

**AUDIT OF TWO 8(A) SOLE-SOURCE CONTRACTS
AWARDED TO CONTRACTORS IN
SBA'S MENTOR PROTÉGÉ PROGRAM**

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Memorandum

U.S. Small Business Administration
Office of Inspector General

To: Dr. Paul Hsu
Associate Administrator for Government Contracting and
Business Development

Date: March 30, 2007

Jennifer Main
Chief Financial Officer

Michael Pappas
Associate Administrator for Field Operations

From: Debra S. Ritt
Assistant Inspector General for Auditing

Subject: Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor
Protégé Program

This report presents the results of our audit of two 8(a) sole-source dredging contracts awarded by the Army Corps of Engineers to contractors participating in the Small Business Administration's (SBA) Mentor Protégé Program. The audit was initiated to determine the validity of a complaint alleging that the contracts were performed by large businesses, in violation of small business procurement laws and regulations and contrary to the intent of the 8(a) and Mentor Protégé programs.

To address the allegations, we evaluated the eligibility of the two companies that received contract awards and determined whether the contracts were performed in compliance SBA's size standards and work performance requirements. We also interviewed officials from SBA's Office of Government Contracting and Business Development and Office of General Counsel. Additionally, we collected information from the Philadelphia and Jacksonville District Offices of the Army Corps of Engineers, SBA's Philadelphia and North Florida District Offices, and the recipients of the sole-source dredging contracts. The audit was conducted from February to September 2006, in accordance with *Government Auditing Standards*.

On September 8, 2006, we reported¹ that one of the reviewed contracts violated SBA's small business procurement requirements and that the contractor provided inaccurate information to the Federal government in order to obtain the contract. As a result, the OIG recommended the contractor be terminated and immediately suspended from the 8(a) program.

BACKGROUND

The Mentor Protégé Program, which is administered under SBA's 8(a) program, encourages financially-sound businesses to mentor eligible 8(a) participants (protégés) by providing technical, management and financial assistance; subcontracting support; and opportunities to compete for Federal contracts through joint ventures with large businesses. To establish a mentor protégé relationship, mentor and protégé firms must enter into a written agreement setting forth the protégé's needs and the assistance the mentor will provide to address those needs. The agreement is approved by SBA's Associate Administrator for Business Development. As of September 26, 2005, SBA's website listed 388 approved mentor protégé agreements.

To joint venture on an 8(a) contract, the mentor and protégé must sign a joint venture agreement, which among other requirements, sets forth the purpose of the venture and responsibilities of the parties involved. The agreement, along with a joint venture application, is provided to SBA for approval prior to contract award. In approving mentor protégé and joint venture arrangements, SBA determines whether the arrangement promotes real developmental gains to the protégé or merely is a vehicle to enable a non-8(a) participant to receive 8(a) contracts.

The two dredging contracts that were the subject of the complaint were awarded as 8(a) sole-source contracts to participants of SBA's Mentor Protégé program. The first contract was awarded by the Jacksonville Corps of Engineers under a joint venture agreement with a large business mentor, [Exemption 6] and its protégé, [Exemption 6], an 8(a) program participant serviced by SBA's North Florida District Office, formed its mentor protégé relationship with [Exemption 6] in 2002. The complainant alleged that the joint venture violated the rules governing the 8(a) sole-source award by subcontracting 100 percent of the work to a large dredging firm called [Exemption 6].

The second contract was awarded by the Philadelphia Corps of Engineers to [Exemption 6] for dredging of the Schuylkill River. [Exemption 6] was an 8(a) program participant that had recently developed a mentor protégé relationship

¹ Management Advisory Report 6-27, *Concerns Related to [Exemption 6] Compliance with 8(a) Business Development Program Requirements* (September 2006).

with [Exemption 6], a large dredging business. The complainant alleged that [Exemption 6] acted as a front by receiving the 8(a) sole-source contract and allowing its mentor to perform 100 percent of the work.

RESULTS IN BRIEF

The audit substantiated the complainant's allegations. The two dredging contracts were not awarded and performed in compliance with 8(a) program laws and regulations. Large businesses performed 86 to 98 percent of the dredging work and materially benefited from the contracts that were sole-sourced to 8(a) participants, contrary to the intent of the 8(a) and Mentor Protégé programs.

Specifically, we found that SBA accepted both contracts into the 8(a) program although neither one met 8(a) size standards. The contract in Jacksonville also failed to demonstrate how the 8(a) contractor would benefit from the joint venture, and in Philadelphia the contractor did not meet other 8(a) program eligibility requirements. The audit also disclosed that both contractors failed to perform the contracts in accordance with applicable laws and regulations. Discussions with responsible Agency officials, the Army Corps of Engineers, and the contractors disclosed that SBA did not detect these deficiencies because it:

- Accepted procurements prior to contract solicitation, leaving it without the information needed to determine whether applicants met the size standards.
- Did not have a sufficient number of trained individuals to effectively perform its oversight responsibilities under the 8(a) program.
- Had not developed sufficient 8(a) program monitoring procedures and properly communicated program requirements.
- Did not hold required procuring agencies accountable for their compliance with 8(a) program monitoring requirements.

Previous work completed by the Office of Inspector General (OIG) and the Government Accountability Office (GAO) have also identified systemic internal control weaknesses in SBA's oversight that will continue to affect the integrity of the 8(a) and Mentor Protégé programs until properly addressed. Unless SBA strengthens internal controls over the 8(a) and Mentor Protégé programs, it cannot ensure that these programs operate as statutorily mandated with minimal potential for fraud, waste and abuse.

The Offices of Field Operations, Government Contracting and Business Development, and Chief Financial Officer reviewed and provided comments on this report prior to its issuance in final. They agreed with the findings and generally agreed with our recommendations. We have summarized management's comments at the end of this report and included their complete responses in Appendix III.

FINDINGS

SBA Accepted the Dredging Contracts Although They Did Not Meet 8(a) Requirements

SBA improperly accepted the Jacksonville and Philadelphia dredging contracts into the 8(a) program, permitting these contracts to be sole sourced to companies who were ineligible for the awards. Specifically, SBA did not ensure the contractors were small, the joint venture arrangement in Jacksonville did not meet SBA requirements, and the Philadelphia contractor did not meet a number of other eligibility requirements specified in 8(a) program procurement regulations.

SBA Did Not Ensure Both 8(a) Contractors Met SBA Size Standards

The audit determined that SBA officials did not ensure that the 8(a) contractors met small business size standard requirements prior to accepting the procurements into the 8(a) program. As part of SBA's acceptance of an 8(a) sole source procurement on behalf of a program participant, it must ensure that the contractor is small according to the contract's designated size standard. Dredging contracts have a unique size standard, where a company must have less than \$17 million in annual receipts and must perform at least 40 percent of the volume dredged with its own equipment or equipment owned by another small dredging concern.

According to the SBA acceptance officials, it was impossible to determine whether the contractors met the 40-percent size standard requirement at the time of the procurement's acceptance. This is because acceptance is required prior to the contract's solicitation and as a result, neither SBA nor the procuring agency knows how and with what equipment the potential contractor will perform the work. Consequently, SBA improperly accepted both contracts into the 8(a) program. As long as acceptance into the program occurs prior to contract award, SBA will continue to lack the information needed to properly accept participants into the program.

The Jacksonville Contractors Did Not Meet SBA Joint Venture Application Requirements

The regulations for the 8(a) program require SBA to review and approve mentor protégé joint venture arrangements prior to contract award to ensure the 8(a) participants:

- develop a joint venture agreement that is fair and equitable to all parties;
- demonstrate they lack the necessary capacity to perform the contract on their own;
- will bring substantial resources and/or expertise to the contract; and
- will receive substantial benefit and perform a significant portion of the contract.

Based on our review of SBA's files, the North Florida District Office did not obtain sufficient support to show the joint venture arrangement met program requirements. The joint venture application failed to demonstrate that the 8(a) participant met the size standard requirements, how the joint venture would perform the required percentage of work, and the resources and expertise the 8(a) participant brought to the contract. Consequently, the audit determined that SBA did not ensure the agreement was fair and in the best interest of the 8(a) participant before approving the joint venture arrangement.

Additionally, representatives from the Jacksonville Corps of Engineers told us that the 8(a) participant brought little value to the joint venture and could not explain how it developmentally benefited from the contract. As a result, we determined that SBA should not have approved the joint venture arrangement and improperly accepted the procurement on the joint venture's behalf.

The Philadelphia Contractor Did Not Meet Other Program Eligibility Requirements

SBA approved the Philadelphia Corps of Engineers' selection of the 8(a) contractor, although the contractor was unable to meet and perform certain procurement requirements, as required by SBA 8(a) program regulations. Prior to soliciting a firm for an 8(a) sole-source contract, a procuring agency must offer the procurement to the applicable SBA district office for acceptance. SBA's acceptance of the procurement is conditioned upon determining, among other things, that the procurement is consistent with the 8(a) participant's business plan,

and that the participant is small for the procurement and complies with its non-8(a) business mix.²

Despite the Philadelphia Corps of Engineers' selection and SBA's approval of the contractor, the audit found that the contractor was not eligible for the 8(a) program. The procurement was not consistent with the contractor's business plan; the contractor did not demonstrate it had the dredging equipment and expertise to comply with the contract's applicable size standards;³ and it did not comply with its 8(a) business target mix. Consequently, SBA should not have accepted the procurement into the 8(a) program. Doing so resulted in the contractor violating 8(a) contract requirements as reported in Management Advisory Report 6-27.

The audit determined that these deficiencies occurred because SBA's Philadelphia District Office was unaware of the unique size standard requirement and performed a limited review of the procurement. The Philadelphia Corps of Engineers also was not aware that the contractor could not receive significant contract assistance from its mentor without an approved joint venture.

Further, recent reductions in SBA's district office workforce have resulted in the loss of experienced personnel, many of which have not been replaced. For example, in the Philadelphia District Office, one employee performs the work that was previously performed by four individuals. District office staff we interviewed expressed concerns about the decrease in its workforce and the resulting effect on its oversight of the 8(a) and Mentor Protégé programs. They told us their workload is excessive, which limits their ability to adequately service the 8(a) participants in their portfolio, and they have not received adequate training on program requirements.

Further, according to the Associate Administrator for Business Development, the 8(a) program office has no control over how district resources, which report to the Associate Administrator for Field Operations, are used. Consequently, district office staffs do not spend a sufficient amount of time overseeing compliance with 8(a) and Mentor Protégé program requirements.

² To ensure that participants do not develop an unreasonable reliance on 8(a) awards and to ease their transition into the competitive marketplace after graduating from the 8(a) program, participants must make maximum efforts to obtain business outside the 8(a) program. Any firm that does not meet its applicable competitive business mix target for the program year is ineligible for sole-source 8(a) contracts in the current program year, until the participant corrects the situation.

³ In 2005, the size standard for dredging contracts required that the company have less than \$17 million in annual receipts and perform at least 40 percent of the volume dredged with its own equipment or equipment owned by another small dredging concern.

Moreover, discussions with SBA officials, including the individual who establishes SBA's small business size standard requirements, revealed they did not know how to properly assess compliance with the 40 percent requirement. For example, the Philadelphia District Office acceptance official stated he would not have accepted the procurement into the 8(a) program on the contractor's behalf had he fully understood the size standard for dredging contracts and properly reviewed the contractor's 8(a) file. Officials in both district offices, believe the program office does not provide meaningful support in interpreting required policies and providing advice on how to handle certain situations. According to the Associate Administrator for Business Development, her office is not permitted to contact the district offices directly, but rather, must work through a liaison designated by the Office of Field Operations.

Contracts Were Not Performed in Accordance With Program Requirements

The audit also disclosed that both dredging contracts were not performed in compliance with work performance requirements; and that the Jacksonville contractor did not comply with its approved joint venture agreement. The work performance percentage, size standard, and joint venture agreement requirements were designed to ensure that 8(a) small business contractors are the primary beneficiaries of 8(a) contracts. The dredging contracts included these requirements and the procuring agencies were expected to monitor the prime contractor's compliance.

SBA was required to ensure the joint venture entity met the work performance requirements and complied with the terms outlined in its joint venture agreement. SBA was also ultimately responsible for ensuring the 8(a) participants complied with the program regulations. SBA's failure to ensure that the procuring agencies were monitoring contractor performance and adhering to program requirements led to abuses of the 8(a) and Mentor Protégé programs.

8(a) Contractors Did Not Perform the Required Percentage of Work

The audit disclosed that the Jacksonville and Philadelphia 8(a) contractors did not perform the required percentage of work for their contracts. SBA regulations require prime contractors for general 8(a) construction contracts, including mentor/protégé joint ventures, to perform at least 15 percent of the cost of the contract with their own personnel. This work performance requirement was included in both dredging contracts in accordance with Federal Acquisition Regulations (FAR) clause, 52.219-14, *Limitations on Subcontracting*.

Despite these requirements, the Jacksonville contractor performed 13.6 percent of the cost of the contract with its own employees (*see Appendix I*) and as reported in OIG Management Advisory Report, 6-27, the Philadelphia contractor performed only 1.9 percent with its own employees. Accordingly, both contractors violated SBA 8(a) work performance requirements and FAR regulations.

Officials from SBA's Jacksonville and Philadelphia District Offices told us they are not involved with the contracts after they are accepted, and many times are unaware the contracts have been awarded. Instead, the district offices rely on the procuring agency to ensure contractor compliance and provide assistance when requested.

Both the Jacksonville and Philadelphia Corps of Engineers acknowledged it was their responsibility to ensure compliance with work performance requirements. Officials from the Jacksonville Corps of Engineers told us they conducted field checks and reviewed certified payroll records and progress reports. However, contract documentation revealed they only received certified payroll records for laborers and workers, but not for managers and salaried employees. Accordingly, they did not receive sufficient information to perform an accurate determination of the percentage of work performed by the protégé. Additionally, the Corps' current internal procurement tracking system, which records and calculates a contract's subcontracting percentage, inaccurately reported that the joint venture performed 44 percent of the contract.

Officials from the Philadelphia Corps of Engineers could not identify which of its procurement officials monitored contractor compliance. The contracting officer stated that the project and on-site construction managers ensure the contractor complies with the work performance requirements, while the construction managers told us they do not know how to calculate the work percentage.

By failing to perform the required percentage of work, the Jacksonville and Philadelphia contractors violated SBA regulations and the terms of their contracts and allowed non-8(a) program participants to receive substantial benefit from the 8(a) contracts. Further, the procuring agencies failed to monitor contractor compliance with the limitations of subcontracting clause, permitting non-8(a) participants to benefit from the 8(a) contracts.

8(a) Contractors Did Not Perform Work in Accordance with Size Standards

The audit determined that neither the Jacksonville nor Philadelphia contractors performed their respective contracts in accordance with SBA dredging size standards. Dredging size standards require that a company must have less than \$17 million in annual receipts and perform at least 40 percent of the volume

dredged with its own equipment or equipment owned by another small dredging concern. The audit disclosed that both contractors met the \$17 million requirement for annual receipts, but failed to perform 40 percent of the dredging with small business equipment. By failing to meet both requirements under the size standard, the contractors violated the terms of their contracts and SBA regulations.

On the Jacksonville contract, neither the mentor nor the protégé owned the dredging equipment needed to demonstrate that 40 percent of the volume was dredged with small business equipment as required by the size standard. The protégé asked SBA to determine whether its mentor could lease the required contract equipment from a large business, bring it into the joint venture relationship for contract performance, and still be considered small under the dredging size standard. In response to this request, SBA rendered an opinion, stating that a large business mentor could rent dredging equipment from another large business and then sublease it to the 8(a) participant or joint venture, and comply with the 40-percent size standard requirement. Based on this opinion, SBA and the Jacksonville Corps of Engineers believed that the contract met the size standard requirement. Jacksonville Corps of Engineers officials were also not privy to the lease agreement and contractor bank statements.

While SBA deemed this arrangement acceptable, we believe it contravenes the intent of the size standard and the program because it permitted a large business to provide the equipment used to perform all of the work. However, under the size standard, the protégé/joint venture can only be considered small and therefore be eligible for the program, if it provided or leased from a small business the equipment used for 40 percent of the volume dredged. Thus, the intent of the size standard was to have small businesses benefit from the work performed.

As we reported in Management Advisory Report No. 6-27, the Philadelphia contractor also did not meet SBA's size standards. The audit disclosed that the mentor provided all of the equipment used for contract performance. This occurred because officials from the Philadelphia Corps of Engineers wrongly believed that the protégé was permitted to use its mentor's equipment to meet the contract's 40 percent size standard requirement. By the time Corps officials were made aware that this was not allowed, only two days of work remained on the contract. Consequently, they took no corrective action to ensure contractor compliance with the size standards.

Jacksonville Contractor Did Not Meet SBA Joint Venture Requirements

Our review of the Jacksonville contractor's joint venture agreement and contract documentation revealed that it violated the terms of its SBA-approved joint venture agreement because:

- the protégé did not manage the project (e.g., it did not oversee contract cost and schedule performance) or maintain the accounting and administrative records, for the joint venture; and
- the mentor did not lease the labor and equipment for the dredge to the joint venture in compliance with SBA's opinion, as discussed earlier.

These deficiencies occurred because neither the North Florida District Office nor the procuring agency monitored the joint venture's compliance with its approved agreement. SBA joint venture policies require district offices to annually review joint ventures and conduct close-out meetings with the venture's participants in order to examine its compliance with prime contractor requirements and ensure the contract was performed as stipulated in the agreement.

Our review of the joint venture's files confirmed that the North Florida District Office did not conduct a post-contract review. District officials explained that due to limited resources, they rely on the procuring agencies to ensure compliance. They only meet with 8(a) participants to ensure participants are satisfied with the joint venture and have received 51 percent of the profits. They further told us they did not request or receive a copy of the 8(a) company's joint venture agreement.

We believe it is imperative that SBA ensure its district offices have the necessary resources to properly perform the post-contract reviews and require accountability to prevent future abuses of SBA of the 8(a) and Mentor/Protégé programs.

Procuring Agencies Failed to Properly Monitor Contract Compliance with Program Regulations As Required By Their Partnership Agreements

The problems noted in the two dredging contracts further highlight that procuring agencies are not effectively monitoring contract compliance with 8(a) program regulations, as required by their partnership agreements with SBA. In 1998, SBA delegated the contract execution function to procuring agencies by entering into partnership agreements with them. The delegated authority included ensuring compliance with 8(a) program regulations.

Reports issued last year by the GAO and the OIG have shown that the lack of procurement agency oversight is a systemic issue across the 8(a) program. GAO reported in its audit, *Increased Use of Alaska Native Corporations' Special 8(a)*

Provisions Calls for Tailored Oversight,⁴ that after reviewing 16 8(a) contracts it found almost no evidence that the procuring agencies are effectively monitoring compliance with the limitations of subcontracting requirement. Also, the OIG report, *Monitoring Compliance With 8(a) Business Development Regulations During 8(a) Business Development Contract Performance*,⁵ disclosed that none of the 23 agencies reviewed monitored whether companies complied with 8(a) regulations when completing contracts.

SBA has allowed this problem to continue as it has not performed the needed surveillance reviews to determine the extent to which agencies are complying with their partnership agreements. As we reported in 2006, we could find no evidence that SBA conducted surveillance or oversight reviews of procuring agencies to ensure they effectively monitored companies for compliance with 8(a) business development regulations.

We consider SBA's inability to effectively monitor procuring agency adherence to the requirements of the 8(a) and Mentor Protégé programs to be a material weakness that should be noted in the Administrator's FY 2007 internal control assurance statement. The Office of Management and Budget Circular A-123 and the Federal Managers' Financial Integrity Act require agencies to maintain an adequate system of internal controls and to assert annually that agencies are in compliance with this requirement. Because we continue to find no evidence of oversight by SBA of procuring agency compliance with SBA 8(a) regulations, we believe the Agency does not have effective internal controls to prevent and detect violations of SBA program regulations.

RECOMMENDATIONS

We recommend that the Associate Administrator for Field Operations:

1. Communicate to district office officials they should not accept procurements on behalf of 8(a) participants unless they have been provided sufficient information from the procurement office and/or the 8(a) participant to ensure procurements are accepted in accordance with federal laws and regulations.
2. Develop effective and efficient controls to ensure district offices are performing required reviews of procuring agencies to ensure they are procuring 8(a) contracts in accordance with federal laws and regulations and their partnership agreements with SBA.

⁴ GAO-06-399, April 2006.

⁵ Audit Report No. 6-15, March 2006.

3. Work with the Associate Administrator for Business Development to better support the district offices in interpreting required policies and providing advice on how to handle certain situations; and report any impediments to improving field support to the Deputy Administrator.
4. Work with the Associate Administrator for Business Development and Associate Administrator for Human Capital to review SBA's district workforce servicing the 8(a) program in the field and develop a plan to ensure sufficient oversight resources are made available to ensure the 8(a) program is maintained in accordance with federal laws, SBA regulations, and internal policies and procedures.

We recommend that the Assistant Deputy Administrator for Government Contracting and Business Development:

5. Rescind its interpretation of NAICS code size standard footnote, *Dredging and Surface Cleanup Activities*, which allows a large business mentor to rent dredging equipment from another large business and then sublease it to the 8(a) participant or joint venture.

We recommend that the Chief Financial Officer:

6. Determine whether SBA's inability to effectively monitor the 8(a) and Mentor Protégé programs should be reported as a material weakness in the Administrator's FY 2007 internal control assurance statement if all recommendations outlined in this report are not completely addressed by that time.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

The Agency provided written comments on a draft of this report. These comments are summarized in the Results in Brief section, and the full text of the comments can be found in Appendix III to this report.

Comments from the Office of Field Operations

OFO partially agreed with recommendations 1 and 3 and fully agreed with recommendations 2 and 4. Where OFO partially agrees, it proposed actions that satisfy the intent of the recommendations.

In its response, OFO stated it was committed to work with the Office of Government Contracting and Business Development (OGCBD) to address the issues and recommendations outlined in the report. To satisfy recommendations 1 – 3, OFO proposed to:

- › Reiterate proper 8(a) procurement procedures to field officials through informational notices, communication, and training.
- › Request the District Director Advisory Council review and comment on revisions to program policies and procedures to ensure their understanding of and input to procedural changes.
- › Serve as a facilitator between the program and field offices and communicate concerns voiced by field officials.
- › Provide continuous contract administration training sessions including sessions on the Mentor Protégé Program and Joint Ventures.
- › Hold district officials accountable for performing 8(a) program requirements..

For recommendation 4, OFO stated that it is in the process of addressing the recommendation and is committed to allocating resources in the most effective and efficient manner to ensure that all program requirements are addressed.

Office of Inspector General's Determination

We find OFO's proposed actions and stated final action target dates for recommendations 1 - 3 to be acceptable. Considering OFO's response that they are in the process of addressing recommendation 4, we request that they provide us a copy of their assessment the current the district workforce in meeting all the requirements according to 8(a) program federal laws and regulations so we may immediately close this recommendation. We request this information by April 30, 2007.

Comments from the Office Government Contracting and Business Development

The OGCBD agree with the report's findings and recommendations and agreed to work with the OFO address recommendations 1-4 by the end of fiscal year 2007. As for recommendation 5, where we recommended OGCBD rescind its interpretation of the dredging size standard which stated mentor protégé joint ventures could lease equipment from a third party, it agreed to do so. By the end

of the fiscal year, OGCBD will require that mentor protégé joint ventures meet the size standard and footnote requirements in the same manner as all other small business.

Office of Inspector General's Determination

We find OGCBD's proposed actions and stated final action target date to be acceptable.

Comments from the Office of the Chief Financial Officer

The Office of the Chief Financial Officer agreed with our recommendation and will work with the 8(a) program to determine whether SBA's inability to effectively monitor the 8(a) and Mentor Protégé programs should be reported as a material weakness in the Administrator's fiscal year 2007 internal control assurance statement. Also in its reply, the Chief Financial Officer noted that we did not identify how we selected our sample of reviewed contracts. To clarify, we did not select a sample of contract but rather, reviewed the two contracts that were subject to a complaint we received. Additional information about the two contracts is outlined in the background and scope sections of this report.

Office of Inspector General's Determination

We find OCFO's proposed actions and stated final action target date to be acceptable.

We appreciate the courtesies and cooperation of Small Business Administration officials from the North Florida and Philadelphia District Offices and Office of Business Development and during this audit. If you have any questions concerning this report, please call me at (202) 205-7203.

cc: Richard Brechbiel
Assistant Administrator for Human Resources

Luz Hopewell
Associate Administrator for Business Development

APPENDIX I.

**Percentage of Work Performed by the Joint Venture on the
Jacksonville Contract**

Cost Category	Cost
Sub contracting expenses	[Exemption 4]
Joint venture equipment	
Joint venture payroll expense	
Payroll G&A	
Other miscellaneous expenses	
Total Contract Costs	\$ 1,558,671.50
Cost of Contract Less profit, fees and materials	1,367,161.91
Total payroll costs incurred by the joint venture	[Exemption 4]
Percentage of the contract cost, excluding materials, performed by the joint venture (187,052.43/1,367,161.91)	13.6%

**Percentage of Work Performed by the Protégé on the
Jacksonville Contract**

Cost Category	Cost
Sub contracting expenses	[Exemption 4]
Joint venture equipment	
Joint venture payroll expense	
Payroll G&A	
Other miscellaneous expenses	
Total Contract Costs	\$ 1,558,671.50
Cost of Contract Less profit, fees and materials	1,367,161.91
Total payroll costs incurred by the joint venture	[Exemption 4]
Percentage of the contract cost, excluding materials, performed by the joint venture [Exemption 4]	2.4%

APPENDIX II. SCOPE AND METHODOLOGY

To determine whether the Small Business Administration (SBA) properly accepted the two procurements into the 8(a) program, we reviewed relevant legislative and regulatory requirements of the 8(a) and Mentor Protégé programs, including Title 13 of the Code of Federal Regulations, section 125, on size standards. We compared the dredging size standards to the annual receipts and volume dredged by the prime contractors for both contracts. We also reviewed SBA's Partnership Agreement with the Department of Defense to determine the required procedures when awarding and monitoring 8(a) contracts.

We reviewed the procurements' offer, acceptance, and source selection documentation from SBA and the procuring agencies. In Jacksonville, we also reviewed the North Florida District Office's review and approval of the joint venture agreement.

To determine whether the two contracts were performed in compliance with program requirements, we reviewed administrative and performance contract documentation including subcontracting agreements, contract expense source documents, and monitoring reports. To determine whether the contractors complied with the size standard requirements, in Philadelphia we reviewed field reports to identify the equipment used for contract performance, and in Jacksonville we reviewed bank records and invoices to assess whether the joint venture met SBA's dredging size standard opinion.

To determine whether the contractors performed the required percentage of work, we reviewed contract expenses and calculated the cost of the contracts less materials, as a percentage of costs incurred by the prime contractors according to payroll records. In Jacksonville, we also determined whether the joint venture complied with its SBA-approved joint venture agreement by reviewing the contract correspondence and reports.

We met with the Office of Business Development and district office officials to determine the extent to which SBA did surveillance reviews and engaged in other monitoring activities to ensure procuring agencies were complying with 8(a) and Mentor Protégé program regulations.

We conducted this audit at SBA's headquarters and Philadelphia and North Florida district offices and the U.S. Army Corps of Engineers Districts in Philadelphia and Jacksonville. We met with representatives from SBA's

Office of Business Development, Office of Size Standards, Office of Government Contracting, Office of General Counsel, SBA's North Florida and Philadelphia and the Army Corps of Engineers Philadelphia and Jacksonville district offices, and, when appropriate, the 8(a) program participants.

We conducted our audit from February 2006 to September 2006, in accordance with *Government Auditing Standards* prescribed by the Comptroller of the United States, and included such tests as were considered necessary to provide a reasonable assurance of detecting abuse or illegal acts.

APPENDIX III. AGENCY COMMENTS



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20418

DATE: March 27, 2007

TO: Debra S. Ritt
Assistant Inspector General for Auditing

FROM: Michael J. Pappas [Exemption 6]
Associate Administrator
Office of Field Operations

SUBJECT: Audit of Two 8(a) Sole-Source Contracts Awarded to
Contractors in SBA's Mentor-Protégé Program

The Office of Field Operations appreciates the opportunity to comment on the March 9, 2007, subject draft report titled "Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor-Protégé Program".

As a general comment, OFO is committed to working with the Office of GC/BD to address the issues in the audit.

RECOMMENDATION #1 - Communicate to district office officials that they should not accept procurements on behalf of 8(a) participants unless they have been provided sufficient information from the procurement office and/or the 8(a) participant to ensure procurements are accepted in accordance with federal laws and regulations.

Response: OFO partially agrees with Recommendation #1. While the 8(a) Business Development programmatic functions and services are delivered at the district level, the responsibility to communicate guidance concerning federal laws and regulations of this nature to district office staff rests with **both** the Office of Business Development and the Office of Field Operations.

Proposed Solutions:

1. **Information Notice:** Office of Business Development draft an Information Notice which communicates information concerning acceptance of procurements on behalf of 8(a) participants. This notice can reiterate a chapter in the SOP or whatever other guidance the GDBD staff deem appropriate. In addition, propose that subsequent notices with "new" information be distributed on a regular basis. OFO will reiterate the issuance and importance of adhering to all appropriate GCBD guidance.

Training - FY 2007 Training Schedule includes a March 28 session on Mentor Protégé and Joint Ventures and a session on the overall 8(a) contracting program (includes Mentor Protégé and Joint Ventures) is scheduled for September 26.

APPENDIX III. AGENCY COMMENTS

RECOMMENDATION #2 - Develop effective and efficient controls to ensure district offices are performing required reviews of procuring agencies to ensure they are procuring 8(a) contracts in accordance with federal laws and regulations and their partnership agreements with SBA.

Response: OFO agrees with Recommendation #2.

Proposed Solutions:

1. Include an element in the QSR that addresses the field office's review of procuring agencies execution of 8(a) contracts. .
2. **Training** – GCBD has scheduled a Contract Administration (i.e. partnership agreements and various contracting mechanisms) session on April 25, 2007. Also scheduled is a general Contracting Overview session on September 26, 2007.

RECOMMENDATION # 3 - Work with Associate Administrator for Business Development to better support the district offices in interpreting required policies and providing advice on how to handle certain situations; and report any impediments to improving field support to the Deputy Administrator.

Response: OFO partially agrees with this recommendation. OFO can collect areas of concern from the district offices regarding ambiguities in policies and procedures and refer them to GCBD. OFO can serve in a facilitator role to obtain clarification or participate in policy discussions, however, the interpretation of policies should be a program office (GCBD) responsibility at a minimum and potentially an Office of General Counsel issue. OFO can work with GCBD to identify Frequently Asked Questions (FAQ) and Answers or best practices and distribute them to field offices.

Proposed Solutions:

- 1) **Mentor Protégé Program SOP** - Has been revised and the Office of BD is anticipating clearance to begin within the next two weeks. OFO can vet the document through the District Director Advisory Council to obtain their comments which could identify policy directives contained therein which need further clarification before the SOP is issued in final.
- 2) **Monthly Conference Calls** - Office of Business Development currently holds monthly conference calls with the Business Development Specialists (BDSs) where topics include the various components of the 8(a)/BD Program. OFO can serve as a conduit to raise topics for discussion on training sessions.

RECOMMENDATION #4 - Work with the Associate Administrators for Business Development and for Human Capital to review SBA's district workforce servicing the 8(a) program in the field and development to ensure sufficient oversight resources are made available to ensure the 8(a) program is maintained in accordance with federal laws, SBA regulations and internal policies and procedures.

Response: OFO is already addressing Recommendation # 4. As the IG is fully aware, there are limited resources in the field and OFO does not have the unilateral

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authority to hire additional staff. Despite any resource challenge, OFO is committed to allocating its resources in the most efficient and effective manner. To that end, OFO manages its resources to ensure all program compliance issues are addressed. The Agency is currently addressing roles and responsibilities in all major program areas, and through this exercise much of Recommendation #4 should be resolved.

Thank you for the opportunity to provide comments.

cc: Dr. Paul Hsu, AA/GC/BD
Calvin Jenkins, DAA/GC/BD
Luz Hopewell, AA/BD
Audrey Delaney, Auditor-In-Charge

APPENDIX III. AGENCY COMMENTS



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

DATE: March 22, 2007

TO: Debra S. Ritt
Assistant Inspector General for Auditing

FROM: Calvin Jenkins, AA/GC&BD [Exemption 6]

SUBJECT: Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program

The Office of Government Contracting & Business Development is pleased to provide the following response to the draft report entitled "Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program", dated March 9, 2007:

Recommendation 1 - 4

The Office of Government Contracting & Business Development has met with the Office of Field Operations and is working with them to address IG Recommendations 1 – 4 by the end of Fiscal Year 2007.

Recommendation 5

In the subject draft audit report, you recommend that the Office of Government Contracting and Business Development rescind its interpretation that an 8(a) Mentor Protégé joint venture may utilize equipment leased by the mentor and provided to the protégé to comply with the size standard requirement that 40 percent of the volume dredged must be performed by equipment owned by the small business contractor or equipment owned by another small business.

We agree with this recommendation. Current regulations for the 8(a) Business Development Program and Small Business Size Regulations contain provisions that suggest different interpretations on this matter. Upon further review of the regulations and the concerns raised by your audit findings, the footnote to the dredging size standard shall be a requirement applied to 8(a) Mentor Protégé joint ventures in the same manner as to all small businesses.

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Accordingly, my office plans to revise its regulations clarifying that 8(a) Mentor Protégé joint ventures must comply with the plain language of footnote to the dredging size standard. A proposed rule will be prepared before the end of fiscal year 2007.

Please feel free to contact me if you have any questions or require additional information.

cc: Michael Pappas, AA/OFO

Dr. Paul Hsu, AA/GCBD

Jennifer Main, CFO

Luz Hopewell, D/BD

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

Date: February 28, 2007

To: Debra S. Ritt
Assistant Inspector General for Auditing

From: Jennifer E. Mail [Exemption 6]
Chief Financial Officer

Subject: Draft Report on the Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program

The draft report on the audit of two 8(a) sole-source contracts awarded to contractors in SBA's Mentor Protégé program contains 6 recommendations. One of the recommendations was addressed to the Chief Financial Officer (CFO). The Office of the CFO is in general agreement with the recommendation.

CFO will work with the office of Government Contracting and Business Development (GCBD) on their corrective action in monitoring the 8(a) and Mentor Protégé programs. We understand that Field Operations also has a role in the process, so we will work with that office as well. OCFO will also evaluate the progress made in the 8(a) and Mentor Protégé programs at the end of this fiscal year. We will work with GCBD and Field Operations to determine whether SBA's inability to effectively monitor these programs should be reported as a material weakness in the Administrator's FY 2007 internal control assurance statement.

For the record however, I would like to point out that the IG report fails to mention the method used for selecting the samples. In order to determine materiality, the proportion of the exception to the entire population needs to be taken into account.

Thank you for the opportunity to provide comments to the draft report.

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