United States General Accounting Office

GAO

Report to Congressional Requesters

September 1992

HIGHWAY CONTRACTING

Disadvantaged Business Eligibility Guidance and Oversight Are Ineffective

GAO/RCED-92-148

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-247934

September 1, 1992

The Honorable Quentin N. Burdick
Chairman
Committee on Environment
and Public Works
United States Senate

The Honorable John H. Chafee
Ranking Minority Member
Committee on Environment
and Public Works
United States Senate

The Honorable Steve Symms
Ranking Minority Member
Subcommittee on Water Resources,
Transportation, and Infrastructure
Committee on Environment
and Public Works
United States Senate

Federal highway law requires state highway agencies to spend at least 10 percent of their federal-aid highway program funds to contract with firms participating in the Disadvantaged Business Enterprise Program. Since 1988, state agencies have received thousands of new applications for participation in the Disadvantaged Business Enterprise Program for federal highways each year. For each application, state agencies must determine whether the firms meet the eligibility standards contained in federal law and regulations. These standards require that the firms be small businesses owned and controlled by socially and economically disadvantaged individuals. To interpret and apply the legal and regulatory standards, states rely on more specific and detailed supplementary eligibility guidance provided by the Department of Transportation (DOT) and the Federal Highway Administration (FHWA).

You raised concerns that states were making inconsistent eligibility decisions in certifying disadvantaged businesses. In response, we agreed to evaluate whether federal guidance and oversight engenders effective and consistent state application of the eligibility standards contained in the law governing the Disadvantaged Business Enterprise Program.

Results in Brief

Ineffective federal guidance has hindered states from consistently applying the eligibility criteria for the Disadvantaged Business Enterprise Program. This situation has occurred because several offices in DOT and FHWA have issued eligibility guidance that is confusing and sometimes conflicting. As a result, interpretations of key eligibility criteria vary among states. For example, DOT and FHWA offices have issued conflicting guidance on the criteria a disadvantaged owner must meet to demonstrate that he or she controls a firm. On the basis of their interpretation of that guidance, certification officials in two states told us that disadvantaged owners cannot rely on the expertise of nondisadvantaged employees to manage a firm's critical operations, while officials in six other states said that they can. Officials in one state used both interpretations.

Confusion and conflicts exist in federal guidance because DOT's approach to providing guidance has not been systematic. For example, there is no clearly designated lead office, uniform order or instruction, or procedure to develop, update, and coordinate distribution of eligibility guidance to the states. Furthermore, although several DOT and FHWA offices provide eligibility guidance to the states, they do not effectively coordinate their efforts. Because of confusing and conflicting guidance, states have interpreted key eligibility criteria differently. As a result, the potential exists that the same firm could be certified as eligible in one state but denied eligibility in another.

Despite varying state interpretations, DOT has not clarified its guidance. Officials from DOT's Office of General Counsel said that DOT is revising the regulation governing the Disadvantaged Business Enterprise Program in part to clarify eligibility guidance. These revisions have been under way since 1988, and although DOT informed a congressional committee that it planned to publish a draft regulation by early 1991, the deadline was not met. In its comments on our report, DOT stated that it planned to issue a notice of proposed rule-making—the first step in the regulatory process—before November 1, 1992, and estimated that it would publish a final regulation in early August 1993.

While FHWA is responsible for overseeing states' implementation of the Disadvantaged Business Enterprise Program for federal highways, it has not established a system to evaluate whether the eligibility criteria are being correctly and uniformly applied. Although FHWA does require its field offices to oversee the state agencies' application of the eligibility criteria in the 50 states, the District of Columbia, and Puerto Rico, field offices

examined eligibility decisions in only 22 state agencies between 1988 and 1991.

Background

The Surface Transportation Assistance Act of 1982 required states to spend at least 10 percent of their federal-aid highway program funds contracting with small businesses owned and controlled by socially and economically disadvantaged individuals, including Blacks, Hispanics, American Indians, and other minority groups. The Surface Transportation and Uniform Relocation Assistance Act of 1987 expanded the Disadvantaged Business Enterprise Program to include women. These provisions were incorporated into the Intermodal Surface Transportation Efficiency Act of 1991.

Title 49 C.F.R. part 23 contains the basic eligibility standards for disadvantaged businesses' participation in DOT's programs at the Federal Transit Administration, the Federal Aviation Administration, and FHWA. In FHWA's program, the states certify firms seeking participation.[1] Businesses that are denied certification may appeal to DOT; DOT's Office of Civil Rights adjudicates these appeals. DOT's Office of General Counsel develops regulations and interpretations and represents the Department if applicants appeal state denials in federal court. FHWA's Office of Civil Rights issues guidance, such as the FHWA program manual, sponsors a training course, and monitors state implementation through FHWA's 9 regional offices and 52 division offices in each state, Puerto Rico, and the District of Columbia. FHWA's Office of Chief Counsel provides legal opinions and advice to FHWA's Office of Civil Rights and the states.

Federal Guidance Leads to Varying State Interpretations

To ensure that applicants are bona fide disadvantaged businesses, states must determine, for each of the thousands of new applications received nationwide each year, who actually owns the firm and who controls it. In addition, if a state comes into possession of credible information, it may initiate a separate investigation and hearing to determine whether the minority or female owner-applicant is in fact socially and economically disadvantaged.

Federal law and regulations provide the basic standards for determining whether applicant firms are eligible to participate in the program. However, state certifying officials need more detailed guidance to help

[1]For the purposes of this report, the term "states," "state highway agencies," and "state agencies" include the 50 states, the District of Columbia, and Puerto Rico.

them interpret and apply the legal and regulatory standards. The officials we interviewed regard (1) the FHWA program manual, (2) DOT's Office of Civil Rights appeal decisions, and (3) DOT General Counsel and FHWA Chief Counsel opinions and memorandums as the principal sources of federal guidance. However, federal guidance has led to confusion and to varying interpretations among states on key eligibility criteria, such as who owns a business, who controls it, and whether an owner is disadvantaged.

Determining Ownership

To determine ownership, 49 C.F.R. part 23 requires states to conclude that a disadvantaged owner made a "real and substantial contribution" of capital to acquire majority ownership in the firm. To make this determination, state certifying officials examine the source of the applicant's funds used to acquire a controlling interest. We found varying state interpretations, as well as differences of opinion within DOT, on the acceptability of using various sources of funds to obtain firm ownership.

Jointly Owned Assets

Officials in the nine states we visited provided us with 76 appeal decisions rendered by DOT's Office of Civil Rights between 1985 and 1991 as examples of federal guidance on whether jointly owned assets constitute a real and substantial contribution to acquire ownership. These decisions have stated that an owner's capital used to acquire majority ownership must be derived from individually owned assets. The decisions have further stated that acquiring ownership with joint accounts shared by an applicant's nondisadvantaged spouse makes a firm ineligible. FHWA's program manual also states that ownership must be acquired through individually owned assets.

Officials in DOT's Office of General Counsel, however, said that they believed this interpretation is too simplistic and that the use of such jointly owned assets does not, by itself, exclude an otherwise eligible firm. Despite this disagreement within the Department, DOT did not clarify its interpretation to the states.

State officials differed on whether jointly owned assets constituted the real and substantial contribution needed to acquire ownership. Certification officials in two states told us that jointly owned assets held with a nondisadvantaged spouse are not an acceptable source of capital. However, certification officials in three states said that such assets can be an acceptable source of funds. In a somewhat different interpretation, certification officials in three other states said that such assets are an acceptable source of capital only if the disadvantaged owner can prove

they were derived from individually owned funds. Certification officials in one state disagreed on the proper interpretation; two officials said that jointly owned assets can be acceptable, while two other officials said that they are acceptable only if proved to be derived from individually owned assets.

Community Property

In stating that disadvantaged owners must derive ownership capital from individually owned assets, federal guidance has created confusion because some states are community property states, where married persons enjoy an interest in the earnings of their spouses.[2] In 1984, New Mexico, a community property state, asked FHWA to review its proposed eligibility criteria for businesses owned by women. In response, FHWA's Chief Counsel stated that community property laws do not disqualify female-owned businesses and that states should instead focus on whether the owner-applicant actually controls the firm. The Chief Counsel's memorandum on this matter was reissued to all of the states in 1988.

In September 1990 FHWA's California Division office reported that "a contradiction in the interpretation of the criteria for ownership" existed between the Office of Civil Rights appeal decisions and the FHWA Chief Counsel's opinion. The FHWA Division Office concluded that state eligibility decision makers "cannot make consistent eligibility determinations" given the "various interpretations and guidance." Again, although differences of opinion and confusion existed, FHWA, as of May 1992, had taken no action to clarify the situation. FHWA regional officials stated that no further action was taken because FHWA did not receive a formal request for clarification from the state.

Inheritances

Contradictory guidance exists on whether an inheritance can be used to acquire ownership. Three DOT Office of Civil Rights appeal decisions, issued in 1986, stated that such funds do not represent a real and substantial contribution—a criterion for acquiring ownership in a firm. FHWA's program manual contains this same position. However, in August 1990, DOT's General Counsel stated that using inherited funds to acquire ownership does not disqualify owner-applicants. While DOT's Office of Civil Rights concurred and reversed its position, FHWA did not update its program manual. Consequently, FHWA's widely distributed manual currently contains an interpretation of eligibility criteria that is contrary to the Department's position. This error was further compounded when, at a March 1991 Civil Rights Conference, FHWA distributed a policy statement to

[2]Community property states include Arizona, California, Idaho, Louisiana, New Mexico, Nevada, Texas, and Washington.

state certifying officials that said "[t]he program does not provide for participation by those who acquire their controlling interest through inheritance . . . ." Again, neither DOT nor FHWA took any action to clarify this apparent contradiction.

Determining Control

To ensure that Disadvantaged Business Enterprise firms are controlled by disadvantaged owners, 49 C.F.R. part 23 requires the owner "to possess the power to direct or cause the direction of the management and policies of the firm and make the day-to-day as well as major decisions of management, policy, and operations." To make this determination, state certifying officials examine the responsibilities and expertise of the firm's owners and employees. State interpretations of the level of expertise an owner must possess to control the firm have differed because DOT and FHWA guidance is confusing and conflicting.

Officials in the nine states we visited provided us with 138 appeal decisions from DOT's Office of Civil Rights rendered between 1985 and 1988 as examples of guidance on the level of expertise an owner must possess to control the firm. These decisions generally stated that the owner must have the technical expertise to control the firm's critical operations, which could include project cost estimating, bidding, marketing, and supervising in the field. These decisions further stated that the owner cannot rely on nondisadvantaged individuals' experience in the firm's critical operations.

In a September 1988 letter, the Office of Civil Rights, with the concurrence of the Office of General Counsel, clarified its position. The letter stated that disadvantaged owners need not have more expertise in a given area than an employee, may delegate functions to employees, and may rely on the judgment of those employees, regardless of their race or sex, providing that the owner possesses sufficient background and expertise to be able to use intelligently and evaluate critically information presented by employees. Officials in DOT's Office of General Counsel told us that they regard this position as the standard for determining the level of expertise an owner must possess to control his or her firm.

Although the September 1988 letter contained a clarification of DOT policy, subsequent guidance contained confusing language. For example, FHWA's 1990 program manual states that disadvantaged owners must be able to make "independent and unilateral business decisions" to prove control. This statement apparently contradicts DOT's earlier opinion because it does

not specify that disadvantaged owners may delegate functions to and rely on the judgments of their employees.

In addition, an appeal decision rendered and distributed to the states after September 1988 stated that the owner-applicant made business decisions with the advice of her employee-husband and that this practice is contrary to DOT regulations. This again appears to contradict the earlier decision allowing owners to rely on employees' judgments. Another appeal decision rendered and distributed after September 1988 stated that the nondisadvantaged partner was more qualified to manage and control the firm's critical operations than the disadvantaged owner. However, according to the position contained in the September 1988 letter, the issue is whether the owner can critically evaluate information provided by employees, not whether an employee is more qualified than the owner.

As a result of these inconsistencies, interpretations differ among states. Certifying officials in two states told us that disadvantaged owners must possess technical expertise in all the firm's critical areas of operation and cannot rely on nondisadvantaged employees for advice or expertise. Officials in one of these states also said that owners cannot share or delegate responsibility for critical operations to nondisadvantaged employees who have superior technical expertise in the critical areas. However, officials in four states said that owners can rely on advice or delegate responsibility for critical areas to employees, regardless of their race or sex, as long as the owner has sufficient background and expertise to use intelligently and evaluate critically information provided by these employees. Officials in another state made both interpretations.

Determining Disadvantaged Status

Title 49 C.F.R. part 23 requires states to initially assume that minorities and women are socially and economically disadvantaged. According to DOT's General Counsel officials, this assumption prevents applicants from having to routinely prove that they are disadvantaged. However, in order to have a means of detecting fraudulent eligibility claims, the regulation allows a state to initiate a separate investigation of an applicant's status when, on the basis of information presented by a third party, there is reason to believe that a minority or female applicant is not socially or economically disadvantaged. In addition, according to FHWA Chief Counsel memorandums issued in 1984 and 1988, a state may challenge an applicant's status if it obtains "credible information" from other than a third-party challenge.

DOT's guidance has caused confusion among state officials because the Department has not provided any additional explanation of what constitutes sufficient or credible information needed to initiate a challenge. We found that, in the absence of such an explanation, state certifying officials have had difficulty determining when to challenge disadvantaged status and that confusion exists within DOT as well. For example, in 1991 a third party challenged an application in one state, alleging that a disadvantaged individual would not have the financial ability to purchase a business as viable and well established as the applicant firm. State officials disagreed on whether or not this challenge provided a sufficient basis for investigating the firm's disadvantaged status. When the state sought FHWA's advice, an Office of Civil Rights official advised the state that the information contained in the third-party challenge was sufficient to allow an investigation of the applicant's disadvantaged status.

However, on the advice of its legal counsel, the state disallowed the challenge but pursued the investigation on its own, pursuant to the 1984 guidance from the FHWA Chief Counsel that allows states to challenge an applicant's status if they obtain "credible information." The state again sought FHWA's advice. Despite the earlier advice from FHWA's Office of Civil Rights, the FHWA division office advised the state not to proceed with the investigation because federal regulations do not allow a state to investigate an owner-applicant's disadvantaged status without an adequate third-party challenge. The FHWA division office presented this advice as interim guidance, subject to review by FHWA headquarters. The state accepted this advice and dropped its investigation. The conflicting views within FHWA were never resolved because the FHWA division did not subsequently forward its interpretation to FHWA headquarters.

In 1988, DOT's Office of Inspector General reported that a state had ignored credible information that an applicant was not economically disadvantaged. FHWA took issue with this finding and stated that the factors cited in the Inspector General's report—a company's gross receipts and ability to obtain loans —were insufficient to warrant investigating the owners' disadvantaged status. As a result, the Office of Inspector General recommended that FHWA clarify what constitutes credible information sufficient to initiate a challenge. However, as of May 1992, neither DOT nor FHWA had provided clarification.

DOT Lacks a Systematic Approach for Providing Guidance to the States

Confusion and conflicts in federal guidance exist because DOT has not taken a systematic approach to providing guidance. For example, there is no lead office, uniform order or instruction, or procedure to update and distribute guidance to the states for certifying disadvantaged businesses. Furthermore, although several DOT and FHWA offices provide federal eligibility guidance to the states, they do not effectively coordinate their efforts.

In the absence of uniform instruction, states rely on various federal guidance. For example, state officials regard DOT's Office of Civil Rights appeal decisions as important sources of policy guidance. But according to Office of Civil Rights officials, that office's primary function is to rule on applicants' appeals of state eligibility decisions; use of its appeal decisions as guidance for future decisions is a secondary function. While the decisions are distributed to the states as guidance, they are summaries that do not contain the facts of the case or sufficient information to allow states to fully apply the guidance they contain. Furthermore, when DOT eligibility criteria contained in appeal decisions have been clarified or superseded by other appeal decisions, by court decisions, by DOT Office of General Counsel opinions, or by other administrative actions, DOT has no mechanism for effectively communicating these changes to the states. States' reliance on positions contained in superseded appeal decisions appears to contribute to the states' widely differing interpretations of the ownership and control criteria.

State officials also regard FHWA's program manual as an important source of policy guidance. Although FHWA developed the manual to promote, among other things, consistency in state eligibility decisions, it did not coordinate with DOT's Offices of Civil Rights or General Counsel in compiling and publishing this manual. As a result, when it was issued, the manual conflicted with other DOT guidance on the criteria for demonstrating ownership and control of a firm. In addition, FHWA did not develop procedures to periodically update the manual to reflect and highlight new or modified policy guidance. Consequently, it contains information superseded by subsequent DOT positions. This situation is particularly significant because the manual was published in conjunction with a training course designed in part to promote uniformity in state eligibility decisions and was used as course material. As of April 1992, over 800 state and FHWA officials had taken the training course and received the manual. About 5,000 additional copies were distributed to state officials, FHWA officials, and other interested parties.

FHWA's program manual is not the only instance in which the several DOT and FHWA offices that provide eligibility guidance to the states did not effectively coordinate their efforts to ensure consistency. Although DOT's Office of General Counsel has the lead responsibility for writing and interpreting the Department's regulations, DOT's Office of Civil Rights did not routinely consult with the General Counsel before ruling on appeal decisions that interpreted those regulations.

DOT has not clearly designated a lead office for developing, updating, and coordinating distribution of disadvantaged business eligibility guidance to the states. Although DOT's Office of Small and Disadvantaged Business Utilization has been delegated responsibility for departmental small and disadvantaged business policy direction, that office has exercised no responsibility for developing policy or guidance for the disadvantaged business program for federal highways. DOT Office of Civil Rights officials said that their office is the lead office for the Department's program; however, they were unable to provide us with any specific DOT delegation of program responsibilities beyond adjudicating applicants' administrative appeals.

Clarifying Regulation Delayed for 4 Years

DOT recognizes the existence of variations in state interpretation of eligibility criteria and problems with federal guidance and plans to address the problems by revising the Disadvantaged Business Enterprise Program regulation. However, this revision of the regulation has been under way since 1988. Drafts have been circulated within DOT, but as of May 1992, the regulation had not yet reached the notice of proposed rule-making stage—the first stage in the regulatory process.

In response to an inquiry from the Chairman of the Senate Committee on Environment and Public Works, the Secretary of Transportation stated on December 19, 1990, that DOT planned to publish a notice of proposed rule-making by early 1991. However, no rule-making was forthcoming and little progress has been made since that time. Officials in DOT's Office of General Counsel said that the revisions had been delayed by other rule-making priorities, such as access to transportation facilities for the disabled and alcohol and drug use by transportation workers. When we completed our review in May 1992, these officials were unable to estimate when a notice of proposed rule-making would be issued.

In a draft of this report reviewed by DOT, we recommended that the Department work with the appropriate committees of the Congress to

establish a timetable and deadline for issuing a revised regulation. In response, DOT stated that it plans to issue a notice of proposed rule-making before November 1, 1992. DOT anticipates a 90-day comment period, with the final rule to be issued no later than 6 months after the comment period closes. Consequently, under DOT's revised timetable, a new regulation would be published by early August 1993.

According to officials in DOT's Office of General Counsel, one of the major objectives of revising the regulation is to improve the consistency of federal guidance and the application of eligibility criteria by states, transit authorities, and airports. Clarifications included in the draft revisions circulated within the Department permit the use of inherited and jointly held assets in acquiring ownership in a firm, provided that, in the case of jointly held assets, the applicant's spouse renounces any ownership rights. These draft revisions also clarify that owners may delegate critical operations of the firm, provided the owner possesses an overall understanding of the firm's business and operations and has the ability to use intelligently and evaluate critically information presented by employees. The proposed draft revisions, however, do not provide examples of what constitutes "credible information" for the purposes of investigating social and economic disadvantaged status.

Federal Oversight Is Not Designed to Detect Inconsistent Eligibility Decisions

Federal oversight has been insufficient to detect inconsistencies in state eligibility decisions or identify areas where clarification of guidance may be needed. FHWA's field offices oversee state Disadvantaged Business Enterprise Program activities on federal-aid highway projects. This oversight consists primarily of reviewing and approving states' implementation plans for the Disadvantaged Business Enterprise Program, assessing compliance with the 10-percent participation goal, and monitoring contract compliance. While field offices are also required to oversee states' application of the eligibility criteria, these offices examined eligibility decisions in only 22 of the 52 state agencies between 1988 and 1991.

FHWA has not established a system to assess whether eligibility criteria are being correctly and uniformly applied by the states. Consequently, inconsistent state decisions usually come to DOT's attention when applicants administratively appeal state decisions to deny eligibility or when the Department is sued in federal court. FHWA does not collect, aggregate, or analyze state eligibility decisions to detect inconsistencies and to evaluate whether the eligibility criteria are being correctly and

uniformly applied. As a result, it has no effective monitoring system to identify areas where further clarification or guidance is needed.

Conclusions

DOT's approach to providing Disadvantaged Business Enterprise Program guidance to the states has resulted in a body of federal eligibility guidance that is confusing and sometimes conflicting. As a result, interpretations of DOT's eligibility policy vary among the states, and the potential exists that the same firm can be certified as eligible in one state but denied eligibility in another.

DOT is aware of varying state interpretations and plans to address the problem by revising the program's federal regulation. However, this effort has been under way for over 4 years, and DOT has taken no action to clarify known areas of states' confusion by—for example—issuing interim guidance. DOT has now proposed a deadline for promulgating a draft regulation. In view of congressional interest and previous delays, DOT should work with the appropriate congressional committees to ensure that those committees concur with the proposed timetable.

Revising the regulation alone will not prevent varying interpretations from recurring. A uniform order or instruction delineating federal disadvantaged business eligibility policy will go a long way toward clearing up areas of confusion. FHWA's program manual can serve this purpose if it is properly coordinated within the Department and significantly revised to correct erroneous and outdated information. Also, FHWA will have to develop procedures for updating the manual in a timely manner to reflect and highlight new or revised guidance.

Currently, several DOT and FHWA offices share responsibility for issuing guidance to the states, but DOT does not have formal procedures to coordinate their efforts. We believe DOT should designate a lead office for developing, updating, and coordinating dissemination of guidance to state highway agencies. We recognize that the specialized responsibilities of DOT's and FHWA's legal counsels and Offices of Civil Rights may require that guidance originate from different sources. Nevertheless, DOT should establish formal coordination procedures to ensure that these offices consistently speak to the states with one voice.

Currently, DOT's method of ensuring that states correctly and uniformly apply eligibility guidance is reactive—interpretation problems usually come to the Department's attention through administrative appeals or

lawsuits. An effective monitoring system will enable FHWA to evaluate whether the eligibility criteria are being correctly and uniformly applied. The results of such analyses can be used to identify areas where clarifications or additions to DOT guidance are needed.

Recommendations to the Secretary of Transportation

To improve the quality of federal guidance and the consistency of state eligibility decisions, we recommend that the Secretary of Transportation

- work with the Senate Committee on Environment and Public Works and the House Committee on Public Works and Transportation to establish a mutually agreeable timetable and deadline for issuing a revised regulation for the Disadvantaged Business Enterprise Program;
- develop a uniform order or instruction delineating federal eligibility policy for state highway agencies certifying disadvantaged businesses, including procedures to update such an order or instruction in a timely manner to reflect and highlight new or revised guidance;
- designate a lead office in the Department for developing, updating, and coordinating dissemination of Disadvantaged Business Enterprise Program guidance to the states, and establish formal coordination procedures among DOT and FHWA offices to ensure consistency; and
- issue interim clarifying eligibility guidance on the Disadvantaged Business Enterprise Program to the states until a new regulation and uniform guidance are completed and issued.

We further recommend that the Secretary direct the Administrator, FHWA, to establish a monitoring system to (1) collect and analyze state eligibility decisions in order to ensure that Disadvantaged Business Enterprise Program eligibility criteria are correctly and uniformly applied among the states and (2) identify areas where revisions or clarifications to DOT and FHWA guidance are needed.

Matter for Congressional Consideration

In view of past delays, the Congress may wish to consider legislation establishing a deadline for DOT to issue a revised Disadvantaged Business Enterprise Program regulation if the Secretary does not establish and meet an agreed-upon deadline.

Agency Comments and Our Evaluation

DOT stated that the issues we raised concerning implementation of the Disadvantaged Business Enterprise Program eligibility standards were accurate. DOT concurred with three of our recommendations to the Secretary and stated that it would designate a lead office, promulgate a

uniform order for, and establish formal departmental coordination procedures for issuing program guidance. Moreover, DOT stated that it would examine all DOT eligibility guidance now available to the states, airports, and transit authorities to identify and rectify inconsistencies or incorrect interpretations.

DOT stated that it is committed to expediting the issuance of a revised regulation and that, as a result, neither a congressionally mandated deadline nor interim clarifying eligibility guidance, as our draft recommended, are necessary. We have modified our recommendation to urge the Secretary to work closely with the appropriate congressional committees to ensure that they concur with the proposed deadline. Although it did not agree with issuing interim clarifying guidance, DOT stated that the preamble issued with the notice of proposed rule-making in November 1992 could serve as interim guidance. The draft preamble statements we reviewed generally sought to clarify DOT's position on known areas of confusion in eligibility guidance. Issuing this preamble would be responsive to our interim guidance recommendation, providing that DOT clearly identifies and disseminates the preamble to the states as interim guidance and takes the other short-term measures it cites in its letter, including providing training, to promote consistent interpretations.

DOT did not concur with our recommendation on establishing a monitoring system because it believes that specific case judgments need to be made by those closest to the situation. Our recommendation was not that FHWA substitute its judgement for those of state certifying officials. Rather, our intention was that FHWA oversight ensure that the basic framework of the eligibility standards—law, regulations, and DOT interpretations—is uniformly understood and applied. We disagree with DOT's contention that disagreements about the application of the eligibility standards are likely to surface through the certification appeals process, because we believe that process may not accurately reflect the extent and magnitude of the problems in the states. Therefore, proactive rather than reactive oversight will help ensure consistent state eligibility decisions.

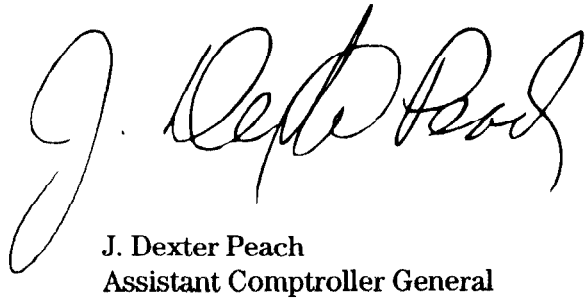
In addition to commenting on our recommendations, DOT expressed concern that our report, by focusing on eligibility, did not convey that the overall program is accomplishing its primary objectives and is functioning smoothly. DOT suggested that we modify the title of our report to clarify our focus on eligibility and that we include language to convey the program's overall success. We are not in a position to comment on the success or failure of any other aspects of the program at this time because

this review focused only on eligibility. We have, however, modified the title of our report to include the word "eligibility" to reflect this focus, as DOT suggested. The full text of DOT's comments is in appendix I.

To accomplish our objectives, we reviewed federal laws, regulations, and eligibility guidance and discussed the issues with state certification officials in nine states, with DOT officials in Washington, D.C., and with FHWA headquarters and regional officials. We performed our work between February and October 1991, with updates through May 1992, in accordance with generally accepted government auditing standards. Details of our scope and methodology are contained in appendix II.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time we will send copies to the Secretary of Transportation; the Administrator, FHWA; and other interested parties. Copies will also be provided to others upon request.

Our work was performed under the direction of Kenneth M. Mead, Director of Transportation Issues, who can be reached on (202) 275-1000. Other major contributors are listed in appendix III.



J. Dexter Peach
Assistant Comptroller General

Contents

Abbreviations

DOT	Department of Transportation
FHWA	Federal Highway Administration
GAO	General Accounting Office

Comments From the Department of Transportation

U.S. Department of Transportation

Assistant Secretary for Administration

400 Seventh St S.W.
Washington D.C. 20590

July 24, 1992

Mr. Kenneth M. Mead
Director, Transportation Issues
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Mead:

Enclosed are two copies of the Department of Transportation's comments concerning the U.S. General Accounting Office draft report entitled "Highway Contracting: Disadvantaged Business Program Guidance and Oversight Are Ineffective."

Thank you for the opportunity to review this report. If you have any questions concerning our reply, please contact Martin Gertel on 366-5145.

Sincerely,

Melissa J. Allen for

Jon H. Seymour

Enclosures

DEPARTMENT OF TRANSPORTATION (DOT) REPLY

TO

GENERAL ACCOUNTING OFFICE (GAO) DRAFT REPORT

ON

HIGHWAY CONTRACTING:

DISADVANTAGED BUSINESS PROGRAM

GUIDANCE AND OVERSIGHT ARE INEFFECTIVE

RCED-92-148

I. SUMMARY OF GAO FINDINGS AND RECOMMENDATIONS:

The GAO draft report maintains that ineffective Federal guidance has impeded state highway agencies from consistently applying the eligibility criteria for the Disadvantaged Business Enterprise Program (DBE). The GAO draft report attributes this situation to the involvement of multiple offices in the Department and the existence of sometimes conflicting guidance. In addition, the GAO draft states that while the Department is revising the regulation governing the DBE program, these revisions have been substantially delayed by other regulatory priorities. Finally, the draft calls on the Department to establish a system to evaluate whether the eligibility criteria are being correctly and uniformly applied.

The draft report recommends that the Secretary of Transportation:

1. Establish, in consultation with the Committee on Environment and Public Works, U.S. Senate, and the Committee on Public Works and Transportation, House of Representatives, a timetable and deadline for issuing a revised DBE program regulation.

2. Develop a uniform order or instruction delineating Federal eligibility policy for state highway agencies certifying disadvantaged businesses, including procedures to update such an order or instruction in a timely manner to reflect and highlight new or revised guidance.

3. Designate a lead office in the Department for developing, updating and disseminating DBE program guidance to state highway agencies, and establish formal coordination procedures among Department of Transportation (DOT) and Federal Highway Administration (FHWA) offices to ensure consistency.

4. Issue interim clarifying eligibility guidance on the DBE program to the states until a new regulation and uniform guidance are completed and issued.

5. Direct the FHWA Administrator to establish a monitoring system to collect and analyze state eligibility decisions in order to ensure that DBE Program eligibility criteria are correctly and uniformly applied across states, and to identify areas where revisions or clarifications to departmental guidance are needed.

II. SUMMARY OF THE DEPARTMENT OF TRANSPORTATION POSITION:

The Department's DBE program, which operates in the transit and airport grant programs as well as the Federal-aid highway program, is effectively accomplishing its primary objectives. In 1991, the program resulted in about $1.5 billion worth of business for DBE firms participating in the highway program alone. At the same time, the Department agrees that the issues raised by the draft report concerning the implementation of the eligibility provisions of the Department's DBE regulation are accurate. The Department will proceed with revising the regulation as a priority matter. The Department will also create new interoffice coordination mechanisms and will resolve the program leadership and eligibility guidance consistency issues.

III. DETAILS OF THE DEPARTMENT OF TRANSPORTATION POSITION:

The DBE Program Meets Its Primary Objective

The statutes mandating the Department's DBE program are intended to ensure that DBE firms receive a portion of contracting funds resulting from the Department's airport, highway, and mass transit financial assistance programs. The Department's program has consistently met this statutory objective. For example, during 1991, the DBE program resulted in about $1.5 billion worth of business for DBE firms from FHWA programs alone. By concentrating on the program's certification process, the GAO report does not convey the understanding that the overall program, including setting contract goals, DBE support services, and obtaining DBE participation in contracts, is functioning smoothly.

We recommend that GAO modify the title of the report to reflect its exclusive focus on the certification process. We also recommend that GAO include language in the report placing its observations about certification issues in the context of the program's overall success in meeting its objectives. Finally, although the report examined the DBE program in the highway area only, we ask that the report refer to the fact that the DBE

program operates in other major DOT grant programs, and that program modifications need to be addressed on a Departmentwide basis.

IV. RESPONSE TO GAO DRAFT REPORT RECOMMENDATIONS:

RECOMMENDATION: Establish in consultation with the Committee on Environment and Public Works, U.S. Senate, and the Committee on Public Works and Transportation, House of Representatives, a timetable and deadline for issuing a revised DBE program regulation.

RESPONSE: Concur in part. The Department plans to issue a notice of proposed rulemaking (NPRM) for the DBE program before November 1, 1992. We anticipate a 90-day comment period, with the final rule to be issued no later than six months after the comment period closes. As the Department is committed to issuing the revised regulation on an expedited basis, establishing a Congressionally-mandated deadline for rulemaking is not necessary. The proposed regulation would provide definitive guidance concerning the specific substantive issues raised by the GAO draft report, including jointly-owned assets, community property, inheritance, criteria for determining control, and disadvantaged status determinations. The proposed regulation would also make clear to state and local certifying agencies that they may not apply different or harsher certification standards to any particular subgroup of potential DBE firms.

RECOMMENDATION: Develop a uniform order or instruction delineating Federal eligibility policy for state highway agencies certifying disadvantaged businesses, including procedures to update such an order or instruction in a timely manner to reflect and highlight new or revised guidance.

RESPONSE: Concur. The Department plans to examine all eligibility guidance now available to the states, transit authorities, and airports to identify inconsistencies or incorrect interpretations. Any inconsistencies or other problems identified will be rectified as part of the regulatory revision. Subsequent guidance issued with respect to the highway, transit, or airport programs will be coordinated through the DBE Council, described in the response to the third recommendation, to ensure consistency and accuracy.

RECOMMENDATION: Designate a lead office in the Department for developing, updating and disseminating DBE program guidance to state highway agencies, and establish formal coordination procedures among Department of Transportation (DOT) and FHWA offices to ensure consistency.

RESPONSE: Concur. The Department will take a number of actions to ensure the consistency of DBE guidance. The lead office role

will be clarified for developing, updating and disseminating DBE program guidance on a departmentwide basis for the highway, transit and airport programs. The Department will create a review mechanism to ensure that all interpretations, guidance, and appeals decisions are consistent with the rule's provisions. Finally, the Department will create a DBE Council, with representation from all DOT offices involved in the DBE program. The council will meet periodically to discuss matters of mutual interest including eligibility requirements. The Council will pay particular attention to the impact that policy changes and appeals decisions have on eligibility criteria.

RECOMMENDATION: Issue interim clarifying eligibility guidance on the DBE program to the states until a new regulation and uniform guidance are completed and issued.

RESPONSE: Nonconcur. As the Department is committed to providing the revised regulation on an expedited basis, we maintain that it is unnecessary at this time to divert resources from that effort to provide interim guidance. The preamble to the DBE NPRM rule can suggest that recipients use the proposed eligibility provisions as interim guidance for implementing the program while the final rule is being completed. In addition, the DBE council will ensure consistency in appeals decisions and responses to any requests for guidance until the final rule is issued. Finally, during this interim period, the Department plans to initiate new training for Office of Civil Rights personnel who handle appeals. This training is intended to ensure that appeals decisions are consistent with the language and intent of the DBE regulation and are properly coordinated within the Department.

RECOMMENDATION: Direct the FHWA Administrator to establish a monitoring system to collect and analyze state eligibility decisions in order to ensure that DBE Program eligibility criteria are correctly and uniformly applied across states, and to identify areas where revisions or clarifications to departmental guidance are needed.

RESPONSE: Nonconcur. The existing DBE regulations were designed to lay out a basic framework for recipients to employ when considering eligibility under the DBE program, while granting recipients the flexibility necessary to independently analyze the data and reach conclusions. The system was designed in this way because the application of eligibility criteria to the facts of specific cases requires judgement. It is appropriate for these judgements to be made by those closest to the situation. Since cases involving disagreement about the application of the eligibility standards are likely to be brought to the Department's attention through the certification appeals process, adding additional operating administration oversight is not necessary.

Scope and Methodology

To evaluate whether federal guidance engenders effective and consistent state application of the eligibility criteria for the Disadvantaged Business Enterprise Program, we reviewed federal laws and regulations, FHWA's program manual, other FHWA headquarters and regional guidance, and opinions issued by DOT's Office of General Counsel and FHWA's Chief Counsel. We discussed this guidance with officials in DOT's Office of Civil Rights, DOT's Office of General Counsel, FHWA's Office of Civil Rights and FHWA's Office of Chief Counsel in Washington, D.C. We also interviewed state officials and reviewed state certification records at state highway agencies in 9 states: California, Connecticut, Florida, Georgia, Illinois, New Jersey, South Carolina, Texas, and Wyoming. We selected these states to provide geographic balance and a variety of larger and smaller states. We also reviewed certification records from 17 other states.

We also examined 389 appeal decisions rendered by DOT's Office of Civil Rights between 1985 and 1991. We did not review all appeal decisions rendered between 1985 and 1991, but rather those provided to us by the officials in the nine states we visited as examples of federal guidance on the issues. In reviewing these decisions we did not examine the case files because those materials are not available to states receiving appeal decisions as guidance, except for the one state involved in the appeal. We also did not attempt to determine whether the appeal decision was correctly decided.

To assess federal oversight, we reviewed FHWA field office inspection and evaluation reports prepared between 1988 and 1991, and interviewed officials in the 9 FHWA regional and 52 division offices. We performed our work between February and October 1991, with updates through May 1992, in accordance with generally accepted government audit standards.

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