



Office of Inspector General
Report of Review

**MBE UTILIZATION IN EPA'S
FINANCIAL ASSISTANCE PROGRAMS**

Report No. E1FMB5-05-0035-5400068

May 4, 1995

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Inspector General Division
Conducting the Audit:

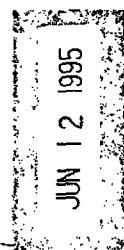
Northern Audit Division
Chicago, Illinois

Regions Covered:

EPA Regions 1, 5, and 7

Program Offices Involved:

Office of Small and Disadvantaged
Business Utilization



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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

MAY 4 1995

OFFICE OF
THE INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Report Number E1FMB5-05-0035-5400068
MBE Utilization in EPA's Financial
Assistance Programs

FROM: Kenneth A. Konz *James O. Ramey*
Acting Deputy Inspector General

TO: Peter D. Robertson
Chief of Staff
Office of the Administrator

Attached is the final report titled MBE Utilization in EPA's Financial Assistance Program. Our objectives were to determine whether (1) State and local governments awarded and monitored contracts in compliance with EPA's Minority Business Enterprise (MBE) requirements, (2) State and local government prime contractors met the MBE program requirements, and (3) EPA's utilization data for the MBE program were accurate.

This report contains findings that describe the results of our review. It represents the opinion of the Office of the Inspector General (OIG). Final determinations on matters in the report will be made by EPA managers in accordance with established EPA audit resolution procedures. Accordingly, the findings described in this report do not necessarily represent the final EPA position.

The report also contains a proposal to change the basis for reporting MBE utilization data (See "Matters for Congressional Consideration", page 14). EPA's current practice is consistent with the direction provided in several EPA Appropriations acts. However, we do not believe that this practice accurately measures the program's annual performance. To encourage attention to this issue, we will distribute this report to members of the U.S. House of Representatives Committee on Appropriations.



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Your response to our draft report is included as Appendix I. Based on that response and discussions at the exit conference, we made appropriate changes to this final report.

Action Required

In accordance with EPA Order 2750, we have designated you as the Action Official for this report. The Action Official is required to provide this office with a written response to the report within 90 days of the final report date. For corrective actions planned, please include details, supporting documentation, and reference the actions to specific milestone dates. These actions will assist this office in deciding whether to close this report. Also, please track all action plans and milestones in the Management Audit Tracking System.

We have no objections to further release of this report to the public. Should you or your staff have any questions regarding this report, please contact Charles Allberry, Audit Manager, Northern Audit Division at (312) 353-4222.

Attachment

EXECUTIVE SUMMARY

PURPOSE

The U.S. House of Representatives Committee on Appropriations (Committee), in House Report 103-555, expressed a continuing concern that prime contractors do not comply with the U.S. Environmental Protection Agency's (EPA) Minority Business Enterprise (MBE)¹ requirements. The Committee requested the Office of Inspector General (OIG) to:

...determine the extent to which this disregard of a Federal mandate (underscoring added) prevails within the contracting community ... [and] to the extent possible ... review the process by which state and local governments award and monitor contracts.

We, therefore, reviewed the MBE activities of EPA financial assistance recipients. Our objectives were to determine whether:

- State and local governments awarded and monitored contracts in compliance with EPA's MBE requirements.
- State and local government prime contractors were meeting the MBE program requirements.
- EPA's utilization data for the MBE program were accurate.

BACKGROUND

In response to President Carter's National Urban Policy of March 1978, EPA established goals for MBE use in the Wastewater Treatment Construction Program. In March 1983, EPA implemented "Procurement Under Assistance Agreements Regulation" (40 Code of Federal Regulations, Part 33). The regulations require recipients to follow six affirmative steps in achieving the goal of awarding a "fair share" of subagreements to MBEs, whenever possible.

¹For purposes of this report, the term "MBE" includes both minority-owned and women-owned businesses, unless otherwise noted.

The fiscal 1991 Appropriations Act temporarily authorized EPA to establish a minimum 8 percent goal for the use of "prime and subcontracts awarded in support of authorized programs." Congress also directed the Administrator to annually report the Agency's efforts in achieving the 8 percent goal. EPA's fiscal 1993 Appropriations Act made the 8 percent goal permanent.

EPA's Office of Small and Disadvantaged Business Utilization (OSDBU) is responsible for establishing policy and providing procedural guidance for the utilization of MBEs under the Agency's financial assistance programs. EPA reported distributing over \$9 billion in financial assistance to states during fiscal 1991 through 1993. Of this total, EPA reported the states obtained over \$6 billion in goods and services, about \$868 million from MBEs. This results in a reported MBE utilization rate for the three-year period of about 14 percent. For the ten-year period ended September 30, 1993, EPA financial assistance recipients reported an average MBE utilization rate of 15 percent.

RESULTS IN BRIEF

Alleged Abuses Within the MBE Program

The Committee had received allegations of various abuses within the MBE program. The Committee requested that we determine whether: (1) recipients of EPA financial assistance agreements encouraged use of MBEs through their contract procedures, (2) prime contractors used MBEs as pass throughs for money, (3) prime contractors named MBEs on bid documents without their knowledge, and (4) prime contractors awarded MBEs large dollar contracts, but only exercised a fraction of the available contract. For two of three states examined, recipients had proactive contracting procedures which encouraged the use of MBEs. There were indications of MBEs being used as pass throughs for one of the six projects we reviewed. We only became aware of the situation because a recipient had taken proactive steps to identify and correct the abuse. We did not find that prime contractors named MBEs on bid documents without their knowledge nor that prime contractors exercised less than the full value of MBE contracts.

EPA's MBE Utilization Data

For the 10 year period ended September 30, 1993, EPA reported that its financial assistance recipients awarded 15 percent

of their contracting dollars to MBEs. The Committee requested that we determine the reliability of the MBE utilization data being reported to Congress. We determined that the reported data were incomplete, inconsistent, untimely, and filled with significant errors. The problems were the result of: (1) a poorly designed reporting form (prescribed by the U.S. Department of Commerce), (2) a lack of clear data definitions and reporting guidance from EPA, and (3) little or no data validation throughout the reporting process. Consequently, the information reported to Congress by the Administrator did not provide an accurate picture of EPA's MBE accomplishments.

RECOMMENDATIONS

We recommend that the Director, OSDBU:

1. Modify the SF-334 and related guidance to collect utilization data based on actual, rather than planned, awards.
2. Work with EPA regions and state agencies to develop specific and consistent reporting definitions.
3. Institute data validation procedures throughout the reporting process.

MATTERS FOR CONGRESSIONAL CONSIDERATION

EPA's MBE goal, as authorized in the fiscal 1991 and 1993 Appropriation Acts, is based on the value of contracts awarded, not the amounts paid to MBEs. Computing MBE utilization based on contract awards does not accurately reflect MBE accomplishments. The amount of a contract award represents potential, not actual, utilization. It would be more accurate to require recipients to report MBE utilization based on actual payments.

EPA's current practice is consistent with the direction provided in the Appropriation Acts. However, this practice does not accurately measure the program's annual performance. We will, therefore, refer this matter to the Committee for consideration in revising the legislative requirement.

AGENCY COMMENTS

EPA generally agreed with our findings and recommendations. The Agency stated that the areas highlighted in the report "raise sufficient concerns that require immediate attention". EPA has proposed general corrective actions, which when developed in further detail and implemented should improve the reliability of its MBE utilization data.

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CHAPTER 1

INTRODUCTION

PURPOSE

The U.S. House of Representatives Committee on Appropriations (Committee), in House Report 103-555, expressed a continuing concern that prime contractors do not comply with the U.S. Environmental Protection Agency's (EPA) Minority Business Enterprise (MBE)² requirements. The Committee requested the Office of Inspector General (OIG) to:

...determine the extent to which this disregard of a Federal mandate (underscoring added) prevails within the contracting community ... [and] to the extent possible ... review the process by which state and local governments award and monitor contracts.

We, therefore, reviewed the MBE activities of EPA financial assistance recipients. Our objectives were to determine whether:

- State and local governments awarded and monitored contracts in compliance with EPA's MBE requirements.
- State and local government prime contractors were meeting the MBE program requirements.
- EPA's utilization data for the MBE program were accurate.

BACKGROUND

In response to President Carter's National Urban Policy of March 1978, EPA established goals for MBE use in the Wastewater Treatment Construction Program. The Agency policy required regional offices to establish goals to ensure participation of minority-owned businesses. Simultaneously, EPA set a separate national goal of 2 percent for use of

²For purposes of this report, the term "MBE" includes both minority-owned and women-owned businesses, unless otherwise noted.

women business enterprises (WBE) in the Construction Grants Program.

In March 1983, EPA implemented "Procurement Under Assistance Agreements Regulation" (40 Code of Federal Regulations, Part 33). The regulation requires recipients of EPA financial assistance to award a "fair share" of subagreements to MBEs, whenever possible. EPA's fair share policy is a numeric objective derived through negotiations between EPA officials and state environmental agencies or recipients of EPA funds. The regulations also require recipients to follow six affirmative steps toward achieving these goals. The six steps include:

- placing qualified MBEs on solicitation lists;
- assuring that MBEs are solicited whenever they are potential sources;
- dividing total requirements, when economically feasible, into small tasks or quantities to permit maximum MBE participation;
- establishing delivery schedules, where the requirements allow, which encourage MBE participation;
- using the services and assistance of the U.S. Department of Commerce's Office of Minority Business Enterprise, as appropriate; and
- requiring the prime contractor, if subcontracts are to be awarded, to take the affirmative steps listed above.

The fiscal 1991 Appropriations Act temporarily authorized EPA to establish a minimum 8 percent goal for the use of "prime and subcontracts awarded in support of authorized programs, including grants, loans, and contracts for wastewater treatment and leaking underground storage tanks grants." Congress also directed the Administrator to annually report the Agency's efforts in achieving the 8 percent goal. EPA's fiscal 1993 Appropriations Act made the 8 percent goal permanent.

EPA's Office of Small and Disadvantaged Business Utilization (OSDBU) is responsible for establishing policy and providing procedural guidance for the utilization of minority and women-owned businesses under the Agency's financial assistance program. EPA reported distributing over \$9 billion in financial assistance to states from fiscal 1991

through 1993. Of this total, EPA reported the states obtained over \$6 billion in goods and services, about \$868 million from MBEs. This results in a reported MBE utilization rate for the three-year period of about 14 percent. For the ten-year period ended September 30, 1993, EPA financial assistance recipients reported an average MBE utilization rate of 15 percent.

SCOPE AND METHODOLOGY

Our review focused on MBE activities within financial assistance programs during fiscal 1991 to 1993. Recipients awarded the majority of procurement dollars during this period in the State Revolving Fund and Construction Grant programs. Therefore, we focused our review on these two program areas.

The number of locations included in our fieldwork was set based on the reporting deadline established by the Committee (April 1995). We selected three states based on one or more of the following criteria:

- the amount of EPA financial assistance provided to the state from fiscal 1991 to 1993,
- the MBE utilization data reported from fiscal 1991 to 1993,
- suggestions from selected national minority organizations and EPA's OSDBU, and
- the amount of time dedicated to the MBE program by EPA's regional coordinators.

We reviewed Massachusetts (EPA Region 1) because it was a major recipient of EPA financial assistance. Massachusetts' fiscal 1991 to 1993 reports showed a significant increase in the percent of contract dollars awarded to MBEs. Also, OSDBU reported MBE compliance problems and was concerned that this state's utilization reports were inaccurate. We included Ohio (EPA Region 5) because of specific interest by the Committee. Also, Ohio's level of EPA financial assistance and procurement activities ranked it in the top five states nationwide. Finally, we examined Kansas (EPA Region 7) because it was one of the few states that reported more contract dollars awarded to women-owned businesses than minority-owned businesses. Also, over a three-year period, the state's reported MBE use ranged from 58 percent to less

than 1 percent. Finally, Regions 1 and 7 have part-time MBE Coordinators, while Region 5 has a full-time Coordinator.

We conducted fieldwork at the EPA regional office responsible for each selected state. We reviewed Federal regulations and conducted interviews with officials from EPA's OSDDBU and Regions 1, 5, and 7. We also interviewed individuals from state and local offices, national minority organizations, and contractors. Finally, we analyzed statistical information reported to Congress and reviewed bid and proposal documents.

On April 17, 1995, we issued a draft report to the Chief of Staff, Office of the Administrator. We held an exit conference and received the Agency's response on May 2, 1995 (see Appendix 1). Based on their response and discussions at the exit conference, we made appropriate changes for this final report.

This review was a short term study of EPA activities. It was not designed to be a statistical research study or a detailed audit. The results of our review, unless specifically stated in the report, cannot be projected to a national level. The review was more limited in scope than an audit and, as such, did not necessarily encompass all generally accepted governmental auditing standards. We conducted this review according to the provisions of OIG Manual Chapter 150, Special Reports. We conducted our fieldwork from October 19, 1994 through April 11, 1995.

PRIOR AUDIT COVERAGE

There were no recent audits of EPA's MBE Program.

CHAPTER 2

ALLEGED ABUSES WITHIN THE MBE PROGRAM

The Committee had received allegations of various abuses within the MBE program. The Committee requested that we determine whether: (1) recipients of EPA financial assistance agreements encouraged use of MBEs through their contract procedures, (2) prime contractors used MBEs as pass throughs for money, (3) prime contractors named MBEs on bid documents without their knowledge, and (4) prime contractors awarded MBEs large dollar contracts, but only exercised a fraction of the available contract. For two of three states examined, recipients had proactive contracting procedures which encouraged the use of MBEs. There were indications of MBEs being used as pass throughs for one of the six projects we reviewed. We only became aware of the situation because a recipient had taken proactive steps to identify and correct the abuse. We did not find that prime contractors named MBEs on bid documents without their knowledge nor that prime contractors exercised less than the full value of MBE contracts.

CONTRACTING METHODS GENERALLY ENCOURAGED USE OF MBES

There appears to be a connection between state requirements for MBE utilization and the effort expended in meeting EPA's goal. Massachusetts and Ohio have their own requirements for the use of MBEs in state procurement activities. In these two cases, the state requirement for MBE participation is greater than EPA's 8 percent goal. Meeting state requirements, therefore, tends to assure the EPA goal is addressed. Kansas, on the other hand, does not have a state requirement for MBE utilization. Its use of MBEs is accomplished without formal, proactive efforts.

EPA regulations include six affirmative steps to use for achieving MBE goals. One step requires contractors to include MBEs on solicitation lists. Ohio and Massachusetts use state organizations to certify and maintain lists of MBEs. Recipients and their prime contractors use the state list to identify MBEs for solicitation. Kansas, in contrast, does not have an MBE certification program or a centralized listing of MBE firms. Kansas looks at bid documents to see if certification information was provided for MBEs. If not, MBEs are requested to self-certify their eligibility.

All three states require the prime contractor to identify, during the proposal process, specific MBE firms to be used as subcontractors. Ohio verifies the MBEs' minority status and project participation by phone or letter. Massachusetts requires the prime contractor to provide evidence of MBE certification and letters of intent from the MBE subcontractors. In Kansas, steps are taken to verify MBE certification only.

Kansas officials described their attitude towards EPA's MBE requirements as "laissez-faire". In 1991, EPA Region 7 issued a report stating that Kansas was in noncompliance with MBE requirements. In 1992, Kansas hired a consultant who also concluded that the state was in noncompliance. However, neither EPA nor Kansas took any corrective actions. Kansas officials stated that they assume their activities are acceptable since no penalties have been assessed for noncompliance.

MBES NOT USED AS PASS THROUGHES

The Committee and a national minority business organization expressed concerns that prime contractors were using MBEs as pass throughs. That is, after receiving a subcontract, the MBE, in turn, subcontracted the work to a non-MBE. Thus, money was passed from the prime contractor, through the MBE, to a non-MBE contractor and, therefore, the MBE performed no actual service.

There were indications of MBEs used as pass throughs in one of six projects we reviewed. However, we only became aware of this situation because the recipient had taken proactive steps to identify and correct the abuse. The Massachusetts Water Resources Authority (MWRA), an EPA recipient, had identified and taken action against this type of abuse. MWRA is responsible for the Boston Harbor Tunnel project. Of the total project cost of about \$4.3 billion, EPA provided about \$529 million through financial assistance agreements. MWRA hired a consultant (Coast and Harbor) to monitor prime contractors' compliance with MBE issues. When Coast and Harbor identified or suspected noncompliance with MBE requirements, it performed a review and presented MWRA with its conclusions. Since 1990, Coast and Harbor performed about 50 reviews on 20 contracts. As a result, MWRA fined contractors over \$600,000 for noncompliance with MBE requirements. In most instances MWRA reported that prime contractors hired MBEs, but the MBEs did not use their own work force.

Because this type of abuse usually involves collusion of two or more parties, discovering it through standard audit tasks is time consuming and uncertain. We, therefore, relied on recipients, MBEs, and others to provide us specific allegations to pursue. Although several sources expressed a belief that pass throughs were a problem, we received only one specific allegation to investigate. Based on subsequent fieldwork, we concluded that there was no support for the allegation.

MBES KNOWINGLY NAMED ON BID DOCUMENTS

Contract proposals usually include a list of subcontractors. This list identifies specific MBE firms the prime contractor intends to use in meeting MBE requirements. The Committee received complaints that prime contractors were naming MBEs on bid documents without the MBEs' knowledge. Then, after receiving the award, prime contractors were either performing the work themselves or using non-MBE firms. This practice gives the appearance of MBE use in order to obtain awards, when in fact there is none.

All three states require prime contractors to include, on the bid documents, the names of MBE firms to be used as subcontractors. We selected a sample of MBEs included on bid documents in each of the three states reviewed. These MBEs confirmed that they were aware of their firm being included on the bid documents.

During our review, we found examples of specific controls used to prevent this type of abuse. For recipients who do not have a defined MBE program, Ohio contacts all of the MBEs listed to verify project participation. Massachusetts requires the winning prime contractor to provide letters of intent signed by the MBE subcontractors attesting to their participation.

Our work did not support the allegation that prime contractors were naming MBEs in contract proposals without their knowledge.

CONTRACTORS FULLY EXERCISED MBE AWARDS

Recipients report MBE utilization based on the total potential value of a contract at the time an award is made. The Committee received complaints that contractors were awarding large subcontracts to MBEs, but exercising only a

fraction of the contract's potential value. This practice would inflate a contractor's actual MBE utilization rate and overstate the financial benefits MBEs received.

In all three states reviewed, a sample of MBEs confirmed that they received at least, if not more than, the original contract amount. Our review provided no evidence that contractors were manipulating the system by exercising less than the contract awards.

CONCLUSION

Widespread abuses of the MBE requirements were not evident in our three state review. In two of the three states, recipients encourage the use of MBEs through their contract procedures. There were limited indications that MBEs were used as pass throughs in one project. However, the recipient took proactive steps to identify and correct these instances. We did not find indications of MBEs being named on bid documents without their knowledge nor MBEs being paid a small portion of the potential contract value.

CHAPTER 3EPA'S MBE UTILIZATION DATA

For the 10 year period ended September 30, 1993, EPA reported that its financial assistance recipients awarded 15 percent of their contracting dollars to MBEs. The Committee requested that we determine the reliability of the MBE utilization data being reported to Congress. We determined that the reported data were incomplete, inconsistent, untimely, and filled with significant errors. The problems were the result of: (1) a poorly designed reporting form (prescribed by the U.S. Department of Commerce), (2) a lack of clear data definitions and reporting guidance from EPA, and (3) little or no data validation throughout the reporting process. Consequently, the information reported to Congress by the Administrator may have understated or overstated the actual utilization rates. In either case, the data did not provide an accurate picture of EPA's MBE accomplishments.

We identified numerous errors, in the reporting and compiling of data, at all levels (i.e., contractors, recipients, states, regions, and OSDBU). The errors identified did not appear to be an intentional misrepresentation of the numbers, but rather the result of a defective reporting process, misunderstood requirements, or human error. The Director, OSDBU does not believe the data collection system is a material weakness. He stated that data problems are related to the manner in which regional staff approach and carry out their responsibilities.

THE REPORTING FORM AND PROCESS

EPA's MBE utilization data are the result of an information stream that begins at the recipient level and flows upward through the regional offices, to OSDBU, and ultimately to Congress. Recipients complete Standard Form 334 "MBE/WBE Utilization Under Federal Grants, Cooperative Agreements, and Other Federal Financial Assistance" (SF-334) for each assistance agreement on a quarterly basis. EPA's MBE Coordinators then summarize the information, for all states in their region, onto EPA Form 6005-2 "Quarterly MBE/WBE Consolidation Report" and submit the summary to OSDBU. Once a year, OSDBU consolidates the data into a report to Congress.

MBE Utilization

In addition to information identifying the individual financial assistance agreement, SF-334 requests data on (1) MBE Procurements Accomplished this Quarter and (2) Total Project Dollars Planned for Procurement this Fiscal Year. EPA Regions 1 and 5 are using these two data elements to calculate the MBE utilization rate as follows:

$$\frac{\text{Procurement Dollars Awarded to MBEs for the Quarter}}{\text{Procurement Dollars Planned for the Fiscal Year}} = \text{MBE Utilization Rate}$$

However, Procurement Dollars Planned for the Fiscal Year represents expectations and not actual awards. As such, the level of actual procurement dollars awarded may be understated or overstated. In addition, the two data elements used in the calculation are not compatible. As a result, the utilization percentages the Administrator reports have no meaning.

Calculating an MBE utilization rate based on contract awards for any particular period requires dividing the total procurement dollars awarded to MBEs during that period by the total procurement dollars awarded to all firms during that same period as follows:

$$\frac{\text{Procurement Dollars Awarded to MBEs}}{\text{Procurement Dollars Awarded to All Firms}} = \text{MBE Utilization Rate}$$

The data which EPA requests from recipients does not include the appropriate information needed to produce the denominator in this calculation.

The Region 7 MBE Coordinator recognized the error in the data requested on the SF-334. In an effort to collect the appropriate data, the Coordinator modified the form by adding a field requesting total procurements awarded during the quarter. A Region 7 official subsequently advised the Coordinator that it was improper to revise the official form. Consequently, the Region requested recipients to report procurements awarded during the quarter in Section 6 [Comments] of the SF-334.

DATA DEFINITIONS AND REPORTING GUIDANCE

Protecting the quality of data reported from hundreds of individual sources requires a high level of consistency in defining what is or is not reported. EPA's reporting instructions are contained in its (1) Guidance for Utilization of Small, Minority and Women's Business Enterprises in Procurement Under Assistance Agreements (May 1986) and (2) instructions attached to SF-334. In reviewing the reporting process, we observed a wide variety of interpretations of what data to report.

OSDBU has not established clear definitions for reporting the data. Definition issues include determining the level of award activity which must be reported and reporting awarded amounts versus actual expended amounts. Additional definition issues include reporting amounts outside the fiscal year in which the activity occurred and reporting activity for projects which have no EPA funding.

The problems of inconsistent data definitions and reporting practices are known among states and EPA regions. However, efforts to obtain improved direction from OSDBU have not been successful. In August 1994, OSDBU sponsored a national conference attended by representatives from EPA regions and states receiving EPA assistance agreements. During the conference, attendees formed work groups to identify and discuss problems in the MBE program. Conference participants identified inconsistent data definitions and reporting practices as problem areas. EPA's Acting Deputy Regional Administrator for Region 1 supported the need to correct the problems identified at the national conference in a memorandum to the OSDBU Director in September 1994. However, as of March 31, 1995, OSDBU had not resolved the concerns addressed at the conference and in Region 1's memorandum.

We observed that individuals preparing the reporting forms at the recipient and regional levels had problems similar to the issues raised at the national conference. For example:

- Recipients do not report based on a consistent universe of activity. The instructions for the SF-334 contain separate reporting thresholds for both financial assistance and procurement awards (i.e., below certain dollar levels reporting is not required). A footnote to these instructions states "There is no reporting threshold for...EPA. Recipients...must report under all assistance agreements regardless of the size of the award". Recipients' reports indicate there is confusion

as to the applicability of thresholds for reporting. Region 7 sends letters to all its recipients advising that all procurement activity must be reported regardless of dollar amount.

- Recipients do not consistently report on MBE accomplishments. Recipients are not consistently reporting on projects that contain both Federal and state funding. Massachusetts reports the Federal portion, while Ohio and Kansas report on both the Federal and state portions. Also, we observed that Kansas reported on a project that does not have any Federal funding.
- Recipients do not timely report MBE utilization. At the direction of OSDDBU, recipients include previously unreported data from prior periods in current period reports. For example, one recipient reported a procurement which had occurred more than a year prior to being reported.
- Recipients do not consistently report MBE utilization. Some recipients report total contract value at the time it is awarded. Others report actual contract disbursements at the time of payment. Some recipients reported a combination of awarded and disbursed amounts.

These types of errors may result in either an understatement or an overstatement of the MBE utilization rate. During our review, we identified errors which, when corrected, would increase or decrease the reported utilization rates. The limited scope of our review and the number and variety of errors prevented us from determining the cumulative effect of the errors. In any event, the errors resulted in inaccurate reporting of MBE accomplishments.

DATA VALIDATION

Data validation is essential to the process of ensuring the information from the recipients is supportable and accurately compiled by EPA. Validation of data, performed on a regular basis, is designed to detect errors which procedural controls did not prevent. Without validation, there is no reasonable assurance that the data reported are reliable.

We discussed procedures with people involved in the reporting process at the state, regional, and OSDDBU levels. The Director, OSDDBU stated that regional staff are responsible

for examining and analyzing data for reasonableness. However, our review found that their efforts primarily focused on collecting and summarizing data reported to them. Little or no efforts were made to examine or analyze the data for reasonableness. The OSDBU employee responsible for compiling the data at a national level stated that her review consists of checking for mathematical accuracy and transposition of numbers from one quarter to the next. As a result, errors go undetected and are passed through the reporting process.

Our examination of utilization data reported in three states identified numerous reporting errors, even though our efforts were limited in time and scope. Reasonable data validation efforts would likely have identified and corrected the following errors:

- In fiscal 1992, Kansas reported \$21 million in procurements with WBE firms. This was significantly higher than had ever been reported in past periods and resulted in an unusually high MBE utilization rate of 58 percent. We reviewed supporting documentation and identified a typographical error in the report. Kansas should have reported about \$2 million in awards; a \$19 million discrepancy. We recalculated the figures correcting errors identified during our review. The result was 8 percent utilization versus the 58 percent originally reported.
- In fiscal 1993, an Ohio recipient reported a \$299,672 award to an MBE in the second quarter and again in the fourth quarter.
- In fiscal 1992, a Kansas recipient reported a \$71,733 award to an MBE in the third quarter and again in the first and second quarters of fiscal 1993.
- In fiscal 1993, Ohio's fourth quarter consolidation report did not include all of the recipients reported data. As a result, about \$1.3 million in MBE awards were not reported to OSDBU.
- In fiscal 1993, the Region 1 MBE Coordinator switched Maine's and Massachusetts' MBE awards. These figures were incorrectly reported to OSDBU on the second quarter consolidation report.
- In fiscal 1993, the Region 1 MBE Coordinator submitted the second quarter consolidation report, and supporting

documentation, to OSDDBU. The MBE awards reported on the consolidation report were about \$9 million higher than supported by the underlying documentation.

CONCLUSION

The current and historical data which the Administrator reports for EPA's MBE program are not reliable as a measure of success. They are, therefore, also not useful in monitoring the program's progress. Although EPA has reported an average utilization rate of 15 percent for the 10 year period through fiscal 1993, our review demonstrated significant weaknesses in the reporting process. We also identified numerous errors in the reported data. These weaknesses and errors may result in the data being either understated or overstated on a cumulative basis. Therefore, we cannot express an opinion on the actual rate of MBE utilization within EPA's financial assistance programs.

RECOMMENDATIONS

We recommend that the Director, OSDDBU:

1. Modify the SF-334 and related guidance to collect utilization data based on actual, rather than planned, awards.
2. Work with EPA regions and state agencies to develop specific and consistent reporting definitions.
3. Institute data validation procedures throughout the reporting process.

MATTERS FOR CONGRESSIONAL CONSIDERATION

EPA's MBE goal, as authorized in the fiscal 1991 and 1993 Appropriation Acts, is based on the value of contracts awarded, not the amounts paid to MBES. Computing MBE utilization based on contract awards does not accurately reflect MBE accomplishments. The amount of a contract award represents potential, not actual, utilization. It would be more accurate to require recipients to report MBE utilization based on actual payments instead of award amounts.

Consider the following hypothetical example.

A contractor awarded a three year subcontract to an MBE with a potential value of \$1 million. During each of the next three years, the MBE actually performs and is paid for work valued at \$250,000 annually.

Under the current practice, the prime contractor would claim \$1 million in MBE participation in the quarter during which the subcontract was awarded. Since the subsequent payments of \$750,000 are not considered in the reporting process, the prime contractor's utilization would ultimately be overstated by \$250,000 (\$1 million - \$750,000). Also, the year in which the utilization is reported differs from the year in which the MBE performs the work and is paid. In contrast, reporting utilization based on actual payments to MBEs would result in correctly claiming \$750,000 in MBE use. It would also cause the utilization to be claimed within the three separate years in which the contract performance took place.

EPA's current practice is consistent with the direction provided in the Appropriation Acts. However, this practice does not accurately measure the program's annual performance. It does, however, create the possibility that contractors could manipulate the system by exercising only small portions of large contract awards. Although we did not find evidence that this abuse was occurring (see p. 7), it would be prudent to revise the reporting base to prevent future abuses.

Changing the reporting basis should not increase the reporting burden on recipients. Under our proposal, utilization reports would contain data on actual payments made to MBEs instead of data on awards. Contractors should be able to easily obtain a summary of payments to MBEs from their accounting systems.

We will refer this matter to the Committee for consideration in revising the legislative requirement.

AGENCY COMMENTS

EPA generally agreed with our findings and recommendations. The Agency stated that the areas highlighted in the report "raise sufficient concerns that require immediate attention". EPA's response proposed several general corrective actions including (1) development of an automated data collection system, (2) working with regional staffs to develop new reporting definitions, (3) implementing an Oversight and

Analysis Workgroup, and (4) developing a certification program for regional staffs and state representatives.

OIG EVALUATION OF AGENCY COMMENTS

The actions proposed, when developed in further detail and implemented, should improve the reliability of EPA's MBE utilization data. For corrective actions planned, please provide details, supporting documentation, and reference the actions to specific milestone dates.

OFFICE OF THE ADMINISTRATOR'S
RESPONSE TO OIG DRAFT REPORT

3-52:5



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

MAY - 2 1995

OFFICE OF
THE ADMINISTRATOR

MEMORANDUM

SUBJECT: Draft Report of Review - MBE Utilization in EPA's
Financial Assistance Programs

FROM: Peter D. Robertson *Peter D. Robertson*
Chief of Staff

TO: Kenneth A. Konz
Acting Deputy Inspector General

This responds to your memorandum of April 7, 1995, requesting that we consolidate comments from the various interested parties regarding the above report. The Office of Small and Disadvantaged Business Utilization (OSDBU) received and consolidated the comments for this report.

The draft report was sent to eighteen recipients. Of the eighteen, only six responded as requested. The responses were from Regions 5 and 7; the States of Massachusetts, Ohio, and Kansas; and the headquarters Grants Administration Division.

Generally, there was consensus that the overall recommendations contained in the IG report had merit. Although there were some disagreements with the general findings, these focused on specific actions and did not adversely impact the recommendations as such. EPA Region V took great exception to the findings made relative to the MBE/WBE programs in Ohio. We also noted the sense of frustration with the reporting requirements and characterization of the program as an unfunded mandate by the State of Kansas. Additionally, the State indicated that the legislature terminated funding for the MBE/WBE program because of poor participation by MBE/WBE participants as well as the high cost of maintaining the program. This is an area that will require further discussion with the State.

Regarding the IG's three specific recommendations, the following represent the consensus of the responding parties:

Recommendation 1

Modify the SF-334 and related guidance to collect utilization data based on actual, rather than planned, awards.

Response to Recommendation 1

In reference to the IG recommendation to modify the SF-334 and related guidance to collect actual rather than planned utilization data, the Massachusetts Department of Environmental Protection, Ohio Environmental Protection Agency, the Kansas Department of Health and Environment and the Grants Administration Division concurred in this recommendation. EPA staffs in Regions 5 and 7, in addition to our OSDBU office, recognized the need to modify the SF-334.

Changing the focus of data collection may require additional training of state representatives. It may also require additional accounting systems or workyears especially at the state or local level. OSDBU anticipates some reluctance by the states to a modification of this form because some states feel the MBE/WBE data collection has become so time-consuming they would prefer not collecting the data. In view of the above, OSDBU is in the process of developing an automated data collection system which gives them primary responsibility for oversight and analysis of this effort. OSDBU will test the viability of the automated data collection system with the States prior to nationwide implementation.

Recommendation 2

Work with EPA regions and state agencies to develop specific and consistent reporting definitions.

Response to Recommendation 2

In response to this IG recommendation, concurrences were received from the Massachusetts Department of Environmental Protection and the Kansas Department of Health and Environment as well as the Grants Administration Division. Regions 5 and 7 took exception to specific examples cited by the IG in the preparation of this report such as the term "widespread" abuses and the regional data validation processes. The response from the Ohio Environmental Protection Agency did not directly address the issue of reporting definitions. However, OSDBU had already initiated plans to develop clearer reporting definitions. At a recent training conference, EPA regional staffs joined with OSDBU to develop the new reporting definitions which will be shared with the states later this year.

Recommendation 3

Institute data validation procedures throughout the reporting process.

Response to Recommendation 3

The Massachusetts and Kansas Departments of Environmental Protection concur in this recommendation. The Ohio Environmental Protection Agency in response to this recommendation indicated they will institute an internal system of checks and balances to validate their data. We will be working with them on this matter.

OSDBU concurs in principle with this recommendation. They believe that an automated data reporting system, coupled with the implementation of their Oversight and Analysis Workgroup, will lead to the development of a sound data validation system. Furthermore, OSDBU's implementation of a certification program for regional staffs and state representatives will greatly minimize any confusion at either the regional or state levels regarding reporting requirements, definitions, and requisite procedures.

In summary, we feel that the areas highlighted by the IG raise sufficient concerns that require immediate attention. On the other hand, the formula used for data collection, which is Congressionally-mandated, has served the Agency well in promoting greater participation of minority and women contractors in the Agency's procurement and financial assistance programs. Given the IG's concerns, we are committed to intensifying our efforts to ensure a greater level of efficiency and effectiveness in our overall operations.

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ABBREVIATIONS

Committee	The U.S. House of Representatives Committee on Appropriations
EPA	U.S. Environmental Protection Agency
MBE	Minority Business Enterprise
MWRA	Massachusetts Water Resources Authority
SF-334	Standard Form 334 - MBE/WBE Utilization Under Federal Grants, Cooperative Agreements, and Other Federal Financial Assistance
OIG	Office of Inspector General
OSDBU	Office of Small and Disadvantaged Business Utilization
WBE	Women Business Enterprise

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