



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

<b>AUDIT REPORT</b>
Issue Date: January 30, 1996
Number: 6-5-H-001-007

To: Dratin Hill  
District Director  
Richmond District Office

From: Peter L. McClintock  
Assistant Inspector General for Auditing

Subject: Memorandum Audit Report - S.W. Day Construction Corporation  
(S.W. Day)

In response to a referral from your office, we completed an audit of S.W. Day's 8(a) program activities. The referral resulted when a former employee of S.W. Day alleged that S.W. Day was being controlled by Armada/Hoffler Construction Company, a large non-8(a) firm.

The 8(a) program was created to help small business concerns owned and controlled by socially and economically disadvantaged individuals develop their business skills and become viable businesses. Firms in the 8(a) program are eligible to receive financial and contractual assistance to aid in their development.

S.W. Day was approved to participate in the 8(a) program on February 11, 1992, and is eligible for 8(a) assistance until February 11, 2001, unless it graduates early, voluntarily withdraws, or is terminated, as stated in Title 13 Code of Federal Regulations (CFR) Section 124.207. S.W. Day has been approved for one primary and 30 secondary Standard Industrial Classification (SIC) codes. As of September 26, 1995, S.W. Day had been awarded 26 8(a) contracts worth at least \$14.2 million.

### **OBJECTIVE AND SCOPE**

The audit objectives were to determine if S.W. Day was managed and controlled by the individual upon whom program certification was based and whether services provided by Armada/Hoffler required a management agreement.

We reviewed 8(a) program regulations, corporate records, financial statements, tax returns, and other pertinent documentation. We also interviewed officials from both SBA and S.W. Day.

Field work was performed from October 1994 to August 1995 and covered S.W. Day's operations from February 11, 1992, to May 31, 1995. The audit was performed in accordance with Government Auditing Standards.

### **PRIOR AUDIT RESOLUTION**

This is our first audit of S.W. Day's 8(a) program activities.

### **RESULTS OF AUDIT**

The relationship between S.W. Day and Armada/Hoffler raised affiliation questions which were validated; however, S.W. Day has taken actions to sever the relationship. Therefore, the affiliation questions no longer exist.

### **CONTROL**

According to Title 13 Code of Federal Regulations (CFR) Section 121.401 (i), affiliation generally arises where one concern shares office space and/or employees and/or other facilities with another concern, particularly where such concerns are in the same or related industry.

S.W. Day was located in the same office building as Armada/Hoffler, and Armada/Hoffler allowed S.W. Day employees to use some of its office space and equipment. The leasing agent for the building was also an affiliate of Armada/Hoffler. During the course of the audit, S.W. Day purchased office space in another building and relocated there.

S.W. Day's first three 8(a) contracts were managed and supervised by Armada/Hoffler employees. S.W. Day, however, discontinued this practice by 1993 and hired these same employees to manage and supervise subsequent contracts.

### **MANAGEMENT AGREEMENT**

Armada/Hoffler performed S.W. Day's accounting requirements without an approved management agreement. Standard Operating Procedure (SOP) 80-05-2,

Chapter 8, requires that any arrangement entered into for the purpose of providing continuing assistance to the management of an 8(a) concern be formalized in a management agreement and approved by SBA. During the course of the audit, S.W. Day took corrective action by purchasing its own accounting system and hiring accounting personnel, enabling the company to become self sufficient.

Armada/Hoffler charged S.W. Day a fee of {FOIA Deletion} percent of the gross profit on S.W. Day's jobs in exchange for accounting services and bonding indemnification. SOP 80-05-2, Chapter 8, requires that fees associated with management agreements be based on net profits. During the course of the audit, i Armada/Hoffler stopped performing accounting services for S.W. Day but continued to provide bonding indemnification. As a result, S.W. Day began paying Armada/Hoffler {FOIA Deletion} percent of the gross profit on each job for bonding indemnification only. Bonding indemnification arrangements do not fall within the scope of management agreements and the associated fees; therefore, they do not have to be based on net profits.

## **CONCLUSION**

We discussed these conditions with the Assistant Administrator for Size Standards who said that the above facts, taken as a whole, indicated a possible affiliation, and, if uncorrected, could represent an opportunity for Armada/Hoffler to exercise control over S.W. Day. He also stated that since Armada/Hoffler is presently providing bonding indemnification only, that service alone is not sufficient enough to indicate an affiliation or control problem. We are not making any audit recommendations because no further action appears necessary.

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

This report may contain proprietary information subject to the provisions of 18 USC § 1905. Do not release to the public or another agency without permission of the Office of Inspector General.

Should you or your staff have any questions, please contact Victor R. Ruiz, Director, Headquarters Operations, at (202) 205-7204.

Attachment

REPORT DISTRIBUTION

Attachment 1

No. of Copies

Recipient

General Counsel, Office of General Counsel .....	2
Associate Deputy Administrator for Management and Administration .....	1
Associate Deputy Administrator for Economic Development .....	1
Associate Administrator for Field Operations .....	1
Associate Administrator, Minority Enterprise Development .....	3
Regional Administrator, Region III .....	2
District Director, Richmond District Office	
Director, Office of Financial Controls .....	1