

# Key Points of Report

## **An Audit Report on Compliance With Historically Underutilized Business Requirements**

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March 1998

### **Overall Conclusion**

In fiscal year 1997, the 20 state entities reviewed for compliance with state Historically Underutilized Business (HUB) requirements demonstrated "good-faith" efforts to increase purchases from HUB vendors. However, the State's HUB program could be enhanced to encourage HUB recertification and prime-contractor monitoring and through fully excluding from HUB calculation expenditures not subject to HUB regulations.

### **Key Facts and Findings**

- Twelve of the 20 entities exceeded the statewide goal in at least one expenditure category.
- These 20 entities spent a total of \$328,693,534 in applicable expenditures. Of this amount, \$36,496,057, or 11.1 percent, was spent with HUB vendors.
- The number of certified HUBs decreased in fiscal year 1997. Additionally, state entities have not been fully adhering to HUB requirements when contracting with prime contractors, and all expenditures not subject to HUB regulations are not fully excluded in HUB calculations.

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*These compliance audits were conducted in accordance with Chapter 321 of the Texas Government Code and Article IX of the 74th Texas Legislature's General Appropriations Act.*

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Section 1:

## All 20 Entities Reviewed for Compliance with State Historically Underutilized Business (HUB) Requirements Demonstrated “Good-Faith” Efforts

In fiscal year 1997, the 20 state entities reviewed by the State Auditor's Office for compliance with state Historically Underutilized Business (HUB) requirements demonstrated “good-faith” efforts to increase purchases from HUB vendors. Twelve of the 20 entities exceeded the statewide goal in at least one expenditure category.

For fiscal year 1996, the General Services Commission (GSC) changed the single, statewide goal of 30 percent HUB participation. Now, instead of one statewide participation goal, six separate expenditure categories exist, and each of these categories has statewide participation goals as shown in Table 1.

Table 1

HUB Expenditure Categories			
Category	Unadjusted HUB Goal <sup>1</sup>	Other HUB Goal <sup>2</sup>	Adjusted HUB Goal <sup>3</sup>
Heavy Construction	11.9%	5.3% (WO)	6.6% (BL, HI, AS, AI)
Building Construction	26.1%	1.0% (AS, AI)	25.1% (BL, HI, WO)
Special Trade Construction	57.2%	10.2% (AS, AI, WO)	47.0% (BL, HI)
Professional Services	20.0%	1.9% (AS, AI)	18.1% (BL, HI, WO)
Other Services	33.0%	N/A	33.0% (BL, HI, AS, AI, WO)
Commodity Purchasing	12.6%	1.1% (AS, AI)	11.5% (BL, HI, WO)
<sup>1</sup> Unadjusted HUB Goal - consists of all minority vendors. <sup>2</sup> Other HUB Goal - consists of categories considered not to be under utilized. <sup>3</sup> Adjusted HUB Goal - is the result of subtracting the “Other HUB Goal” from the “Unadjusted HUB Goal” column. AI - American Indian AS - Asian Pacific American BL - Black American HI - Hispanic American WO - Women (all women excluding AI, AS, BL, and HI women)			

Source: The information source for total and HUB expenditures was the General Services Commission's *Annual Historically Underutilized Business (HUB) Report for Fiscal Year 1996*.

The 20 entities reviewed spent a total of \$328,693,534 in applicable expenditures during fiscal year 1996. Of this, \$36,496,057, or 11.1 percent, was spent with HUB vendors.<sup>1</sup> (See Table 2 for more detailed information about the HUB-related performance of the 20 entities.)

<sup>1</sup> The GSC excludes payments for claims and judgments, interfund transfers, interagency payments, investments, interest payments, principal payments, public assistance payments, rentals and leases, utilities, salaries, benefits, travel, grants, scholarships, real estate purchases, right-of-ways, and bonds.

Table 2:

HUB Performance					
Entity	Percentage of Applicable Payments to HUBs	Good-Faith Effort	Categories in which HUB Goal was Exceeded (Fiscal Year 96)	Total Applicable Expenditures (Fiscal Year 96)	HUB Expenditures (Fiscal Year 96)
The University of Texas at Austin	12.11%	✓	None	\$148,644,770	\$18,005,478
University of Houston	7.29%	✓	None	61,178,345	4,457,205
The University of Texas Health Science Center at San Antonio	11.12%	✓	Commodity Purchasing	33,201,367	3,693,380
Stephen F. Austin University	5.11%	✓	None	18,324,158	935,709
Prairie View A&M	7.28%	✓	None	17,469,167	1,271,466
Sam Houston State University	11.37%	✓	None	11,470,788	1,304,251
Lamar University-Beaumont	15.16%	✓	Commodity Purchasing	9,986,394	1,514,138
Sul Ross State University	11.40%	✓	None	6,970,948	794,420
The University of Texas at Brownsville	21.95%	✓	Commodity Purchasing	5,905,013	1,295,920
Texas Water Development Board	15.80%	✓	Commodity Purchasing	4,187,655	661,535
Department of Housing and Community Affairs	32.77%	✓	Professional Services Commodity Purchasing	3,457,424	1,133,110
Workers' Compensation Commission	19.00%	✓	Commodity Purchasing	2,623,582	498,431
Library and Archives Commission	12.30%	✓	Commodity Purchasing	1,965,985	241,822
Public Finance Authority	9.05%	✓	Commodity Purchasing	1,083,542	98,089
School for Blind and Visually Impaired	18.16%	✓	Commodity Purchasing	1,012,032	183,816
Animal Health Commission	35.15%	✓	Commodity Purchasing	553,489	194,537
Board of Dental Examiners	43.37%	✓	Commodity Purchasing	280,313	121,581
Commission on Human Rights	5.84%	✓	None	205,771	12,019
Veterans Commission	54.60%	✓	Other Services Commodity Purchasing	144,970	79,150
Texas Aerospace Commission	0.00%	✓	None	27,821	0
Total of all entities	11.1%	20/20	12/20	\$328,693,534	\$36,496,057
✓ The entity achieved an acceptable level of effort toward meeting the GSC's criteria in the judgment of the auditor.					

Source: The information source for total and HUB expenditures was the General Services Commission's *Annual Historically Underutilized Business (HUB) Report for Fiscal Year 1996*.

There may be valid reasons why an entity might be considered to have made a good-faith effort if the entity did not attain the statewide goal, including:

- Not all expenditures within a given object or category of expense are subject to management's control. For example, an entity may be required to contract for essential services from another federal or state agency or nonprofit organization. These would appear as non-HUBs and would count against the entity's attainment.
- Fewer HUB firms may be available for certain specialized or local expenditures. While GSC rules allow an entity to modify its HUB goals according to such market-related considerations, not many have done so, and modified entity goals would not affect the GSC's HUB calculation.
- Some entities have continued to use "graduated" HUB vendors; doing so decreases the entity's HUB usage percentage because those dollars are considered non-HUB dollars.

In addition to published HUB results, the auditors considered the following types of information in determining whether the entity demonstrated good-faith:

- Planning: The entity included HUB policies, goals, and programs in its strategic plan (Government Code, Section 2161.123[a-c]).
- Activities: The entity designated a HUB coordinator who attended HUB training seminars and distributed HUB rules and procedures at marketing and other outreach events to locate potential HUB vendors.

Purchasers used the GSC's list and other sources to identify HUBs and provided contractors with a reference list of certified HUBs for subcontracting.

The coordinator instructed buyers on HUB requirements to have bond and insurance requirements that would reasonably permit more than one business to perform the work. The HUB coordinator also instructed buyers about HUB requirements to ensure specifications, terms and conditions reflect the entity's actual requirements (Government Code, Section 111, paragraph 8).

- Reporting Requirements: The entity met state reporting requirements including estimates of expected HUB vendor awards, monthly information, annual progress reports and self-reported subcontracted and non-treasury expenditures (Government Code Section. 2161.122(a-d)).

As further support for demonstrating a good-faith effort, entities may submit a supplemental letter including documentation as prescribed by the GSC (Government Code, Section 111.13). Examples of good-faith efforts could be:

- Identifying the percentage of contracts awarded to women and/or minority-owned businesses that are not certified as HUBs

- Demonstrating that a different goal was appropriate given the entity's mix of purchases
- Demonstrating that a different goal was appropriate given the particular qualifications required by an entity for its contracts
- Demonstrating that a different goal was appropriate given that graduated HUBs cannot be counted toward the goal

The State Auditor's Office communicated directly to management the strengths and weakness of each entity's HUB-related procedures. (See Table 3 for examples of weaknesses and strengths.)

Table 3

Observations About HUB-Related Procedures at Audited Entities	
Examples of Weaknesses	Examples of Strengths
<p>Contractors do not suffer a loss or pay a penalty for submitting low HUB participation percentages (for subcontractors).</p> <p>Some HUB goals seemed higher than the available pool from which HUB vendors could be chosen.</p> <p>Several state entities did not report their expected awards to HUBs by the 60th day as required by Government Code.</p> <p>Some contracts were closed before requiring prime contractors to show good-faith in subcontracting with HUBs by submitting a checklist and supporting documentation within 14 days following selection, but prior to award of the contract.</p>	<p>One entity hired a consultant to improve its HUB program.</p> <p>Some entities demonstrated marketing and outreach programs, such as holding vendor fairs, assisting vendors in getting certified, advertising in minority journals, and attending breakfast meetings with minority company owners.</p> <p>Some HUB coordinators and some purchasing managers have attended the GSC's Economic Opportunity Forum.</p> <p>Some HUB coordinators have attended training on HUB requirements.</p> <p>Many entities have included the HUB policies and goals in their strategic plans.</p> <p>Some HUB coordinators are making quarterly and sometimes monthly reports to the entity's management, in addition to their published HUB results.</p>

## The State's HUB Program Could Be Enhanced to Encourage HUB Recertification and Prime-Contractor Monitoring and to Fully Exclude Expenditures Not Subject to HUB Regulations

Through the review of 20 state entities, it was found that the State's HUB program could be enhanced in the areas of HUB recertification and prime-contractor monitoring, and through fully excluding from HUB calculations expenditures not subject to HUB regulations.

The number of certified HUBs decreased in fiscal year 1997. One of the possible reasons for this decline is a more stringent HUB certification process. The State may consider a survey of former HUB vendors to determine why they did not recertify. Information from the survey could be used to promote HUB certification.

We also found that entities have not been fully adhering to HUB requirements when contracting with prime contractors. Prime contractors do not suffer a loss or pay a penalty for low HUB participation, and some contracts close before prime contractors are required to show good-faith in subcontracting with HUBs. The legislation rider might be amended to emphasize the state entity's responsibility to monitor the HUB compliance of prime contractors.

Additionally, all expenditures not subject to HUB regulations are not fully excluded in HUB calculations. Through the Uniform Statewide Accounting System (USAS), the State might consider ways to fully exclude expenditures that are beyond management's control. For example, it might:

- Establish a category of vendor codes for contracts with state agencies, universities, and sole-source contracts.
- Establish new expense objects that can be excluded from HUB calculations.

Appendix:

## Objective, Scope, and Methodology

In accordance with Chapter 321 of the Texas Government Code and Article IX, Section 111 (9) of the 74th Legislature's General Appropriations Act, the State Auditor's Office has audited 20 entities in fiscal year 1997 to determine whether they had made a good-faith effort to increase their purchases and contracts with historically-underutilized businesses (HUBs).

The entities reviewed for compliance with HUB requirements were those scheduled for management control audits during fiscal year 1997.

To ensure quality and consistency across the reviews, the State Auditor's Office developed a standard audit program and an internal control questionnaire based on the HUB law and related riders and rules, piloted the program, refined it, and distributed it to audit teams beginning in August 1996. Although the audits looked primarily at the entity's performance in fiscal year 1996, the auditors were also provided fiscal year 1997 information as it became available.