

# DISABLED VETERAN BUSINESS ENTERPRISE PROGRAM

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## ***Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success***

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### *Audit Highlights . . .*

*Our review of the Disabled Veteran Business Enterprise (DVBE) program found that:*

- Many awarding departments do not report their DVBE participation levels; of those that do report, most do not meet the 3 percent participation goal.*
- The reasonableness of the 3 percent goal itself is not clear.*
- Outreach to potential DVBEs should be more aggressive.*

*Other factors that contribute to the State's failure to meet the DVBE goal are:*

- The program's overly flexible legal structure and limited clarifying regulations.*
  - The frequency with which certain departments exercise their discretion to exempt contracts from DVBE participation.*
  - Lack of effective evaluation of bidders' good-faith efforts and monitoring of contractors' compliance with contract DVBE requirements.*
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REPORT NUMBER 2001-127, JULY 2002

Departments of General Services', Transportation, and Health Services and Health and Human Services Agency responses as of January 2003<sup>1</sup>

The Joint Legislative Audit Committee requested that we determine the extent to which departments that award contracts (awarding departments) are meeting the 3 percent Disabled Veteran Business Enterprise Program (DVBE) participation goal and to identify statutory and procedural mechanisms that could assist in overcoming any barriers to fulfilling this goal. We found that many awarding departments do not report DVBE participation as required under law, and even fewer departments actually meet the goal. Specifically, we found:

**Finding #1: Awarding departments' DVBE participation statistics are not always accurate, and the methodologies they employ are at times flawed.**

State law requires each awarding department to report to the governor, Legislature, the Department of General Services (General Services), and the Department of Veterans Affairs (Veterans Affairs) by January 1 each year on the level of participation by DVBEs in state contracting. General Services then issues a summary report.

Our own review showed that some awarding departments did not report DVBE statistics and others could not always provide supporting documentation for the DVBE statistics they reported. For example, for fiscal year 2000-01, the Department

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<sup>1</sup> Department of Veterans Affairs; Youth and Adult Correctional; State and Consumer Services; Business, Transportation and Housing; and Resources agencies responses as of September 2002.

of Fish and Game (Fish and Game) reported \$12.1 million in DVBE participation but could identify only \$431,000 in specific contracts, or less than 3.6 percent of the total. In addition, the Department of Health Services (Health Services) could not provide any summarized documentation for the numbers it reported. Health Services asserted that it had documentation in individual contract files to support its figures, but indicated it would be too time intensive to tally the information for our review.

Additional problems with the accuracy of DVBE participation information exist. The reporting methodology General Services established is contrary to statutory requirements. According to statute, the 3 percent DVBE participation goal applies to the overall dollar amount expended each year by the awarding department. However, under current reporting regulations issued by General Services, awarding departments must report the amount winning bidders “claim” they will pay to DVBEs under the contract. In its clarifying instructions, General Services has asked awarding departments to report the amounts “awarded” in contracts, rather than amounts actually paid to DVBEs.

To ensure DVBE statistics are accurate and meaningful, we recommended General Services require awarding departments to report actual participation and maintain appropriate documentation of statistics, continue its periodic audits of these figures for accuracy, and, if the audits reveal a pattern of inconsistencies or inaccuracies, address the causes in its reporting instructions.

***General Services’ Action: Partial corrective action taken.***

General Services has interpreted the statutes governing DVBE reporting to provide participation statistics to be reported based on the value of contracts awarded instead of dollars actually expended. According to General Services, this is the same methodology used in the small business participation report (California Government Code, Section 14840). General Services believes it is important to use consistent reporting standards to allow for program comparisons. Nevertheless, General Services is revisiting this issue based on the concerns raised by the Bureau of State Audits. However, a General Services’ consultant concluded that reporting actual data would be costly.

As to the issue of requiring departments to maintain documentation of participation statistics, General Services has added an instruction to the new participation report form that addresses the necessity of maintaining supporting documentation. General Services is also continuing to

include the audit of the DVBE reporting process within its comprehensive external compliance audit program performed of other state agencies. The results of these audits are being used to identify areas for possible improvement within the reporting process.

**Finding #2: Not all state agencies have finalized and implemented their plans to monitor their departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, require a DVBE improvement plan.**

In June 2001, the governor issued executive order D-43-01, which requires all state agency secretaries to review the DVBE participation levels achieved by the awarding departments within their agencies. Further, the executive order requires each secretary to require awarding departments to develop an improvement plan if the 3 percent goal is not achieved or the data is not reported. Three of five state agencies responding to our survey indicated that they were still developing procedures to monitor the DVBE participation levels of their subordinate awarding departments.

We recommended those state agencies that have not already done so should finalize and implement their plans to monitor awarding departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, monitor their efforts to improve DVBE participation.

***Agency Action: Partial corrective action taken.***

On June 28, 2002, the Governor directed that all state departments and agencies submit monthly reports to the State and Consumer Services Agency regarding DVBE participation. Based on the reporting forms developed by the State and Consumer Services Agency, state departments and agencies are required to report total contracting dollars, dollars paid to DVBEs, and DVBE participation percentages. In addition, departments that have not met the 3 percent DVBE participation goal are required to explain why.

The Health and Human Services Agency (HHS) indicates that it has established policies to monitor department reporting of DVBE participation. In compliance with the governor's executive order D-43-01, HHS has collected and submitted department improvement plans for increased



DVBE participation. The Business, Transportation and Housing Agency indicates it is monitoring DVBE participation and providing oversight of all its departments and offices. It reports that the agency as a whole exceeded the 3 percent participation goal for fiscal year 2001–02 and thus far in the current fiscal year has further increased its participation rate. The Youth and Adult Correctional Agency; State and Consumer Services Agency; and the Resources Agency did not submit a six-month response addressing this recommendation.

**Finding #3: The State does not know how many DVBEs can be certified and the extent to which they can provide needed goods and services to the State. As a result, the reasonableness of the 3 percent goal is uncertain.**

Even though the law establishes a 3 percent participation goal for every awarding department, our review did not find sufficient evidence to support the assumption that this is an equitable share of contracts for DVBEs. When the DVBE legislation was being drafted in 1989, several awarding departments opposed the bill on the grounds that the 3 percent goal was unrealistic.

The awarding departments' concern about enough DVBEs to justify the 3 percent goal seems to have been valid. As of May 2002, General Services had only 797 DVBEs certified and available for contracting. The services these DVBEs offered and their geographical distribution did not always match the State's needs. All five agencies responding to our survey and many awarding departments' improvement plans identified a limited pool of DVBEs as one of the impediments to meeting the 3 percent DVBE participation goal.

To determine if the 3 percent DVBE goal is reasonable, the Legislature may wish to consider requiring either General Services or Veterans Affairs to commission a study on the potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs.

Based on the results of this study, the Legislature may wish to consider doing the following:

- Modify the current DVBE participation goal.

- Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.

***Legislative Action: None.***

We have found no indication that any study on DVBE-eligible firms has been commissioned. Further, the DVBE participation rate remains at 3 percent, while the reasonableness of this goal remains unclear.

***Veterans Affairs' Action: None.***

According to Veterans Affairs' September 2002 update to its response to the audit, it is intending to commission a study on the potential number of DVBE eligible firms in the State. However, it is unclear if this step has been taken because Veterans Affairs has not submitted its six-month update of its response, which was due in December 2002.

**Finding #4: General Services is not sufficiently aggressive or focused in its outreach and promotional efforts for the DVBE program.**

As the administering agency for the DVBE program, General Services has been responsible for certifying eligible businesses as DVBEs and conducting promotional and outreach efforts to increase the number of certified DVBE firms.

It is unclear to what extent General Services' outreach activities target disabled veterans' groups. General Services was also unable to readily quantify its outreach activities. The information it ultimately provided was based on old personal calendars and planners. We also could not evaluate the effectiveness of these outreach activities since General Services only selectively monitors the results.

To ensure the DVBE program is promoted to the fullest extent possible, we recommended General Services aggressively explore outreach opportunities with the U.S. Department of Veterans Affairs and organizations such as the American Legion, Disabled American Veterans, and Veterans of Foreign Wars. In particular, General Services should cultivate a clear working relationship with county veteran service officers. It should also maintain complete records of its outreach and set up a system to track effectiveness. For example, General Services could consistently

survey newly certified DVBEs to determine how they heard about the program and what convinced them to apply for certification. Finally, General Services and Veterans Affairs should continue to work to develop their joint plan for improving the DVBE program, finalizing and implementing it as soon as possible.

***General Services' and Veterans Affairs' Action: None.***

On June 28, 2002, the governor directed the implementation of a more intensive DVBE outreach effort, with the resources dedicated to that effort moved from General Services to Veterans Affairs. According to General Services, on August 1, 2002, the two DGS staff members performing the outreach function physically transferred to Veterans Affairs.



Veterans Affairs has not provided a six-month update to its response on the above recommendation. According to its September 2002 response, Veterans Affairs anticipated having an outreach plan by January 1, 2003.

**Finding #5: Some awarding departments exempt a significant number of contracts, potentially limiting their ability to maximize DVBE participation rates.**

Under statute, the DVBE participation goal applies to an awarding departments' overall expenditures in a given year. Therefore, awarding departments have the discretion to apply DVBE participation requirements on a contract-by-contract basis.

The frequency with which certain awarding departments exempt contracts from DVBE requirements is significant. Further, some of these awarding departments are not tracking the value of the contracts they exempt or the required compensating increase in participation goals for their remaining non-exempt contracts. For fiscal year 2000–01, two of the five awarding departments we reviewed, Health Services and Caltrans, did not compensate for these exemptions with increased participation on other contracts, and subsequently reported they did not meet the participation goal. According to our calculations, Health Services exempted 48 percent of DVBE-eligible contract dollars it reported in fiscal year 2000–01, which means it would have had to average almost 6 percent on all remaining eligible contracts to meet the goal. Similarly, General Services' procurement division estimated that it exempted over 50 percent of its contracts during fiscal year 2000–01.

Awarding departments offer varying reasons for their exemption decisions. Some departments we reviewed exempt all contracts with certain characteristics, and the reasonableness of these blanket decisions may not be clear. For example, at least one unit within four of the five departments we reviewed has indicated it exempts all contracts it believes do not offer a subcontracting opportunity for DVBEs. However, this practice may significantly reduce a department's chances for obtaining more DVBE participation.

To maximize DVBE participation, we recommended awarding departments attempt to use DVBEs as prime contractors instead of viewing them only as subcontractors. Further, the awarding departments should periodically examine the basis for their assumptions behind blanket exemptions for whole categories of contracts to ensure the exemptions are justified.

***General Services', Health Services', and Caltrans' Action: Partial corrective action taken.***

As of January 2003, General Services, Health Services, and Department of Transportation (Caltrans) responded to this recommendation. General Services has restated its policy to staff, stating that all contracts will include a DVBE participation goal unless the chief deputy director grants a waiver from those requirements. Health Services indicates that as of September 2002, its contracting management unit began requesting Health Services' programs to confirm that no certified DVBE firms are available to perform likely subcontract services in the service location. Caltrans indicates that it will mail solicitation packages to qualified DVBEs when contracting opportunities become available for services they can perform.

**Finding #6: Awarding departments do not consistently scrutinize and evaluate good-faith effort documentation or ensure that DVBEs are actually being used as called for in contracts.**

The effectiveness of the implementation of the good-faith effort may be diminished by the lack of consistent or meaningful standards for awarding departments to follow when evaluating bidders' documentation of such efforts. Although statute requires General Services to adopt standards, it has not issued much direction to awarding departments on how to evaluate a bidder's good-faith effort. The State Contracting Manual offers

appropriate suggestions for procedures in assessing good-faith effort, but the suggestions are not binding. There is also no clear requirement in statute requiring awarding departments to monitor actual DVBE participation to ensure the contractor is complying with the contract's DVBE requirements.

A common result of this lack of direction is the cursory evaluation of a bidder's good-faith effort documentation and inconsistent monitoring of actual DVBE usage. For example, Health Services does not instruct staff to independently verify bidders' statements that they solicited DVBEs to participate as subcontractors. Before February 2002, Health Services also lacked policy to monitor actual DVBE participation. Caltrans also does not follow up to ensure the DVBEs that the bidder claimed to have solicited were actually contacted. Although Caltrans' procurement unit did have a policy to monitor actual DVBE participation to ensure contract compliance, we saw no monitoring consistent with this policy in a sample of their contract files.

To ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies. General Services should issue regulations on what documentation the awarding departments should require and how they should evaluate that documentation. These standards should include steps that ensure the documentation submitted is accurate. Similarly, General Services should issue regulations on what steps departments should take to ensure contractors meet DVBE program requirements. These steps might include requiring awarding departments to monitor vendor invoices that detail DVBE participation or requiring the vendor and DVBE to submit a joint DVBE utilization report.

***Legislative Action: None.***

We found no indication that the Legislature has required awarding departments to follow General Services' policies regarding the evaluation of bidders' good-faith effort documentation.



***General Services' Action: None.***

General Services has indicated it has not yet had the resources to address this recommendation. However, it plans to review the feasibility of adding the recommended provisions to regulations.

**Finding #7: The efficiency and effectiveness of the DVBE program could be improved with legislation aimed at providing incentives for DVBE participation and penalties for bidders who do not comply with program requirements.**

Legislation establishing the DVBE program does not have adequate provisions to ensure compliance with program goals.

To increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following:

- Replace the current good-faith effort step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.
- Enact a contracting preference for DVBEs similar to the one for the small business program—that is, allow an artificial downward adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.
- Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.
- Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.



***Legislative Action: None.***

We found no indication that the Legislature has passed legislation addressing the recommendations presented above.

