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A Review of Selected Entities for Compliance with State Historically Underutilized Business Requirements

August 23, 1999

Members of the Legislative Audit Committee:

The nine entities reviewed during fiscal year 1999 for compliance with state Historically Underutilized Business (HUB) requirements demonstrated good-faith efforts to purchase goods and services from HUB vendors. This means that, while the nine entities may not have met all statewide goals for money spent with HUB vendors, they made reasonable efforts to achieve the goals. Agencies are not penalized for not meeting the HUB goals. Six of the entities exceeded the statewide HUB goal in at least one expenditure category.

The entities reviewed spent about \$14.5 million with adjusted HUB vendors (those recognized as being underutilized within six categories of expense) in fiscal year 1998, while the State spent approximately \$550 million with adjusted HUB vendors.

Attached you will find the following information:

- Details of HUB performance at the entities reviewed in fiscal year 1999
- Overview of the State HUB Program including a section on how participation is measured

Since fiscal year 1996, we have reviewed 60 state entities for compliance and found only one not making a good-faith effort. In *An Audit Report on Management Controls at Texas Woman's University* (University) published in August 1998 (SAO Report No. 98-066), we reported that the University was not complying with HUB requirements. In October 1998, we referred the University to the General Services Commission (Commission) for assistance. The Commission is statutorily responsible for assisting state entities in achieving compliance.

We recently received information from the University that indicates that it is working toward regaining compliance status and plans to fully resolve this issue by December 31, 1999. The University's Internal Auditor will report the University's progress to us, and we will update the Commission and the Legislative Budget Board if this issue is not satisfactorily resolved. If the University does not achieve compliance within a twelve-month period, the Legislative Budget Board has the ability to revoke purchasing authority that the Commission delegated to the University under Government Code, Section 2155.131 or 2155.133.

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Improvements were possible at many of the entities we have reviewed to date. Strengths and weaknesses were communicated directly to management during our review at each entity.

We will continue to coordinate with the General Services Commission to monitor the HUB program.

If you have any questions about this report, please contact Elizabeth S. Arnold, CIA, CGFM, Audit Manager, at 479-4700.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

ggh/cbg

Attachment

Objective, Scope, and Methodology

The objective of the reviews was to determine whether each entity had made a good-faith effort to implement state HUB requirements. The reviews were conducted in accordance with Chapter 321, Texas Government Code, and Article IX, Section 124(8), General Appropriations Act, 75th Legislature. We performed the reviews during scheduled management controls audits. These audits were conducted in accordance with *Government Auditing Standards*.

cc: Mr. Carl Mullen, Acting Executive Director
General Services Commission
Executive Directors or Presidents of the
Agencies and Universities Included in This Report
Board Chairs or Chancellors of the
Agencies and Universities Included in This Report
Internal Audit Directors of the
Agencies and Universities Included in This Report

Section 1:

HUB Performance at Nine Entities Reviewed in Fiscal Year 1999

Overall Conclusion

All nine entities reviewed during fiscal year 1999 demonstrated good-faith efforts to comply with HUB requirements. Additionally, six of the entities exceeded the HUB goal in at least one expenditure category.

Table 1 summarizes the entities' performance and illustrates their success in using HUB vendors. The nine entities spent \$14,542,002 on HUB goods and services, while the State spent about \$550 million.

Table 1

Fiscal Year 1998 HUB Performance					
Entity	% of Applicable Payments to Adjusted HUBs	Good-Faith Effort	Categories in which HUB Goal was Exceeded	Total Applicable Expenditures	Adjusted HUB Expenditures
Secretary of State	9.0%	✓	None	\$ 2,276,192	\$ 205,533
State Office of Administrative Hearings	26.8%	✓	Commodity	125,823	33,743
Adjutant General's Department	17.4%	✓	Other Services	6,480,286	1,127,355
Texas Military Facilities Commission	8.5%	✓	None	7,944,347	672,001
State Board of Public Accountancy	3.5%	✓	Commodity	1,173,003	40,730
Research and Oversight Council on Workers' Compensation	25.4%	✓	Other Services	34,315	8,714
State Office of Risk Management	15.4%	✓	Commodity	1,611,267	247,733
Texas A&M University	9.6%	✓	None	115,287,765	11,123,999
Texas A&M University - Kingsville	8.4%	✓	Professional Services	12,941,106	1,082,194
Total	9.8%	9/9	6/9	\$147,874,104	\$14,542,002

✓ The entity achieved an acceptable level of effort in the judgment of the auditor.

Source: The total applicable and adjusted HUB expenditure amounts were calculated using data in the General Services Commission's *Annual Historically Underutilized Business (HUB) Report for Fiscal Year 1998*.

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The remaining tables focus on each entity's expenditures to adjusted HUBs. They show how each entity attempted to reach state HUB goals, by procurement type and category of expense.

Table 2 shows how the nine entities procured HUB goods and services: treasury funds, non-treasury funds, subcontracts, or term contracts. Approximately 27.6 percent of adjusted HUB expenditures were made from treasury funds; these expenditures are captured automatically by the statewide accounting system. In contrast, expenditures from non-treasury funds and subcontracted amounts are self-reported by each entity.

Table 2

Total Adjusted HUB Expenditures by Procurement Type					
Agency	Treasury	Non-Treasury	Subcontracts	Term Contracts ¹	Cumulative Total ²
Secretary of State	\$ 206,453	\$ 0	\$ 0	\$ 919	\$ 205,533
State Office of Administrative Hearings	34,103	0	0	360	33,743
Adjutant General's Department	1,147,224	0	1,900	21,770	1,127,355
Texas Military Facilities Commission	81,355	30,604	562,168	2,125	672,001
State Board of Public Accountancy	40,807	0	0	77	40,730
Research and Oversight Council on Workers' Compensation	8,714	0	0	0	8,714
State Office of Risk Management	247,787	0	0	54	247,733
Texas A&M University	1,506,357	9,629,360	0	11,718	11,123,999
Texas A&M University - Kingsville	737,440	382,044	0	37,290	1,082,194
Total	\$4,010,240	\$10,042,008	\$564,068	\$74,313	\$14,542,002
Percent of Total Adjusted HUB Expenditures	27.6%	69.1%	3.9%	.5%	100% ²
¹ Term contracts are contracts administered by the General Services Commission on the entity's behalf; they are subtracted from the entity's totals for treasury, non-treasury, and subcontracts to arrive at a cumulative amount. ² Totals are rounded, so they may not equal the sum of amounts in columns.					

Source: The above amounts were calculated using data in the General Services Commission's *Annual Historically Underutilized Business (HUB) Report for Fiscal Year 1998*

Table 3 shows HUB expenditures for five of the six categories of expense. (The entities did not have any Heavy Construction expenditures, so this category does not appear in the table.) The bolded percentages indicate instances in which an entity exceeded the state goal. For example, three entities exceeded the goal for Commodities, while none of them met the goal for Special Trade Construction. It is useful to examine HUB expenditures by category of expense, as this indicates areas in which an entity may need to improve its HUB performance.

Table 3

Adjusted HUB Expenditures by Category of Expense										
Category	Building Construction		Special Trade Construction		Professional Services		Other Services		Commodities	
Adjusted HUB Goal	25.1%		47.0%		18.1%		33.0%		11.5%	
	HUB \$	HUB %	HUB \$	HUB %	HUB \$	HUB %	HUB \$	HUB %	HUB \$	HUB %
Secretary of State	-	-	-	-	-	-	\$119,998	8.7%	\$85,535	9.6%
State Office of Administrative Hearings	-	-	-	-	-	-	10,095	18.2%	23,648	33.6%
Adjutant General's Department	-	-	\$30,768	5.3%	\$1,900	1.5%	945,919	37.8%	148,768	4.6%
Texas Military Facilities Commission	\$618,815	10.5%	7,358	1.2%	26,586	11.5%	4,464	0.5%	14,778	4.9%
State Board of Public Accountancy	-	-	-	-	-	-	28,641	2.7%	12,088	12.6%
Research & Oversight Council on Worker's Compensation	-	-	-	-	-	-	8,056	65.2%	658	3.0%
State Office of Risk Management	-	-	-	-	-	-	-	-	247,733	69.7%
Texas A&M University	-	-	17,400	1.6%	2,996	0.3%	2,013,833	7.4%	9,089,770	10.6%
Texas A&M University - Kingsville	-	-	114,663	3.6%	110,681	18.9%	105,410	5.5%	751,440	10.4%
TOTAL	\$618,815	-	170,189	-	142,163	-	3,236,416	-	10,374,418	-

Source: General Services Commission's *Annual Historically Underutilized Business (HUB) Report for Fiscal Year 1999*. The data are unaudited. HUB expenditure information for each agency is available on line at www.gsc.state.tx.us/98_hub_gov_agy_rpt/hub_rpt_by_agy.html.

An Overview of the State HUB Program

What is the HUB program?

The Historically Underutilized Business (HUB) program is designed to encourage state entities to procure goods and services from businesses owned by women and minorities. The program is legislated in Chapter 2161 of the Texas Government Code.

Who administers the program?

The General Services Commission (Commission) administers the HUB program. The Commission is required to:

- Adopt rules to govern the program.
- Certify that HUBs meet ownership criteria.
- Identify opportunities for increasing HUB participation.
- Assist state entities in meeting state HUB goals.
- Assist HUBs regarding state procurement.
- Maintain a directory of certified HUBs.
- Issue semi-annual and annual reports on entity HUB performance.

The State Auditor's Office is required to periodically monitor state entities to ensure that they have made a good-faith effort to implement the program. For information on our approach, see the Objective, Scope, and Methodology.

What are HUBs?

In general, companies owned and managed by members of one of the following groups are considered HUBs:

- Native American (American Indian)
- Asian
- Black
- Hispanic
- Women

Vendors who wish to be considered HUBs must apply to the Commission for certification according to various criteria. After reaching a certain size, which varies by the type of expense, HUB vendors "graduate" from HUB status and are no longer considered HUBs.

How is HUB participation measured?

The Commission sets statewide goals and measures HUB participation according to six procurement categories, as shown in Table 4.

Table 4

Statewide Goals Per HUB Expenditure Categories ¹			
Category	Unadjusted HUB Goal ²	Other HUB Goal ³	Adjusted HUB Goal ⁴
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)
Commodities	12.6%	1.1% (AS, AI)	11.5% (BL, HI, WO)
AI – Native American (American Indian) AS – Asian Pacific American BL – Black American HI – Hispanic American WO – Women (all women excluding AI, AS, BL, and HI women)			
¹ The Commission excludes from HUB calculations: payments for claims and judgments, interfund transfers, interagency payments, investments, interest payments, principal payments, public assistance payments, rentals and leases, utilities, salaries, wages, benefits, travel, grants, scholarships, real estate purchases, rights of way, and bonds. ² The Unadjusted HUB Goal consists of all minority vendors in that category. ³ The Other HUB Goal consists of vendors considered to be less underutilized in that procurement category. For example, women vendors are not considered as underutilized in heavy construction as the other HUB vendor groups. ⁴ The Adjusted HUB Goal is the result of subtracting the “Other HUB Goal” from the “Unadjusted HUB Goal” column. The adjusted HUB goals are the main focus of statewide measurement efforts.			

Source: General Services Commission's *Annual Historically Underutilized Business (HUB) Report for Fiscal Year 1998*

For HUB reporting purposes, treasury expenditures are captured through the Uniform Statewide Accounting System. Non-treasury expenditures and subcontracts are self-reported by state entities.

Objective, Scope, and Methodology

This is the State Auditor's Office's fourth report on entity compliance with state HUB requirements. The entities reviewed for compliance were scheduled for management control audits during fiscal years 1996 through 1999. The management control audits were conducted in accordance with *Government Auditing Standards*.

The objective of the reviews was to determine whether each entity had made a good-faith effort to implement state HUB requirements. The reviews were conducted in accordance with Chapter 321, Texas Government Code, and Article IX, Section 124 (8), General Appropriations Act, 75th Legislature.

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

- Did the entity include HUB policies, goals, and programs in its strategic plan (Government Code, Section 2161.123[a-c])?
- Did the entity designate a HUB coordinator who attended HUB training seminars and attempted to locate potential HUB vendors?
- Did purchasers use the Commission's list and other sources to identify HUBs, and did they provide contractors with a referenced list of certified HUBs for subcontracting?
- Did the HUB coordinators instruct buyers to set bond and insurance requirements that would reasonably permit more than one business to perform the work? Did the HUB coordinator also instruct buyers to ensure that specifications, terms, and conditions reflect the entity's actual requirements (Government Code, Section 111[8])?
- Did the entity meet 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, an entity may submit a supplemental letter that includes documentation as prescribed by the Commission (Government Code, Section 111.13). Examples of good-faith efforts are as follows:

- 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 (HUBs that have outgrown disadvantaged status) cannot be counted toward the goal

There are valid reasons an entity might be considered to have made a good-faith effort even though the entity did not attain a statewide goal. These reasons include the following:

- Not all expenditures within a given object or category of expense are subject to management's control.
- Fewer HUB firms may be available for certain specialized or local expenditures.
- Some entities have continued to use "graduated" HUB vendors.