantage.

We reviewed one file in which the individual had total assets of approximately \$5.7 million, yet the applicant firm was nonetheless certified as an SDB. The OCE certification analysis did not mention total assets, but stated that the owner was economically disadvantaged based on his adjusted net worth and compensation. At a total approaching \$6 million, the individual’s assets seem excessive for someone claiming economic disadvantage, especially after the *Pride Technologies, Inc.* OHA ruling.

Income was insufficiently analyzed when determining economic disadvantage.

None of the reviewed OCE certification analyses included a discussion of whether the adjusted gross income of the company’s owner was in the top two percent of all filers, and only three of the ten reviewed files included a discussion of whether the company’s owner adjusted gross income was in the top one percent of all filers. According to 13 CFR 124.104 (c), SBA will examine personal income for the past two years in considering factors relating to the personal financial condition of any individual claiming disadvantaged status. According to one OHA ruling, *Autek Systems Corporation* (1992), SBA may properly conclude that a socially disadvantaged individual is not economically disadvantaged based solely on the high income of such socially disadvantaged individual relative to the income of Americans generally. A second OHA ruling, *Oak Ridge Tool-Engineering, Inc.* (2000), found that excessive personal income alone can result in a finding that an individual is not economically disadvantaged, even if the individual’s net worth is within the regulatory limit. A third OHA ruling, *Corvus Group, Inc.* (2002), found that SBA reasonably determined that the business owners were not economically disadvantaged when each owner’s average adjusted gross income over the past two years placed each among the top two percent of all filers. Moreover, the SDB Training Manual (p.7) indicates that “high average two year income (example: top 1-2% of U.S. taxpayers)” is one of the “red flag” factors affecting economic disadvantage.

Industry standards were not being used to compare the financial performance of the applicant concern with that of its peers when determining economic disadvantage.

In all ten of the files reviewed, we found no evidence that industry standards were used to compare the financial performance of the applicant concern with that of its peers as one of the criteria for determining economic disadvantage. SDB officials appeared unaware that they were required to make this comparison in determining economic disadvantage. According to 13 CFR 124.104 (c), “SBA will also consider the financial condition of the applicant compared to the financial profiles of small businesses in the same primary industry classification, or, if not available, in similar lines of business, which are not owned and controlled by socially and economically disadvantaged individuals in evaluating the individual's access to credit and capital. The financial profiles that SBA compares include total assets, net sales, pre tax profit, sales/working capital ratio, and net worth.” Also, an OHA ruling, *Shashikant P. Savla, D/B/A Kabil Associates* (1991), found that the applicant concern’s financial profile must be compared to non-disadvantaged businesses in the same or similar line of business.

Reference books that contain financial performance statistics of firms in particular industries are available from various vendors. However, according to SBA officials, such books have not been purchased by SBA for several years, so neither the SDB Certification Program nor the 8(a) Program had the current reference books necessary to make those comparisons.

Recommendations

We recommend that the Acting Associate Administrator for Business Development:

- 1A. Develop and implement procedures to ensure that SDB reviewers properly apply all four criteria for determining economic disadvantage, per 13 CFR 124.104(c), using 8(a) Program thresholds for maximum income and total assets, and industry financial performance comparisons.
- 1B. Ensure that SDB and 8(a) employees who conduct eligibility reviews have access to the current reference material necessary to compare a company's financial performance with that of its peers.
- 1C. De-certify the one small business concern found by auditors to be unqualified for SDB certification, and have it removed from the database of SDB firms maintained on the Centralized Contractor Registry (CCR) web site.

Finding 2: SDB Eligibility Reviewers were not Checking for Applicant Past-Due Taxes or Other Delinquent Federal Financial Obligations.

SDB eligibility reviewers were not checking whether applicants answered affirmatively to a question concerning derogatory financial information on their SDB application form (SBA Form 1010). On two applications, the business owner had checked "Yes" next to the question, "Does the firm have any past due taxes or any other delinquent Federal, state or local financial obligations outstanding or liens against it?" One applicant's file showed a defaulted SBA loan and tax liens. The other file did not contain any explanation concerning the delinquent Federal obligation. Neither reviewer write-up in the files addressed these issues, yet both firms were nonetheless certified.

These actions contradicted regulations prohibiting applicants with prior Federal loan defaults from participating in the 8(a) Program and, hence, the SDB Certification Program. Additionally, querying SBA's loan accounting data base using data from the program office's application tracking system revealed seven other SDB owners whose companies were certified from June 2001 to April 2004 with defaulted SBA loans.¹ For these seven companies, three of the owners stated on the SBA Form 1010 that the firm did not have any delinquent Federal obligations, one stated the firm did, two apparently did not submit the SBA Form 1010, and one

¹ While we requested data from the SDB application tracking system concerning companies certified from FY 2001 through FY 2003, we received data that overlapped that time period.

owner correctly stated his company did not have a defaulted loan but did not note that another company he owned defaulted on a SBA loan. Consequently, firms that have defaulted on Federal obligations can still be certified as SDBs and potentially win preferred government contracts.

According to 13 CFR 124.108 (e), “neither a firm nor any of its principals that fails to pay significant financial obligations owed to the Federal Government, including unresolved tax liens and defaults on Federal loans or other Federally assisted financing, is eligible for admission to or participation in the 8(a) BD program.” According to 13 CFR 124.1002, 8(a) BD eligibility criteria will be used when qualifying as an SDB, unless otherwise stated in the CFR. There are no separate provisions for SDBs concerning this requirement. Moreover, two OHA cases, *Brushworks Unlimited* (2000) and *Curtoom Construction* (1996), found that SBA had appropriately terminated participant(s) in the 8(a) Program for failing to pay Federal obligations.

The SDB Certification Program did not have procedures for verifying that applicants have not defaulted on Federal obligations such as SBA loans. Furthermore, according to an SDB Certification Program official, they believed 13 CFR 124.108 (e) only applied to 8(a) firms, and Office of General Counsel and SDB Certification Program staff informed him that a default on a Federal obligation was not a permanent bar itself to SDB certification. However, the CFR is clear that this requirement applies to the SDB Certification Program. The SDB Program office will not comply with current government regulations until procedures are implemented to check for loan delinquencies or defaults on Federal obligations.

Recommendations

We recommend that the Acting Associate Administrator for Business Development:

- 2A. Develop and implement procedures to ensure that SDB eligibility reviewers check all applicants for possible defaulted SBA loans by, for example, querying SBA’s loan accounting system using the applicant’s Social Security number.
- 2B. Update the SDB eligibility reviewer checklist to include a review of questions answered affirmatively on the SBA Form 1010.
- 2C. Develop and implement procedures to ensure that SDB eligibility reviewer write-ups include a discussion to address questions answered affirmatively on the SBA Form 1010.
- 2D. Develop and implement procedures to ensure that SDB eligibility reviewers recommend denial of SDB certification if a firm or any of its principals do not comply with 13 CFR 124.108(e).
- 2E. Determine whether the company responding affirmatively to a question on the SBA Form 1010 concerning derogatory financial information, but not providing an explanation, is in violation of 13 CFR 124.108(e).

- 2F. Give each SDB or its owner found to have defaulted on a Federal Government debt or unresolved tax lien an opportunity to pay back the outstanding obligation. If this is not possible, then de-certify the firm and remove it from the database of SDB firms maintained on the Centralized Contractor Registry (CCR) web site.

Finding 3: Criteria for Managing Agency Records were not Followed.

SBA did not comply with its record management procedures in that files are not adequately safeguarded, and was unable to locate files initially requested during our audit. We found several SDB application files to be missing. Auditors originally requested ten specific files for review, but had to select five additional files because some could not be located. An SDB Program staff member said it took two people two hours to retrieve six out of the ten files originally requested. Additional time was needed to find their replacements due to files being out of order. The missing files were found after the OIG completed its review. One program official indicated that shared facilities and inadequate file space have promoted disorganized records management. Officials also noted that the file room had recently been moved twice and files might have been misfiled during the moves.

According to Standard Operating Procedure (SOP) 0041 2, *Records Management Program* (p. 9), adequate and proper documentation of Agency decisions should be made and preserved. The SOP also mandates the safeguarding of documents to ensure security and confidentiality for persons directly affected by the Agency's activities.

Missing case files affects the integrity of SBA's operations and can make SDB re-certification more difficult without the original application documents. Furthermore, the security and confidentiality of SDB applicants' personal information are not adequately protected if their files are missing. At a minimum, disorganized files promote the inefficient use of staff resources when records cannot be retrieved in a timely manner.

Recommendation

- 3A. We recommend that the Acting Associate Administrator for Business Development ensure that the SDB application filing system safeguards critical program documents in accordance with SOP 0041 2, *Records Management Program*.

Finding 4: Program Officials Need to Ensure that the new Database Contains Correct Information.

Officials from the Office of Certification and Eligibility (OCE) did not follow the guidance of OMB Circular A-123 in developing management controls to ensure that reliable information was obtained and maintained. The program office currently uses a database to track the processing of SDB applications. Since the database was designed to be more than a tracking system, it contains numerous data fields in addition to the tracking data. We attempted to use

some of this data to conduct our audit survey, but encountered numerous problems with the reliability and integrity of the information. Examples of such problems included null fields in columns for “net worth” and “adjusted net worth,” incomplete data in other fields, and significantly fewer business owners than businesses contained in the database.

Program officials said they plan to implement a new database and migrate “scrubbed” data from the application tracking system to the new database. Additionally, program participants will be asked to confirm the accuracy of the data. Due to the sheer volume of information that must be cleaned-up, however, the old data may still not be sufficiently accurate to be used reliably after incorporation into the new system.

According to OMB Circular A-123, as Federal employees develop and implement strategies for reengineering agency programs and operations, they should design management structures that help ensure accountability for results, and include appropriate, cost-effective controls. The Circular defines “management controls” as the organization, policies, and procedures used by agencies to reasonably ensure reliable and timely information is obtained, maintained, reported and used for decision making.

During the time period we were reviewing, the Program Office was only using the database for tracking application files. As such, it appears that little if any emphasis was placed on ensuring the accuracy of the data contained in the other fields. Program officials also confirmed that no management controls had been developed to ensure the accuracy of the data, such as a second level review, and there was nothing to prevent an applicant from mistakenly being entered twice. Due to this lack of controls, there is risk that the new database could be corrupted by migrating inaccurate and unreliable data from the application tracking system to the new database.

Recommendation

- 4A. We recommend that the Acting Associate Administrator for Business Development ensure the reliability and integrity of all data in the tracking system before that data is migrated to the new database.

SBA MANAGEMENT’S COMMENTS

SBA Management generally agreed with Findings 1, 3, and 4, and with the exception of Recommendation 1C, agreed with all the recommendations contained in those findings. For Recommendation 1C, they did not want to de-certify the firm found unqualified for program participation based on the owner of the firm’s total assets without further investigation. Management stated that the OHA opinion cited in the report “does not mandate a finding of no economic disadvantage, under any circumstances, if an individual has \$4.1 million in total assets.” SBA Management wants to further investigate this matter because “there may be other circumstances warranting a finding of economic disadvantage.”

SBA management agreed with the language of Finding 2's title and the recommendations in that finding, but disagreed with the finding's premise. Specifically, they disagreed that regulations prohibit applicants with prior Federal loan defaults from participating in the SDB Certification Program. SBA Management agreed that the CFR language states that 8(a) Program eligibility criteria will be used when qualifying as an SDB, unless otherwise stated in the SDB subpart of the regulations. However, they described how two other 8(a) Program eligibility requirements were handled in the SDB subpart of the regulations to demonstrate that it is not at all clear that the CFR portion cited above applies to defaulting on prior federal loans. Specifically, another 8(a) Program eligibility requirement was repeated in the SDB portion of the CFR and it could be argued that this was done "to distinguish it from additional eligibility criteria that are *not* required for SDB." Another 8(a) Program eligibility requirement, "good character," was not included as an exclusion in the SDB portion of the CFR despite the fact that SBA stated in the Federal Register that it was not a requirement for SDB certification. SBA Management requested that we modify the final report to exclude any references to SBA non-compliance with the regulations.

SBA Management also discussed improvements that they have already taken to implement some of the recommendations. At a meeting held at the conclusion of the audit survey, OCE officials noted that they have taken steps to improve processes associated with reviewing, tracking, and filing SDB applications. Specifically, program officials said eligibility reviewers are now using OHA cases as guidance in determining excessive individual income and total asset amounts for economic disadvantage, two levels of review are now employed to strengthen case determinations, a recently issued Standard Operating Procedure (SOP) provides better guidance on many matters, they have received the reference books for peer business performance comparisons, the application backlog has been reduced, and the filing system has been revamped. Additionally, program officials have drafted an SBA Policy Notice to clarify that "good character" and not defaulting on Federal financial obligations are requirements for SDB certification.

OIG EVALUATION OF SBA MANAGEMENT'S COMMENTS

Since SBA Management generally agreed with Findings 1, 3, and 4, we have limited our evaluation to the points of disagreement. Specifically, we disagree that SBA needs to further investigate whether the company cited in recommendation 1C should be de-certified. The Program Office "investigated" this issue during the audit and presented us with their written analysis of why they believed the individual was economically disadvantaged. We disagreed that the circumstances included in their analysis warranted a determination that the assets were not excessive, and note that they did not include this analysis in their formal comments to this report. Further, since the *Pride Technologies, Inc.* OHA case found that \$4.1 million is an excessive amount of assets, we believe that a subsequent finding that assets nearly 40 percent greater are not excessive would be arbitrary and capricious. As such, we have not changed the recommendation.

We also disagreed with SBA Management's response to Finding 2. Specifically, our finding applies only to an applicant's history of one or more defaults on Federal financial

obligations and not to the broader issue of “good character.” The issue of defaulted Federal financial obligations is not otherwise provided in the SDB subpart of the regulations, per 13 CFR 124.1002(a), and it therefore applies in determining an applicant’s qualifications for program certification. As such, we have not modified the finding.

Finally, we agreed with several minor text changes suggested by SBA Management and incorporated those changes into this report.

* * * * *

The recommendations in this audit report are based on the conclusions of the Auditing Division. **The recommendations are subject to review, management decision and 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 30 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 Programs Group at (202) 205-7577.

Attachments

Redacted for FOIA



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

Attachment 1

MEMORANDUM

DATE: October 26, 2004

TO: Robert G. Seabrooks
Assistant Inspector General for Auditing

FROM: Frank J. Lalumiere *Ex. 6 10-25-04*
Deputy Associate Deputy Administrator
Office of Government Contracting and
Business Development

Al Stubblefield *Ex. 6 10/25/04*
Acting Associate Administrator
Office of Business Development

RE: Response to Draft Audit Report---Review of the Small Disadvantaged
Business (SDB) Certification Program

Thank you for the opportunity to comment on your review of the SDB certification program. We agree with most of your findings and recommendations, and are already implementing many of the suggested changes to improve our program delivery and management controls.

This office agrees generally with Findings 1, 3, and 4. With regard to Finding 1, we request that the draft report on p.3 accurately reflect the regulations at 13 C.F.R. 124.104(c), by referring to two years' "personal income" rather than "adjusted gross income." (1st paragraph under Finding 1). This office has already made substantial progress on Recommendations 1A and 1B, as we have already incorporated an examination of an individual's personal income and total assets into SDB analyses and the office has recently received the reference books for the peer business performance comparisons. Regarding Recommendation 1C, this office respectfully disagrees with a recommendation to decertify this firm without further investigation. The decision of the Office of Hearings and Appeals (OHA) referenced in your draft report does not mandate a finding of no economic disadvantage, under any circumstances, if an individual has \$4.1 million in total assets. The *Pride* decision holds that SBA was not arbitrary and capricious in deciding this amount was excessive, in this particular case. It does not hold that SBA must find any amount over \$4.1 million to be excessive in all circumstances in the future. Although, as you state in your report, this individual's assets in the case your office reviewed may "seem excessive," there may be other circumstances warranting a finding of economic disadvantage, and this office would appreciate an opportunity to further examine this file, in lieu of an automatic decertification. Going forward, as the

analysts are now examining the applications for excessive total assets and excessive personal income, situations such as this are unlikely to arise.

With regard to Finding 3, this office agrees that improvements in our filing system were necessary and agree with Recommendation 3A. In addition to an on-going re-organization of our filing system, copies of all Agency SDB decisions in FY05 are being kept in readily accessible binders in chronological order.

With regard to Finding 4, this office agrees that any new database for the SDB program should contain accurate information and we agree with Recommendation 4A.

However, regarding Finding 2, while agreeing with both the language of your finding, that “SDB Eligibility Reviewers were not Checking for Applicant Past-Due Taxes or Other Delinquent Federal Financial Obligations,” and the recommendations to include this as criteria for SDB certification, this office does not agree with the premise on which this Finding is based. Your report states on p.5 that these actions [not addressing delinquent Federal obligations] “contradicted regulations prohibiting applicants with prior Federal loan defaults from participating in the 8(a) Program and, hence, the SDB Certification Program.” You further state (p.6) that: “the CFR is clear that this requirement applies to the SDB Certification Program.” We respectfully disagree with these two assertions. In fact, it is not at all “clear” from the regulations that this requirement applies to SDB certification.

It is true that 13 CFR 124.1002(a) states that in determining whether a firm qualifies as an SDB, there should be reliance on 8(a) criteria unless otherwise provided in the SDB subpart of the regulations. Citizenship is one of the requirements included in the 8(a) criteria. 13 CFR 124.101 states that an 8(a) firm must be “unconditionally owned and controlled by one or more socially and economically disadvantaged individuals who *are of good character and citizens* of the United States...” (Emphasis added). However, within the SDB subpart, 13 CFR 124.1002(d) states: “*Additional eligibility criteria*. Except for tribes, ANCs, CDCs and NHOs, each individual claiming disadvantaged status must be a citizen of the United States.” Therefore, it could be argued that citizenship was specifically included in the SDB criteria to distinguish it from additional eligibility criteria for 8(a) that are *not* required for SDB. This would include the “other eligibility requirements” included in 13 CFR 124.108, such as good character and Federal financial obligations. This interpretation is bolstered by the history of the SDB regulations. In the Agency’s comments accompanying the promulgation of the Final Rule for the SDB program, the supplementary information included a brief description of an SDB certification decision: “Such a decision will include the ownership and control of the firm, the size status of the firm, and the disadvantaged status of those individuals claiming to be disadvantaged.” 63 FR 35767, 35768 (June 30, 1998). Nowhere does it state that the decision include an examination of character or Federal financial obligations. Further, in the discussion of public comments, SBA explained that the proposed 124.1002(d) would have required SBA to consider the character of individuals claiming disadvantaged status, but the Agency decided against it as a matter of policy, stating that “SBA does not believe that SBA should look at the character of the firm or

individuals claiming disadvantaged status as part of its SDB determination.” 63 FR 35767, 35768 (June 30, 1998). Therefore, the final rule 124.1002(d) included only citizenship, not good character.

As it is not at all clear that examining these criteria has been a regulatory requirement for SDB certification, and to more accurately represent that this would be an Agency policy change to improve our program, we suggest rephrasing the explanation of the finding. This would entail modifying the two assertions referenced above on pages 5 and 6, as well as any other reference to our alleged non-compliance with our regulations. We would also suggest revising the language on p.1 which claims that “SDBs must meet all 8(a) eligibility requirements except that they do not have a ‘potential for success’ requirement and their owners have a higher adjusted net worth dollar limit for program entry,” and the language on p.2 in Survey Results, which asserts that: “Contrary to regulations, eligibility reviewers were also certifying companies as SDBs when their owners had defaulted on government obligations.”

In sum, we do agree with the ultimate conclusion of Finding 2: that examining good character and Federal financial obligations would be a positive improvement to the SDB program. This office is also in agreement with all six recommendations pertaining to Finding 2. In fact, we have a Policy Notice currently in clearance, which would clarify the policy of the Agency to now include character and Federal financial obligations as criteria for SDB. (Note: the draft report erroneously states that the management action includes the drafting of an *Information* Notice.) Once this Policy Notice is issued, this office will proceed with implementing your recommendations.

We appreciate the opportunity for input and look forward to working with you to maintain the integrity of the SDB program and certification process.

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