



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

AUDIT REPORT
Issue Date: February 18, 1998
Number: 8-7-H-009-008

To: William A. Fisher
Acting Associate Administrator for
Minority Enterprise Development

From: Peter L. McClintock
Assistant Inspector General for Auditing

Subject: Memorandum Audit Report - 8(a) Program Eligibility of Magnum
Technologies, Inc. (Magnum)

At the request of your office, the Office of Inspector General (OIG) completed an audit of Magnum's 8(a) program eligibility. Your office's concern was based on information that (*FOIA Deletion*), the majority owner of Magnum, may have understated (*FOIA Deletion*) net worth so that Magnum would be eligible for the program.

Magnum, located in Chantilly, VA, was admitted into the 8(a) program on February 21, 1992, and is eligible for 8(a) assistance until February 21, 2001, unless it graduates early, voluntarily withdraws, or is terminated. Magnum's 8(a) eligibility is based on social and economic factors of (*FOIA Deletion*), who owns 51 percent of the company. As of November 26, 1997, Magnum had been awarded four 8(a) contracts with a total estimated award amount of \$4.4 million.

OBJECTIVE AND SCOPE

The audit objective was to determine whether (*FOIA Deletion*) net worth was accurately reported and within the initial and continuing eligibility thresholds. Field work was performed from August 1997 through November 1997. OIG auditors reviewed 8(a) program regulations, corporate and personal financial statements and tax returns, and other pertinent documentation. They also interviewed SBA officials and (*FOIA Deletion*). The audit was performed in accordance with Government Auditing Standards.

PRIOR AUDIT RESOLUTION

This is the OIG's first audit of Magnum.

RESULTS OF AUDIT

(FOIA Deletion) inaccurately reported (FOIA Deletion) net worth to SBA when (FOIA Deletion) applied for admittance to the 8(a) program and in conjunction with four continuing eligibility reviews. While (FOIA Deletion) net worth was inaccurately reported, it was found to be within the \$250,000 initial eligibility threshold; however, it increased to the extent where it exceeded the \$750,000 continuing eligibility limitation in 1996 and 1997. Therefore, Magnum was ineligible to receive two 8(a) contracts that have a total estimated award amount of \$4.1 million.

To be eligible to participate in the 8(a) program, companies must be at least 51 percent owned by individual(s) determined by SBA to be socially and economically disadvantaged. Individuals are not considered economically disadvantaged for initial and continuing eligibility purposes if their net worth exceeds \$250,000 and \$750,000, respectively. Program participants are required to report their net worth to SBA at the time they apply to the program and annually thereafter.

Magnum became ineligible for the 8(a) program in 1996 when (FOIA Deletion) overcame his economic disadvantage. SBA found Magnum eligible to continue in the program because (FOIA Deletion) understated (FOIA deletion) net worth in annual reports to SBA. OIG auditors found (FOIA Deletion) reported net worth was understated by amounts ranging from \$492,862 to \$647,689 from 1994 to 1997. Despite the magnitude of the understatements, (FOIA Deletion) net worth exceeded the eligibility limit only in 1996 and 1997. The inaccuracies in (FOIA Deletion) reported net worth are shown on the following table.

INACCURACIES IN REPORTED NET WORTH					
	<u>1991</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>
REPORTED NET WORTH FOR 8(A) PURPOSES					
<u>AMOUNT ASSETS WERE UNDERSTATED</u>		<i>(All figures</i>			
STOCKS AND MUTUAL FUNDS					
RETIREMENT ACCOUNT			<i>On graph</i>		
SHARE OF JOINTLY-OWNED COMPANY					
LOAN RECEIVABLE				<i>FOIA deleted)</i>	
OTHER ASSETS					
<u>AMOUNT LIABILITIES WERE OVERSTATED</u>					
FAMILY LOANS					
OTHER LIABILITIES					
NET UNDERSTATEMENTS					
ADJUSTED NET WORTH					

The OIG determined (*FOIA deletion*) 1996 net worth for 8(a) program purposes was \$(*FOIA deletion*). Although this exceeded the \$750,000 continuing eligibility limit, Magnum was not found ineligible for continued program participation because (*FOIA deletion*) reported that his net worth was \$(*FOIA deletion*). (*FOIA deletion*) omitted an investment in a jointly-owned company, a loan receivable from the company, and various mutual fund investments. He also understated the value of his retirement account and stock investments.

When (*FOIA deletion*) was overdue for the 1997 report, SBA informed him that Magnum would be terminated from the 8(a) program if the net worth report was not received. (*FOIA deletion*) then reported his net worth as \$ (*FOIA deletion*), and SBA found Magnum eligible for continuing participation. Three days later, during this audit, (*FOIA deletion*) informed the OIG that his net worth was actually \$ (*FOIA deletion*). (*FOIA deletion*) told the OIG that he provided an incomplete account of his net worth for the eligibility review in order to meet the deadline imposed by SBA. (*FOIA deletion*), however, did not provide his revised net worth to SBA program officials who conducted the eligibility review.

Two 8(a) contracts that have a total estimated award amount of \$4.1 million were inappropriately awarded to Magnum after the company became ineligible for the 8(a) program. As of December 11, 1997, one of the contracts, SBA Contract No. (*FOIA deletion*), awarded by the Department of Justice, had not been completed.

RECOMMENDATIONS

We recommend the Acting Associate Administrator for Minority Enterprise Development

- 1A. initiate action to terminate Magnum from the 8(a) program, and
- 1B. suspend Magnum from receiving contract support and all other forms of 8(a) program assistance immediately.

AUDITEE'S RESPONSE

(*FOIA deletion*) agreed with our findings and recommendations, however, (*FOIA deletion*) expressed concern with a statement in the draft report regarding the number and worth of 8(a) contracts received while in the program. (*FOIA deletion*) believed the draft report made it appear that the company has made great profits from these contracts while revenues have been around \$400,000. For one of the contracts awarded, no work had been performed or revenues received. On another contract, (*FOIA deletion*) believed that valuing the contract at \$4 million, the estimated award amount, makes invalid assumptions because it is an indefinite delivery indefinite quantity (IDIQ) contract with only a \$500 minimum contractual obligation. Magnum's written comments are included as Attachment 1.

EVALUATION OF AUDITEE'S RESPONSE

Although Magnum's 8(a) revenues totaled about \$400,000, the OIG believes it is more important to recognize the potential 8(a) revenues the company may receive based on current estimates. The report has been revised to clarify that Magnum's 8(a) contracts have a total estimated award amount of \$4.4 million. Although we agree that Magnum has not performed any work or received any revenues on one contract, the contract remains enforceable as it has not been canceled. On the other contract, Magnum was one of 15 contractors that received an IDIQ contract from the same procuring agency. The total of all orders from the 15 contracts could not exceed \$60 million, and each contractor was guaranteed a minimum of \$500. The contracting officer estimated that each contractor would receive an equal value of orders, or \$4 million. As of January 20, 1998, Magnum has received one order totaling \$300,235 from this contract and may receive additional orders through September 4, 2002.

SBA MANAGEMENT'S RESPONSE

SBA officials agreed with the findings and recommendations and stated that actions to terminate and suspend Magnum from the program are being taken. Their comments are responsive to our recommendations.

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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 corporate and personal financial records. **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 proposed management decision for the recommendation within 30 days on the SBA Form 1824, Recommendation Action Sheet. If you disagree with the recommendation, please provide you reasons in writing.

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