HIGHWAY CONTRACTING

Assessing Fraud and Abuse in FHWA's Disadvantaged Business Enterprise Program
November 30, 1988

The Honorable Daniel P. Moynihan  
Chairman, Subcommittee on Water 
      Resources, Transportation, and 
      Infrastructure  
Senate Committee on Environment 
     and Public Works  
United States Senate

Dear Mr. Chairman:

In response to your request, this report presents the results of our review of the Federal Highway Administration's (FHWA) Disadvantaged Business Enterprise Program. Specifically, the report discusses the nature and extent of program fraud and abuse, the results of disadvantaged business investigations, and the approaches used by FHWA and states to minimize fraud and abuse.

As arranged with your office, unless you publicly release its contents earlier, we plan no distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary of Transportation; the Administrator, Federal Highway Administration; the Director, Office of Management and Budget; and other interested parties.

This work was performed under the direction of Kenneth Mead and Victor Rezendes, Associate Directors. Other major contributors are listed in appendix IX.

Sincerely yours,

J. Dexter Peach  
Assistant Comptroller General
Executive Summary

Purpose

States have awarded over $5.3 billion in federal-aid highway funds to small businesses owned and controlled by socially and economically disadvantaged individuals since the Federal Highway Administration's (FHWA) Disadvantaged Business Enterprise Program was initiated in 1983. Concerned over reports that some businesses have engaged in practices that have enabled them to wrongfully obtain highway contracts, the Chairman, Subcommittee on Water Resources, Transportation, and Infrastructure, Senate Committee on Environment and Public Works, asked GAO to examine fraud and abuse in the disadvantaged business program. Our specific review objectives were to determine the (1) nature and extent of program fraud and abuse, (2) results of disadvantaged business program investigations, and (3) approaches used by FHWA and states to minimize fraud and abuse.

Our detailed review of the program at the state level was limited to New York and Pennsylvania.

Background

The Surface Transportation Assistance Act of 1982 established FHWA's disadvantaged business program to help expand the contracting opportunities available to minority-owned and controlled small businesses. In 1987 the Congress revised the program to include women-owned small businesses. As a general rule, states must spend at least 10 percent of their federal-aid highway funds annually with disadvantaged businesses.

FHWA oversees the program, while states determine the eligibility of new applicants and annually reassess the eligibility of certified businesses. States must also monitor contractors' compliance with requirements and sanction those that do not comply. Sanctions available to states include decertifying businesses and excluding businesses from highway contracting for specified periods.

Results in Brief

The extent of fraud and abuse nationwide is not known, primarily because FHWA does not have data needed to measure the extent of such problems. However, federal and state officials agree that irregularities have primarily involved ineligible businesses that obtain contracts, or eligible businesses that engage in questionable arrangements.

The Department of Transportation's (DOT) Inspector General along with New York and Pennsylvania have investigated alleged program fraud...
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and abuse. While most cases were resolved by administrative action, several were resolved by judicial action.

FHWA and the states GAO reviewed have strengthened the procedures used to certify new program applicants, monitor contractors’ compliance, and sanction those not complying. However, New York was not complying with the requirement that states’ annually assess the continued eligibility of certified businesses.

While steps have been taken to improve the program, FHWA does not have nationwide information on key program activities, such as on the results of all investigations, certification and reassessment actions, and program monitoring reviews.

Principal Findings

Nature and Extent of Fraud and Abuse

While the extent of program fraud and abuse is unknown, federal and state officials agree that irregularities generally fall into two categories: (1) ineligible businesses are certified and obtain contracts based on inaccurate or misleading information and (2) eligible businesses engage in questionable activities. The officials said, for example, that some businesses owned and controlled by white males have obtained benefits by identifying their wives or minority employees as business heads.

Disadvantaged Business Enterprise Investigations

Since the program’s inception in 1983, DOT’s Inspector General has conducted 89 disadvantaged business investigations nationwide. Of 70 closed cases, 53 were resolved by administrative action and 17 by legal action. Of the 53 cases resolved administratively, 21 resulted in actions against contractors and 32 were closed without any specific actions because allegations were not substantiated. Of 17 cases prosecuted, 12 resulted in convictions and 5 resulted in acquittals. In the closed cases, contractors paid federal and state governments a total of $1,040,434 in fines and restitution. In addition, 90 investigations were done by New York and Pennsylvania officials. All but one of the 61 closed cases were resolved administratively, either by taking action against contractors or closed without action because of insufficient evidence. In the one judicial action, Pennsylvania prosecutors obtained the conviction of four contractors.
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Administrative Sanctions Encouraged

Disadvantaged business fraud cases are difficult to get accepted for prosecution. Federal and state officials have found it difficult to obtain sufficient evidence of wrongdoing and have found prosecutors reluctant to accept cases involving projects completed on time, within budget, and that meet highway work standards. As a result, FHWA has encouraged states to use administrative sanctions.

Approaches Used to Minimize Fraud and Abuse

Three principal administrative approaches are being used to minimize fraud and abuse: (1) assess the eligibility of new applicants, (2) annually reassess the eligibility of certified businesses, and (3) monitor states' and contractors' compliance.

According to FHWA, all states have developed procedures that generally comply with federal requirements, although the quality of decisions can vary among states. The agency also said that New York is the only state that has not implemented a program to annually reassess the eligibility of certified businesses. FHWA and both states GAO reviewed devised monitoring programs that include both routine oversight by central and field office personnel and periodic monitoring to further assure states' and contractors' compliance.

Insufficient Data on Key Program Activities

While steps have been taken to improve program operations, FHWA does not collect and compile nationwide summary information on the results of key program activities. It does not have data on the results of all disadvantaged business investigations; new and reassessment applications received, approved, and denied; or on program monitoring reviews citing major violations and corrective actions taken.

In GAO's opinion, data on key program activities would improve management controls. The data would, for example, help FHWA and the Congress to better (1) gauge the extent of fraud and abuse, (2) identify regulations that require clarification, (3) assess the effects of policy changes on gaining improved compliance, and (4) focus limited resources on monitoring states with major problems.

Recommendations

GAO recommends that the Secretary of Transportation direct the Administrator, FHWA, to
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- expand its information system to annually obtain and compile pertinent summary information on the results of key program activities, as detailed in chapters 2 and 3, and
- assist New York's Department of Transportation in the development of a plan for annually reassessing the eligibility of certified businesses. Until the state agency can reduce the large number of certified businesses due reassessments and begin adhering to the required annual cycle, FHWA should require that the state give reassessment priority to examining the eligibility of businesses at the time they are actually awarded contracts.

Agency Comments

The Department of Transportation disagreed with GAO's recommendation that FHWA annually collect and compile summary information on key program activities. In its opinion, such action would be burdensome and would not be cost-effective. (See app. VI.) GAO recognizes that obtaining and compiling such information will likely involve additional costs and resources. However, GAO believes that more meaningful and timely information is needed to foster effective management oversight of the program. GAO is not advocating a new management information system. Rather, it is recommending that such information be collected and included in FHWA's existing system. DOT generally agreed with the recommendation that FHWA help New York develop a reassessment plan, and that New York give priority to examining businesses at the time they are awarded contracts.

The New York and Pennsylvania State Departments of Transportation generally agreed with the report. (See app. VII and VIII, respectively.) In its comments, New York said that it has discussed steps with FHWA to obtain approval of its reassessment procedures.
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Abbreviations

DBE  Disadvantaged Business Enterprise
DOT  Department of Transportation
FHWA  Federal Highway Administration
GAO  General Accounting Office
OIG  Office of Inspector General
Members of the Congress and federal and state program officials have expressed concern about fraud and abuse in the Federal Highway Administration's (FHWA) Disadvantaged Business Enterprise (DBE) Program. The program was created by the Surface Transportation Assistance Act of 1982. In an attempt to expand the highway contracting opportunities for small businesses that are owned and controlled by socially and economically disadvantaged individuals, the act requires that at least 10 percent of the federal-aid highway funds states spend in a fiscal year be awarded to DBEs. Through the opportunities provided by the program, it is hoped that disadvantaged businesses can develop to the point where they can compete effectively with other highway contractors.

Legislative History of FHWA's DBE Program

FHWA informally encouraged the use of minority-owned businesses in federal-aid highway work as early as 1975. In 1980 the Department of Transportation (DOT) administratively established programs designed to expand the contracting opportunities for minority- and women-owned businesses. A formal DBE program was legislatively established by the Surface Transportation Assistance Act of 1982 (P.L. 97-424). Section 105 (f) of the act requires that on an annual basis not less than 10 percent of federal-aid highway funds be awarded to socially and economically disadvantaged small businesses.

The Surface Transportation and Uniform Relocation Assistance Act of 1987 (P.L. 100-17) made several major revisions to the DBE program. The act required that DOT develop minimum certification procedures for states to use when deciding whether businesses that apply for certification meet the program's eligibility criteria. The procedures require that states (1) interview program applicants at their home office, (2) visit applicants at work locations, (3) review financial and technical business documents, and (4) examine the resumes of the principal owners of applicant firms. Although the 1987 legislation did not change the program's overall 10-percent minimum goal, women-owned businesses were

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1 Federal regulation states that individuals who are members of certain groups are presumed to be socially and economically disadvantaged for the purposes of DBE program participation. These groups are Black Americans, Hispanic Americans, Native Americans, Asian-Indian Americans, Asian-Pacific Americans, and women.

2 States that want to establish an annual disadvantaged business program goal that is less than 10 percent must obtain a waiver from the Administrator, Federal Highway Administration.

3 To obtain DBE certification, businesses must meet the Small Business Administration's small business size standards, be owned by socially and economically disadvantaged individuals, and be managed and controlled by such individuals.
added to the group of businesses classified as socially and economically disadvantaged for the purpose of program participation. Previously, DOT had administratively established a separate program to assist women-owned businesses. Under that program, states were requested to spend at least 2 percent of federal-aid highway funds with such businesses.

Program Administrative Responsibilities

Although the federal government provides funding assistance to states for many highway construction and improvement projects, states are largely responsible for carrying out the projects. The DBE requirement is one of many federal requirements that states must comply with in order to receive federal highway aid. Under the DBE program, state responsibilities include determining the eligibility of new program applicants and issuing certificates to those who meet the eligibility criteria, reassessing annually the eligibility of certified businesses, and publishing annually lists of certified businesses. Additional responsibilities include establishing and obtaining FHWA approval of overall annual program participation goals for the state, establishing DBE participation goals for individual projects, monitoring contractors' compliance with program requirements, and sanctioning those contractors that do not comply.

FHWA is the federal agency responsible for implementing the DBE requirement for federal-aid highway projects. FHWA administers the disadvantaged business program through its headquarters Civil Rights and Highway Operations offices, 9 regional offices, and 52 division offices—1 in each state, the District of Columbia, and Puerto Rico. The headquarters offices are jointly responsible for developing and recommending program policies, regulations, instructions, and procedures; monitoring the activities of the agency's field offices and the states; and providing technical guidance. The agency's regional and division offices oversee program operations in various ways, including reviewing and approving states' annual DBE program plans, conducting periodic monitoring reviews, and providing technical guidance and advice.

The Status of the DBE Program

Since 1984, the first full year after the program was created, the program's 10 percent goal for DBE participation in federal-aid highway contracts nationwide has been exceeded. On an aggregate basis over the 1984-87 period, 12.3 to 15 percent of federal-aid funds have been spent annually with disadvantaged small businesses. Over this period, these businesses were awarded a total of $5.3 billion in federal aid highway
contracts. (See app. I and II for more detailed information on states' goal achievement and contract awards.)

Objectives, Scope, and Methodology

In a March 10, 1987, letter, the Chairman, Subcommittee on Water Resources, Transportation, and Infrastructure, Senate Committee on Environment and Public Works, requested that we review fraud and abuse in FHWA's DBE program. On the basis of that letter and subsequent discussions with the Chairman's office, our specific review objectives were to determine the

- nature and extent of program fraud and abuse,
- results of DBE investigation cases, and
- approaches used by FHWA and states to minimize fraud and abuse.

Our overall approach was to obtain nationwide data relating to these areas and supplement the data with more detailed information from two states—New York and Pennsylvania. We selected these states, with FHWA’s assistance, because of various factors such as their differing administrative structures, implementation practices, and experiences investigating DBE cases. Although these states are not statistically representative of state DBE programs nationwide, the information we obtained from them provides a fuller understanding of the experiences and concerns relating to the program.

We conducted our detailed work at FHWA headquarters in Washington, D.C.; DOT's Office of Inspector General (OIG); and the Department of Justice. Field work was conducted at FHWA regional offices in Albany, New York, and Baltimore, Maryland; FHWA division offices in Albany and Harrisburg, Pennsylvania; an OIG field office located in Baltimore; and at the New York and Pennsylvania Departments of Transportation.

We obtained a general overview of the program through our review of program literature and our attendance at a DBE conference sponsored by the American Road and Transportation Builders Association and a DBE task force meeting held by the American Association of State Highway and Transportation Officials.

This amount does not include the approximately $930 million in awards made to women-owned small businesses prior to 1987.

Nationwide data on the number of disadvantaged businesses that have received awards are not available, since FHWA does not require states to submit such information.
To obtain information on the nature and extent of fraud and abuse in the DBE program, we conducted a literature search and subsequently reviewed data available from such sources as the Transportation Research Board, the American Association of State Highway and Transportation Officials, the National Association of General Contractors, and the National Association of Minority Contractors. We also interviewed officials from the Department of Transportation's OIG; FHWA's Offices of Highway Operations, Civil Rights, and General Law; Justice's Criminal Division-Fraud Section; and representatives of the aforementioned national contractor associations. Additional information was obtained through discussions with FHWA and state officials in New York and Pennsylvania, including the New York State Department of Transportation's Assistant Commissioner for Legal Affairs and the Pennsylvania Department of Transportation's Inspector General.

To determine the results of DBE investigations handled by DOT's OIG and New York's and Pennsylvania's Departments of Transportation, we obtained and reviewed lists of their investigations to determine the source of the allegations, the organizations to whom cases were referred for action, and the ways by which the cases were resolved. We also reviewed selected cases in detail to obtain a fuller understanding of the specific nature of the investigations and their disposition. Our case file reviews were supplemented by discussions with OIG, FHWA, Justice, and state officials concerning the results of specific cases, the procedures used to investigate cases, and the difficulties associated with prosecuting alleged program abusers.

To determine how FHWA oversees states' DBE programs, we reviewed FHWA directives and memorandums that address program control areas such as certification, contract compliance monitoring, and administrative sanctions. Further, we reviewed FHWA headquarters and field office monitoring reports. We supplemented these efforts through discussions with FHWA headquarters and field personnel, and where possible, accompanied FHWA officials on their state monitoring visits. As part of this effort, we examined on a limited basis the extent to which FHWA headquarters and the field offices we reviewed were adhering to the internal control practices set forth in program regulations and agency directives.

To obtain information on how states administer their programs, including their efforts to minimize fraud and abuse, we focused on key administrative control points—certification, contract monitoring, administrative sanctions, and investigations. In New York and Pennsylvania, we interviewed key program and enforcement officials and
examined documents, including certification applications and guidelines, certification appeal case files, contract goal-setting and monitoring directives, DBE contract monitoring reports, and investigation case files. We also observed (1) first-time certification and reassessment interviews, (2) certification and reassessment appeal hearings, (3) state pre-construction meetings and, where possible, (4) state monitoring reviews.

Chapter 2 of this report describes the general nature of DBE program fraud and abuse and discusses some of the information deficiencies that make it difficult to assess the extent to which such problems exist nationwide. The chapter also provides information on the results of cases investigated by DOT's OIG and by the two states we reviewed. Chapter 3 describes the efforts made by the Congress, FHWA, and individual states to improve controls over program operations to minimize fraud and abuse. It also discusses the need for FHWA to centrally collect information on the results of certification, reassessment, and monitoring activities. Our recommendations are presented in chapter 3.

Comments on a draft of this report were received from DOT, as well as the New York and Pennsylvania State Departments of Transportation and are included as appendixes VI, VII, and VIII, respectively. We conducted our review between May 1987 and June 1988 in accordance with generally accepted government auditing standards.
According to federal and state officials, DBE program fraud and abuse has primarily involved businesses that either (1) are ineligible to be DBEs, but obtain certification and contracts based on inaccurate or misleading information, or (2) meet the minimum eligibility criteria, but engage in questionable contractual arrangements with other contractors. Opinions vary among federal, state, and industry officials concerning the extent of such problems nationwide. However, the extent of fraud and abuse nationwide remains unknown largely due to data limitations at the federal level concerning the universe of DBE investigations nationwide. Further, many of the program irregularities that have been detected have been resolved by states administratively without initiating fraud investigations.

DOT’s OIG and the two states we reviewed have investigated allegations of program fraud and abuse. While most of their investigations have been ultimately resolved by administrative action, several cases were resolved by judicial action. Federal and state officials have found that investigating and prosecuting DBE cases are difficult and time-consuming to conduct. Despite the problems officials have had getting DBE cases accepted for prosecution, they believe that prosecuting major fraud cases will send a message to the highway contracting industry that such fraud will not be tolerated and thus may help deter contractors from engaging in such activities.

FHWA has encouraged states to place greater emphasis on using administrative sanctions to enforce program requirements without resorting to referring cases to prosecutive agencies—especially since officials have experienced difficulty getting DBE cases accepted for prosecution. By focusing on the use of administrative sanctions, FHWA officials believe that states can deal more swiftly and effectively with contractors found in noncompliance. We also found that New York and Pennsylvania were taking steps to enhance their ability to enforce requirements through administrative sanctions.

**DBE Program Qualifications and Requirements**

Federal law requires that businesses that want to obtain DBE certification must (1) meet the Small Business Administration’s small business size standards, (2) be owned by one or more socially and economically disadvantaged individuals (DOT regulations require that such individuals own at least 51 percent of the business), and (3) be managed and controlled by such individuals. Federal regulations and/or policies further require certified businesses to carry out all the work that they are contractually responsible for—indipendently of non-DBE contractors and...
perform work that is necessary and meaningful for the completion of projects. While DBE contractors are allowed to accept some technical assistance from other contractors, officials of these businesses are expected to supervise their own employees at work locations and make all management decisions.

The Nature of DBE Fraud and Abuse

Federal and state investigations, congressional oversight hearings, and the media have cited instances of fraud and abuse in the program since its inception in 1983. Some situations have involved businesses ineligible to be DBES, but that have obtained certification and contracts on the basis of inaccurate or misleading information. Other situations have involved businesses that meet the eligibility criteria, but engage in questionable contractual arrangements with other highway contractors that may, upon further investigation, reflect fraudulent or abusive activity. (See app. IV and V for selected synopses of DBE investigations.)

According to federal and state officials, their investigations of alleged wrongdoing have revealed that some businesses have been improperly granted DBE certification and contracts because they provided inaccurate or misleading information in support of their certification applications. In some cases, women and minorities have been portrayed as the major owners of businesses to obtain program benefits, when they in fact function in lesser roles in businesses that are actually controlled by others, such as their husbands and employers. In one case, OIG investigators found that the woman president of a highway guardrail company had not really exercised financial and managerial control over the company. The business and its president pled guilty to making false statements in order to gain admittance to the program.

In other cases, certification has been granted to bogus businesses—that is, companies that exist only on paper. According to federal and state officials, the certification of these bogus businesses has enabled some prime and subcontractors to obtain program benefits they were not entitled to by submitting false documentation using the names of these bogus entities. To illustrate, an OIG investigation found that a prime contractor apparently set up two women as the owners of a bogus disadvantaged business. The investigators reached this conclusion based on several findings including that (1) the DBE was financially and managerially dependent upon the prime contractor and (2) one of the women owners was the wife of the prime contractor and also served as secretary for both the DBE and the prime contractor. The DBE was decertified.
Although certified businesses are required to perform a meaningful project function, federal and state officials have found situations where DBE contractors simply serve as "brokers" between prime contractors and other subcontractors. For example, investigators in one state we reviewed found that a DBE functioned as a broker since it did not purchase and install the materials requested by the prime contractor. In addition, the business did not supply any equipment or labor to carry out the project. In this case, the DBE was suspended from the program for 1 year.

In other situations, federal and state investigators have found that some DBEs were not maintaining managerial control of their project activities and operating independently of other contractors. Situations have been identified where the work assigned to DBEs was actually supervised and carried out using the equipment and employees of prime contractors. For example, OIG investigators found that in one such situation the DBE was paid money by a prime contractor to function as a "front". The prime contractor did the work assigned to the DBE, and then submitted false documents to the state claiming credit for the work against the project's DBE goals. The contractor agreed to pay the state about $237,000 in compensatory damages, court costs, and legal fees.

Opinions vary among federal and state officials, as well as among representatives of various segments of the highway contracting community concerning the pervasiveness of program fraud and abuse nationwide. The extent to which such problems have been identified is unknown, however, largely because FHWA does not have a process for systematically obtaining and compiling information on all DBE investigations handled annually by states. The agency also does not have summary information on the many irregularities that have been resolved by states through administrative action without conducting fraud investigations.

Specifically, we found that FHWA does not have nationwide summary information covering such areas as the (1) types of alleged violations investigated, (2) methods by which cases were identified, (3) number of open and closed investigations, (4) status of the cases, and (5) types of actions taken. Although some information on DBE investigations is available from DOT's OIG data base, an OIG official stated that the data base only includes information on a small proportion of cases investigated nationwide. The 89 investigations handled by the OIG over the 1983-87 period only represent those it initiated or were referred to it by other federal agencies, states, and individuals through the OIG fraud hotline.
The database does not include investigations handled by states without the OIG’s involvement. We found in New York and Pennsylvania alone a total of 60 closed investigations that were not included in the OIG’s data base.

**Difficulties Investigating and Prosecuting Alleged DBE Fraud Cases**

Fraudulent acts are commonly defined as actions by individuals who purposefully misrepresent facts in order to obtain funds under false pretenses. Federal and state program and investigative officials and prosecutors agree that investigating and successfully prosecuting cases of alleged DBE fraud—as with other types of fraud—is difficult. According to these officials, DBE fraud investigations are difficult and time-consuming to conduct, since some contractors have devised increasingly sophisticated schemes to obtain program benefits—with the result being that investigations often require extensive coordination over extended periods of time among federal and state agencies. Officials explained that such investigations generally involve detailed reviews of documentation such as payroll records, financial statements, and cancelled checks. They also typically involve interviews with the contractors under investigation, their employees, other contractors who have interacted with those contractors under investigation, and state officials, including highway project engineers.

Even if such extensive investigations indicate that contractors may have engaged in wrongdoing, it is difficult to get DBE fraud cases accepted for prosecution. According to OIG, Justice, and state officials, the Justice Department and state prosecutive agencies consider various factors when deciding whether to accept or reject a case for prosecution. These factors include the dollar recovery potential of a case, the strength of the evidence presented, the availability of alternative administrative remedies that may be more efficient and effective to address particular situations, and the workload and case priorities of prosecutors. These officials further commented that prosecutors are especially reluctant to take on DBE cases involving highway projects that were completed on-time, within budget, and met highway work standards. Such cases are especially difficult to get prosecuted, according to these officials, when the main consequence of the alleged irregularity was that the intent of the program was undermined because non-DBE contractors performed the work that was to have been done by DBE contractors.

The OIG, with assistance from the Justice Department, developed guidelines for its investigators. The guidelines recommend that investigators
undertake extensive fraud investigations if early discussions with prosecutors indicate that such cases would likely be prosecuted, or there is a likelihood of significant administrative action based on the investigations. The guidelines also suggest that investigators concentrate on major cases, such as those involving major highway projects or systemic problems, because the Justice Department and states are more likely to prosecute these cases. In addition, program officials, investigators, and prosecutors believe that focusing on the major cases will bring visibility to the investigations and thus send a clear message to the highway contracting industry that DBE fraud will not be tolerated. The following sections summarize the results of the DBE cases investigated by DOT's OIG and the two states we reviewed.

Office of Inspector General DBE Investigations

DOT's OIG conducted 89 investigations of suspected DBE fraud nationwide from 1983 through October 1987. Of that number, 21 cases emanated from OIG investigations, with the remaining 68 cases being referred to the OIG by states, other federal agencies, and individuals through the OIG fraud hotline. Of the 70 investigations closed as of October 1987, 53 were eventually resolved through administrative action and 17 through judicial action. (See app. IV for synopses of 6 OIG cases.)

The 53 cases that were eventually resolved administratively—including 18 cases that had been initially referred by the OIG to federal or state prosecutors—were resolved in various ways. Our analysis of OIG data disclosed that 32 of the 53 cases were closed without any action being taken against contractors because the allegations could not be substantiated. In the remaining 21 cases, various actions were taken against contractors including (1) decertifying contractors, (2) preventing contractors from obtaining contracts for specific periods, (3) imposing fines against contractors, and (4) requiring contractors to institute new operating procedures to bring them into compliance.

Regarding the 18 OIG cases referred for prosecution but rejected and eventually administratively resolved, our review of case files and discussions with OIG officials disclosed that prosecutors declined cases for such reasons as (1) insufficient evidence of criminal wrongdoing, (2) higher caseload priorities, and/or (3) the availability of alternative administrative remedies. To illustrate, one case involved a prime contractor charged with setting up a bogus company for the sole purpose of achieving its project participation goal. The U.S. Attorney's office declined to prosecute the case stating that while criminal acts may have been committed, a criminal case would probably not be successful.
because there were no monetary losses and there were no allegations of poor workmanship. If these had been factors, they would have added greater support to the government’s case. In any event, the federal prosecutor believed that the case could be effectively resolved through administrative action. The case was also declined by a state Attorney General’s office. Eventually, the case was resolved administratively with the state withholding $93,000 from payments to the contractor.

Concerning the 17 OIG fraud cases accepted for prosecution, 5 cases resulted in the defendants being acquitted and 12 cases resulted in the defendants being convicted. The contractors were found guilty of one or more serious abuses. The abuses included the submission of false documentation to obtain certification and the participation in arrangements whereby the equipment and employees of non-DBE contractors were used to perform the DBE’s work. In the cases that involved these latter types of activities, it was determined that the contractors conspired to submit false information to the state highway agency, claiming that the work had been completed by certified businesses. While none of the contractors received jail sentences, disciplinary actions were taken against those who were convicted. The actions included disqualifying the contractors from obtaining highway contracts for periods ranging up to 1-1/2 years and requiring the payment of fines or other restitution.

In the closed OIG cases, highway contractors paid a total of $1,040,434 as a result of judicial and administrative actions. According to an OIG official, this amount represents $216,009 in federal recoveries, $497,325 in state recoveries, $271,000 in court-ordered restitution, and $56,100 in fines.

New York and Pennsylvania DBE Investigations

New York and Pennsylvania state transportation officials have also investigated highway contractors suspected of wrongdoing associated with program requirements. Of a total of 61 closed investigations handled by these states since the program’s 1983 inception (60 of which are not reflected in the closed OIG cases discussed in the previous section), all but one of the cases were resolved through administrative actions. In the one investigation resolved through judicial action, Pennsylvania prosecutors obtained the conviction of four highway contractors who admitted to criminal wrongdoing. (See app. V for synopses of 7 DBE investigations handled in these states.)
### Results of New York's Investigations

In New York, between 1984 and 1987, state transportation agency officials handled 66 DBE investigations, of which 49 were closed at the time of our review. The cases emanated primarily from a special state agency investigative task force. Of these 49 cases, 26 were closed without any judicial or administrative action. The remaining 23 cases were resolved through administrative action against contractors. The state has not prosecuted any DBE cases involving highway projects.

Regarding the 23 cases where some administrative action was ultimately taken, the suspected abuses included (1) prime contractors submitting claims that certified businesses completed a segment of work when, in fact, the prime contractors or other subcontractors actually completed the work, (2) certified businesses that were not owned or controlled by disadvantaged individuals, and (3) certified businesses that were not adequately controlling the activity for which they were contractually responsible. Specifically, the state transportation agency decertified 15 DBEs, suspended 3 certified businesses from the DBE program, and excluded 5 contractors from the contracting process for periods ranging up to 2-1/2 years. In one case, a DBE was decertified because agency officials determined that the business had relinquished control of its daily business operations on a highway project to non-DBE subcontractors. In another case, a prime contractor suspected of establishing bogus companies so that it could meet project participation goals, paid a $300,000 monetary penalty to the state for this program abuse.

### Results of Pennsylvania's Investigations

During the 1984-87 period, the Pennsylvania transportation agency handled 24 DBE investigations, of which 12 cases were closed at the time of our review. Regarding these 12 cases, we found that the state agency resolved 5 cases by taking some type of administrative action against the contractors such as decertifying DBE's and excluding contractors from the state's highway program for periods ranging up to 3 years. In six of these cases, however, no actions were taken against the contractors. One case resulted in judicial action.

In the one Pennsylvania case where the state convicted highway contractors of fraud and conspiracy, a prime contractor had used its own equipment and employees to do the work that was the contractual responsibility of a DBE, but claimed that the work was done by the DBE. It was also determined that the certified business received funds from the prime contractor in exchange for its cooperation in the arrangement. The certified business was assessed fines and restitution which totaled $25,000 and was excluded from highway contracting for 3 years. The...
The prime contractor was required to pay $295,000 and also was excluded from obtaining highway contracts for 2 years. In addition to the principal defendants in this case, two other contractors were convicted because they admitted that they engaged in inappropriate dealings with the same DBE. These contractors were assessed fines and restitution that totalled $40,000 and $55,000, respectively. Also, they each were placed on probation for 1 year.

**FHWA Encourages States to Use Administrative Sanctions to Enforce Program Requirements**

FHWA, the Department of Transportation’s Office of Inspector General, the Department of Justice, and state officials agree that the use of administrative sanctions to help enforce program requirements has taken on greater importance in recent years, given the difficulties getting DBE cases accepted for prosecution. FHWA has encouraged the expanded use of sanctions in a 1986 and a 1987 memorandum to its field offices and the states. As stated by the agency in its 1986 memorandum, administrative sanctions offer a “swift and equitable treatment” of program irregularities.

Federal regulations require that the states’ programs include a component for enforcing the federal DBE requirements. In view of this requirement and the fact that there are differences in state laws and enforcement practices in terms of the types of sanctions that state highway agencies can impose against contractors, in 1986 FHWA surveyed the states to determine their sanctioning procedures and practices. FHWA disseminated the survey results to its field offices and the states for their consideration in strengthening their programs. The survey found that states, including the two we reviewed, had authority to use various administrative sanctions to enforce DBE program requirements. The states’ sanction options included decertifying DBEs, prohibiting contractors from obtaining highway contracts for specific periods, and assessing monetary penalties against contractors.

Additionally, we found that FHWA and state officials in New York and Pennsylvania are taking actions designed to strengthen their ability to enforce program requirements. FHWA and state officials in Pennsylvania, for example, have been jointly working to develop a schedule of administrative sanctions that could possibly be included in all of Pennsylvania’s federal-aid highway contracts to cover varied types of program noncompliance. Officials told us that, in their view, the inclusion of detailed sanction provisions in contracts should help deter some contractors from engaging in abusive or fraudulent activities. They also said that, by outlining specific sanction possibilities in contracts, the
state transportation agency should have greater support for taking punitive action against contractors found in noncompliance. While several administrative issues remain to be worked out, an FHWA division official estimated that the sanction schedule should be completed by mid-1989.

In response to recommendations made by a 1985 state transportation agency disadvantaged business task force, New York officials established in 1987 a special unit to investigate alleged program irregularities. The unit’s responsibilities include investigating the activities of highway contractors suspected of program abuses and working with the agency’s contract review unit to resolve problems involving contractors that have not complied with program requirements. Since the significance of violations can vary, general guidelines have been developed to help agency officials make sanction decisions. According to the agency’s Assistant Commissioner for Legal Affairs, the guidelines recommend, for example, that consideration be given to such factors as the substance and impact of a violation, the number of times the violation occurred, the period over which it occurred, and whether there was any evidence suggesting that the violation represented a deliberate attempt to circumvent DBE program requirements.

Conclusions

Since the inception of FHWA’s DBE program in 1983, various program irregularities have been identified by the media, members of Congress, and federal and state officials. These irregularities have primarily involved businesses that either have not met the eligibility criteria but obtained certifications and contracts by submitting inaccurate and misleading information, or that met the criteria but engaged in questionable contractual arrangements with other contractors.

Divergent views have been expressed by federal, state, and industry representatives concerning the extent of program fraud and abuse nationwide. However, the extent that such problems have been identified cannot be determined at this time primarily because FHWA does not systematically collect and summarize information on the outcome of all DBE investigations and on those irregularities handled by states without resorting to in-depth fraud investigations. We believe that the availability of more detailed information on the results of DBE investigations—along with detailed information on other key program activities such as the results of certification, reassessment, and monitoring activities that
we discuss in chapter 3—would be beneficial from a management control standpoint. Such data should be beneficial to FHWA program managers and the Congress in discharging their oversight responsibilities. For example, nationwide summary information on the results of all DBE investigations should provide them with a fuller understanding of the extent of program fraud and abuse nationwide and permit them to more effectively analyze how such problems have changed over time.

Regarding DBE investigations, federal and state officials have found it difficult to investigate allegations of wrongdoing by contractors and to get prosecutors to accept such cases for judicial action. We agree with these officials that despite such difficulties, it is still worthwhile to pursue major DBE fraud cases in order to deter contractors from engaging in fraudulent activities. Although information was not available on all DBE investigation cases initiated nationwide, we found that DOT’s OIG and the two states we reviewed had investigated DBE fraud cases between 1983 and October 1987. While some cases were prosecuted and several contractors were convicted, most of the cases were ultimately resolved through administrative actions against contractors or closed without action because of insufficient evidence.

Concerning the use of administrative sanctions, we found general agreement among FHWA, DOT’s OIG, Justice Department, and state officials that program operations can be strengthened by using administrative sanctions to enforce DBE requirements. We concur with these officials on the potential usefulness of such enforcement actions, particularly since officials have had difficulty getting some DBE fraud cases accepted for prosecution. Moreover, we support FHWA’s actions to encourage the expanded use of administrative sanctions to help swiftly and equitably enforce program requirements.
As FHWA’s DBE program has evolved, concerns about program fraud and abuse have led the Congress, FHWA, and individual states to take steps intended to improve program management controls—including certifying and monitoring procedures—to assure that only eligible disadvantaged businesses receive program benefits. In 1987, the Congress enacted legislation to strengthen program controls by requiring states to incorporate certain minimum procedures into their certification processes—including conducting personal interviews of program applicants and visiting their home offices. We found that the two states we reviewed—New York and Pennsylvania—had implemented comprehensive procedures for determining the eligibility of new applicants that generally complied with the federal laws and regulations governing the program. Since the program’s inception, states have been required to annually reassess the eligibility of certified businesses that want to remain in the program. We found, however, that New York was not complying with this regulatory requirement. Since changes can occur in business size, corporate structure, and financial status, some businesses certified for and obtaining federal-aid highway contracts may not meet current eligibility criteria.

Additionally, we found that FHWA and the states we reviewed had broad-based programs to monitor state and contractors adherence to program requirements. In general, their programs complied with federal requirements and guidance. The approaches used to help minimize program fraud and abuse included regular oversight by headquarters and field office personnel and also periodic monitoring reviews as a further check to assure program compliance.

Although various positive steps have been taken to improve how the program is administered, we found that FHWA does not regularly obtain summary information on states’ certification and reassessment activities and the results of federal and state DBE monitoring reviews. Nationwide data are not available on such areas as the number of new and reassessment applications received, approved, and denied. Further, data are not available on the (1) number of DBE monitoring reviews that identified major violations, (2) types and frequencies of major violations, and (3) types and frequencies of corrective actions. The compilation of such data would enhance the ability of federal program managers and the Congress to oversee program operations.
Before a business can obtain a federal-aid contract as a DBE, federal regulations require states to certify that the business is a small business, owned and controlled by socially and economically disadvantaged individuals. The Surface Transportation and Uniform Relocation Assistance Act of 1987 (P.L. 100-27) mandated that DOT develop certain minimum procedures for states to incorporate into their certification processes. The legislation requires that states (1) interview all applicants, (2) visit the applicants at work locations, (3) analyze various technical and financial documents such as lease agreements and partnership agreements, and (4) review the resumés of principal owners of applicant firms.

According to FHWA headquarters program officials, states have developed procedures for assessing the eligibility of new program applicants that generally comply with federal requirements. While these officials acknowledged that variances exist in the quality of some certification decisions, overall they believed that states have made efforts to preclude ineligible businesses from gaining acceptance to the program. They said that their conclusion is based on various oversight activities, including their reviews of states' annual DBE program plans and their periodic reviews of states' implementation practices—including observations of certification interviews and certification appeal proceedings.

Our New York and Pennsylvania reviews disclosed that these states have procedures that generally meet federal requirements. Through our review of program documentation and our observation of certification interviews and appeal proceedings in both states, we believe these states have implemented comprehensive procedures to assess the eligibility of new applicants. Both Pennsylvania and New York had applicants submit (1) detailed applications, (2) resumés of principal owners, and (3) extensive supporting data covering financial, corporate, and technical business information. To strengthen the quality of their eligibility determinations, certifying officials in both states drew upon the diverse expertise of staff attorneys, accountants, business analysts, engineers, and civil rights personnel. An FHWA official said, and we agree, that this team approach can be a useful technique to help minimize the possibility of ineligible firms becoming certified because such individuals bring various perspectives to the eligibility assessment process.

Consistent with federal requirements, the certification procedures in these states also included an on-site interview component for new applicants. Pennsylvania's certification procedures require officials to visit new applicants with home offices within the state even before site visits...
were required by federal law. According to a state transportation agency official, on-site certification visits are routinely made to the home offices of applicants located in bordering states and the District of Columbia. Applicants from more distant states are asked to travel to Pennsylvania for an interview or, if that is impractical, applicants are interviewed by telephone. Data for the 1986-87 period showed that the agency conducted 327 on-site interviews (236 for in-state applicants and 91 for out-of-state applicants) and conducted 22 telephone interviews.

New York amended its procedures for assessing the eligibility of new applicants in 1987. The state’s procedures now require officials to visit the home offices of first-time applicants located within the state. State officials told us that when they assess the eligibility of out-of-state applicants, they check that the business has a certification from its home state and that an on-site interview was conducted. If an interview was done, New York officials said that they generally use the results when making their eligibility determinations. In some instances, however, they will conduct the on-site interviews for applicants in nearby states. Aggregate data covering the January to September 1987 period showed that state officials conducted 98 on-site interviews for new applicants.

FHWA officials believe, and we agree, that the on-site interview practices employed by Pennsylvania and New York for firms seeking initial certification were reasonable, especially since it is often impractical from a resource standpoint for state officials to visit applicants in other states. The approaches used by these states were, in fact, consistent with FHWA guidance issued in 1987 and 1988 that encouraged states to employ various alternative certification techniques—including using the results of home office visits done by an applicant’s home state.

Overall, we found that states’ implementation of the above certification procedures (including those implemented as a result of the 1987 federal legislation) had resulted in a sizable number of new applicants being denied certification because they did not meet program eligibility criteria. Our review of Pennsylvania certification data disclosed that over the 1983-87 period, 657 of 1,451 applications acted on (about 45 percent) were denied. In New York, state transportation agency data covering the 1985-87 period showed that 84 of 303 applications acted on (about 28 percent) resulted in denials.¹

¹The state transportation agency was not able to provide data on certification activity that occurred from 1983 through August 1985.
States Required to Annually Reassess DBE Eligibility

Since 1983 states have been required to annually reassess the eligibility of certified businesses. FHWA requires that the states obtain federal approval of their reassessment procedures. To facilitate the process, businesses are also required by federal regulation to annually submit updated information that supports their program eligibility or submit an affidavit certifying that the information in the state’s files is still accurate. Some states require that these businesses submit new applications with extensive supporting documentation. FHWA officials believe that reassessing the eligibility of certified businesses is an important strategy to help prevent ineligible businesses from receiving program benefits—especially since changes can occur over time in a firm’s organization, business size, ownership, and/or control that make it ineligible to participate in the program. Reassessments can also help officials identify circumstances that were not found during the initial screening process and that render some certified businesses ineligible for the program.

We surveyed FHWA regional officials nationwide to determine whether the states in their respective regions had developed and implemented procedures that were approved by FHWA for annually reassessing the eligibility of previously certified businesses. Our survey efforts revealed that all states, except New York, had developed and obtained FHWA approval of their annual reassessment procedures and that most states were implementing their procedures according to schedule. (See app. III for information on states’ reassessment procedures.)

As noted above, New York has not complied with the federal requirement that it develop and implement procedures for annually obtaining and reviewing updated information from certified businesses. A state agency official estimated that as many as 700 certified businesses may be due certification updates. FHWA and state transportation officials in New York told us that the agency has been unable to obtain and review updated information annually, because they have had to dedicate their limited staff resources to assessing the eligibility of the large number of new certification requests (518 new applications were submitted over the 1985-87 period) the agency has received. Also, the agency has had problems identifying which DBES are still in business and thus due certification updates. FHWA officials recognized that given the agency’s constraints it would probably take the state several years to reassess all those businesses due updates and begin adhering to the required annual reassessment cycle. Nonetheless, these officials maintain that reassessing certified firms was an important technique for helping to weed out firms that do not meet current program eligibility criteria.
We agree with FHWA on the importance of certification reassessments, especially since experience has shown that some ineligible companies have succeeded in becoming certified and obtaining program benefits. Our review of New York investigation files disclosed that state agency officials identified ineligible businesses that had obtained disadvantaged business contracts. In one 1985 case, for example, investigators found that a certified business was not actually managed and controlled by a disadvantaged owner and did not function independently of other contractors. From November 1982 to March 1985, the business had been awarded contracts worth in excess of $535,000. In another 1985 case, a state agency investigation revealed that a certified business that was supposedly owned and controlled by a woman was really headed up by her husband. The business had received disadvantage business contracts worth about $221,000. In our view, annual reassessments may have enabled agency officials to prevent such ineligible businesses from obtaining contracts.

As of June 1988, state transportation officials in New York had not developed and implemented a plan for handling its large backlog of certification reassessments. FHWA’s Assistant Division Administrator in New York told us that while FHWA was aware of the state transportation agency’s problem, the state agency would be allowed to establish its own reassessment priorities given its resource constraints and the large number of new applications it had to act on.

In Pennsylvania, we found that all certified businesses were being required to submit updates annually. Businesses were also required to submit detailed supporting documentation such as financial statements and tax returns. According to a state agency certifying official, from the program’s inception through mid-1987 all certified businesses located in Pennsylvania, bordering states, and the District of Columbia were subjected to annual reassessment visits. (Over the 1986-87 period, Pennsylvania officials conducted 297 on-site reassessment interviews, 221 for in-state businesses and 76 for out-of-state businesses.) Since mid-1987, however, resource limitations and the size of the agency’s DBE program have led officials to limit their on-site reassessment activities. Officials now consider various factors when deciding whether to conduct an on-site reassessment visit—factors that we found to be consistent with the reassessment guidance issued by FHWA in 1987 and 1988. We found, for example, that Pennsylvania officials considered (1) whether a business received over $500,000 in federal-aid highway contracts in a year, (2) whether there were any specific concerns about its eligibility or operations, and (3) whether a business’ annual update indicated changes.
that could impact its eligibility. State agency data showed that over the 1986-87 period, 27 of 297 DBEs that were re-examined lost their certification through the reassessment process.

### FHWA and States Have Implemented DBE Monitoring Programs

Program monitoring is another important part of the process for assuring that states and contractors comply with federal program requirements. FHWA has devised and implemented a multi-pronged approach for monitoring state and contractor activities, involving both headquarters and field office personnel that generally followed the agency’s general guidance. New York and Pennsylvania also have devised and implemented multi-dimensional approaches for monitoring contractors’ compliance with DBE requirements that generally comply with federal monitoring requirements and guidance. In these states, monitoring is conducted by both central office and field personnel and covered contractors’ performance from bidding through project completion.

### FHWA Monitoring of States and Contractors

FHWA has developed a multi-pronged approach for monitoring states’ and contractors’ adherence to program requirements. FHWA’s headquarters Office of Civil Rights officials (sometimes accompanied by Office of Highway Operations officials) conduct compliance reviews which focus on federal-aid highway DBE program requirements. Along with assessing states’ programs, these headquarters reviews assess FHWA regional and division monitoring activities. While some problems are identified through headquarters reviews, FHWA officials told us that they rely primarily on their field offices for more detailed program oversight.

FHWA field offices oversee states’ programs by reviewing and approving annual DBE plans that include information on each state’s annual participation goal and its certification, monitoring, and enforcement procedures. We also found that the agency’s field offices (primarily at the division level) also oversee states’ programs through routine contract administration which includes (1) attending states’ pre-construction meetings at which prime contractors are informed of their DBE contractual obligations and (2) incorporating a DBE component in their general on-site monitoring of on-going highway projects. Field offices also periodically undertake various reviews—some performed by regional civil rights personnel, others done by division engineers. These reviews, which can take as much as 5 days to complete, assess the adequacy of state monitoring procedures and implementation practices at the central, district, and project levels.
FHWA officials told us that the scope and frequency of monitoring reviews are based on various factors. These factors include the availability of resources and the results of prior reviews. Similar to the headquarters reviews, these field office reviews may cover a state's entire program or focus on a specific element, such as DBE certification or contract monitoring. In examining several individual monitoring reports, we found that the reviews also included a review of specific federal-aid highway projects to assure that states established the necessary controls at work locations.

FHWA conducted a special survey of its field offices and obtained data for us on the number of monitoring reviews conducted by FHWA and states' civil rights personnel. Data on the reviews completed during the 1983-87 period are contained in table 3.1.

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<td>Division/state offices&lt;sup&gt;a&lt;/sup&gt;</td>
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<sup>a</sup>FHWA estimated that 95 percent of the reviews done at the state level were done by state transportation agency civil rights offices.

FHWA oversight of DBE activities were similar in many respects in the two states we visited. The division offices in both states review states' annual DBE program plans. In doing so, FHWA division officials said that they check that the plans comply with federal requirements and that they detail the procedures used to (1) certify first-time program applicants, (2) annually reassess certified businesses, and (3) monitor and enforce program requirements. Further, these division officials said that they monitor states' programs through periodic reviews that resulted in written reports.

We examined three reports (two issued in 1985 and one issued in 1987) prepared by FHWA's Pennsylvania division office, and found that the office recommended that the state transportation agency improve its project monitoring controls. The office also recommended that the state agency develop specific DBE sanctions to deal with prime contractors that have not made good faith efforts to meet their project goals. At the time of our review, the state agency was in the process of implementing both recommendations.
In addition to the oversight activities mentioned above, we found that division officials in Pennsylvania were doing other types of program monitoring. For example, a division official said that they routinely attend state agency meetings at which DBE applicants denied certification appeal the state agency’s decision. According to these officials, they usually include DBE assessments when they do their general compliance monitoring of federal-aid highway projects. According to a division official, these diverse activities provide an expanded understanding of how well the state is carrying out its program responsibilities.

States Monitor Contractors’ Adherence to DBE Requirements

As part of their DBE programs, states are required to monitor highway contractors to assure that they adhere to all DBE requirements. FHWA and state officials believe it is essential that state officials regularly observe the activities of contractors and review documentation to assure, for example, that DBE subcontractors actually perform meaningful work and control their project responsibilities. In their view, detailed project-level monitoring is important to help ensure that (1) only work done by certified businesses is credited towards a contract’s project participation goal and (2) suspicious arrangements are detected, investigated, and if required, dealt with expeditiously to preclude contractors from unfairly benefitting from the program. These officials believe that it is equally important to conduct monitoring reviews periodically, as a further check to assure compliance.

Both New York and Pennsylvania have established detailed procedures for monitoring contractors’ adherence to program requirements. We found that state highway engineers responsible for regularly monitoring individual highway projects had also been delegated the primary responsibility of assuring that contractors adhered to DBE contractual requirements. They were required, for example, to (1) determine whether the work subcontracted to DBEs was actually performed by the specified contractors, (2) review payroll records submitted by prime contractors and attest to their accuracy, and (3) determine that the DBEs operating on projects have valid certifications.

In the two states we reviewed, the DBE monitoring activities of project engineers was supplemented by periodic monitoring by other state transportation agency officials. In New York, for example, civil rights personnel located in the agency’s 11 engineering regional offices were doing in-depth, scheduled, reviews on selected projects. While summary information was not available on the number and results of such reviews conducted since the program’s inception, officials told us that in
1987 approximately 50 to 60 in-depth reviews were conducted. In addition, these officials conduct unannounced reviews of all projects in their respective jurisdictions about every 45 to 50 days to assure compliance with all civil rights contract provisions. For projects with a DBE requirement, the regional officials interview prime contractors, DBE officials and their employees, and review relevant project documentation. We observed several reviews, and believe that they can be useful for monitoring contractors' activities and for helping to resolve problems expeditiously. FHWA regional officials believe that New York has established a well-run monitoring program and, as a result, have on occasion requested that officials from other states in the region observe how New York officials do their monitoring reviews.

In Pennsylvania, we found that the monitoring activities of project engineers were being supplemented by periodic, unannounced project reviews by agency civil rights officials. Because of resource constraints within the agency's civil rights office, however, officials said that they were relying on state quality assurance engineers (who check for general compliance with all contract requirements) to do most of these unannounced monitoring reviews. An agency official said that over the 1986-87 period, 160 quality assurance reviews of federal-aid projects contained a DBE component. FHWA and state transportation agency officials in Pennsylvania told us that additional monitoring was being done by state district engineers, through such activities as (1) holding pre-construction meetings with prime contractors to convey information concerning contractors' DBE contractual requirements and (2) checking prime contractors' attainment of project goals.

FHWA does not regularly obtain and compile nationwide summary information on the results of states' certification and reassessment activities. Likewise, the agency does not maintain summary information on the results of FHWA and state DBE monitoring reviews.

With respect to certification and reassessment activities, FHWA does not maintain summary information on such things as the number of new and reassessment applications annually received, approved, and denied by states nationwide. While FHWA conducted a one-time nationwide survey of all states in 1985 and obtained such information for fiscal year 1984 and the first quarter of 1985, the agency has not requested that states submit updated information for subsequent years.
Regarding the results of monitoring activities, information was not centrally available covering such areas as the (1) number of DBE reviews conducted that identified major violations, (2) types and frequencies of the major violations, (3) number of open and closed recommendations, and (4) the types and frequencies of corrective actions taken.

The Director of FHWA’s Office of Highway Operations agreed with our observation that given the emphasis placed on administrative controls to combat fraud and abuse in the DBE program, nationwide information on the results of states’ annual certification and monitoring activities could be useful. He also agreed with our observation that simply tracking the number of monitoring reviews, for example, was not a meaningful measure from a nationwide perspective for (1) assessing changes in the quality of states’ programs and (2) gauging the extent to which DBE program fraud and abuse has been identified within the highway contracting industry. This official said, however, and we recognize, that developing a national data base that contains summary information covering the program components outlined above can require the agency to incur some costs and can be time-consuming for those who must collect and compile the data.

Conclusions

Determining the eligibility of new DBE program applicants is an important first-line defense to help prevent ineligible businesses from gaining entrance to and benefitting from the program. Recognizing the importance of the certification process to the integrity of the program, we found that the federal government and individual states have taken steps to improve the procedures. While FHWA officials believe that states have developed procedures for assessing the eligibility of new applicants that generally comply with federal requirements, they pointed out that just as implementation practices vary from state to state so do the quality of some certification decisions. Based on our review of New York’s and Pennsylvania’s procedures and our observance of several certification interviews and certification appeal hearings, we believe that these two states have developed and implemented procedures to determine the eligibility of new applicants that generally comply with federal requirements.

Regarding annual reassessments of certified businesses, we agree with FHWA officials that such assessments can be useful to help determine the continued eligibility of certified businesses—especially since changes can occur which make businesses ineligible for the program. Pennsylvania’s experience illustrates how the annual reassessment process
can be a useful management tool given that 27 of 297 certified businesses reassessed were eliminated from the program during the 1986-87 period.

Given the benefits that can be obtained through reassessments, we believe a prudent course of action would be for FHWA to work with New York to develop a realistic, long-term DBE reassessment plan. In the interim, until a plan is implemented and the state agency can begin to meet the required annual reassessment cycle, FHWA should require New York to give reassessment priority to those certified businesses that are being awarded highway contracts. While we recognize that this procedure may slow down the awards process in some instances, we believe that it is a necessary precaution to prevent ineligible businesses from wrongfully obtaining contracts.

Compliance monitoring is another important administrative control strategy for helping assure that the program only benefits socially and economically disadvantaged businesses. We found that FHWA and the states we reviewed had implemented reasonable approaches to help assure program compliance. Illustratively, we found that New York and Pennsylvania delegated primary responsibility for monitoring to highway project engineers because they are in the best position to identify questionable working relationships between DBE and non-DBE contractors. In our opinion, the presence of engineers at highway work locations may help deter some contractors from engaging in fraudulent or abusive activities. Further, we support FHWA's and states' strategies of supplementing monitoring by project engineers with periodic reviews conducted by headquarters and field personnel as a further check to assure compliance.

There are actions that, in our opinion, FHWA could take that would enhance the ability of its program managers and the Congress to oversee DBE program operations nationwide. Just as FHWA does not presently have nationwide information on the results of all DBE investigations, it also does not have information on the results of certification, reassessment, and monitoring activities. Specifically, we believe that FHWA should obtain information on the number of new and reassessment applications states reviewed, approved, and denied annually. Further, it should annually obtain information on the results of DBE monitoring reviews including the (1) number of reviews conducted, (2) types and frequencies of major violations identified, (3) number of open and closed recommendations, and (4) types and frequencies of corrective actions taken.
We recognize that obtaining and compiling such information may necessarily involve some additional costs and may be somewhat time-consuming for those collecting and summarizing the information annually. Nonetheless, we believe that having more meaningful and timely information on critical program activities is needed to help facilitate effective program management. For example, such data should improve program management by enabling FHWA managers and the Congress to better gauge the extent of fraud and abuse nationwide, assess the effects of changes in program policies and control practices on achieving improved compliance over time, identify areas that perhaps require regulatory clarification, and redirect limited federal monitoring resources.

Recommendations

We recommend that the Secretary of Transportation direct the Administrator, Federal Highway Administration, to:

- expand its information system to annually obtain and compile pertinent summary information on the results of key program activities. The data could include the results of all investigations, certification and reassessment actions, and FHWA and states' monitoring reviews.
- assist New York's Department of Transportation in the development of a plan for annually reassessing the eligibility of certified businesses. Until the state agency can reduce the large number of certified businesses due reassessments and begin adhering to the required annual cycle, FHWA should require that the state give reassessment priority to examining the eligibility of businesses at the time they are actually awarded contracts.

Agency Comments and Our Evaluation

The Department did not agree with our recommendation that FHWA expand its information system to annually collect and compile summary information on the results of key program activities. It said that based on FHWA's past experiences in obtaining nationwide data and assuring its reliability, the system we recommend would impose an administrative burden on FHWA and the states in terms of both financial and personnel resources. Moreover, the Department questioned the usefulness of the proposed action for assessing the extent of fraud and abuse in the DBE program. In its opinion, having such a system would not provide information on shams and fronts that are not detected and continue to receive DBE contracts. (See app. VI.)

We recognize that the adoption of our recommendation may require FHWA and the states to commit some additional financial and personnel
resources. In making our recommendation, however, we did not envision the establishment of a new, elaborate management information system. Rather, we envisioned an expansion of FHWA's existing system to include selected key information that could be used by FHWA managers and the Congress to better gauge nationwide trends in the nature and extent of program improprieties. As we pointed out in chapter 2, opinions vary among federal, state, and industry representatives concerning the nature and extent of fraud and abuse in the program nationwide. In our view, such differences have been fueled by the limited information available at the national level. We continue to believe, therefore, that more meaningful and timely quantitative and qualitative information on critical program activities is needed to provide officials a firmer basis for proving or disproving the various assertions made about the extent of fraud and abuse in the DBE program, and to help facilitate effective program management.

In its response, the Department also said that it was disappointed that we only reviewed the DBE programs in New York and Pennsylvania—two large Eastern states. It said that at the entrance conference, FHWA had suggested that GAO should review the program of states in other geographical areas for the study to be truly representative of how the program is being implemented nationwide.

We acknowledge in the report that activities in New York and Pennsylvania are not statistically representative of state DBE programs nationwide. However, the information we obtained from these states provides a fuller understanding of the experiences and concerns relating to the program. Further, in discussing the scope of our review at the entrance conference as well as at subsequent meetings, FHWA officials pointed out that by examining the New York and Pennsylvania DBE programs we would obtain a good overview of states' experiences dealing with program fraud and abuse. Moreover, FHWA officials agreed that even if other states from geographically dispersed areas of the country were included in our review, it would not be possible to do a study representative of the DBE program as a whole given that there are essentially 52 separate programs nationwide. As the officials pointed out, while all states' DBE programs operate under the broad requirements and parameters set forth by federal legislation, directives, and guidelines, they have unique attributes reflective of differences in such areas as their organizational structures, available resources, management philosophies, and state laws.
The Department of Transportation generally agreed with the recommendation that FHWA help New York develop a reassessment plan, and that New York give priority to examining certified businesses at the time they are awarded contracts. In addition, the Department provided technical comments on a draft of this report and changes have been made, where appropriate.

The New York and Pennsylvania State Departments of Transportation also provided written comments on a draft of this report and expressed general concurrence with its contents. In its response, New York said that it had already discussed with FHWA steps to jointly pursue avenues towards obtaining FHWA approval of its procedures for reassessing DBEs. (See app. VII and VIII, respectively.) Changes have also been made to the report, where appropriate, based on technical comments.
### Federal-Aid Highway DBE Goal Achievement Statistics Fiscal Years 1984-1987

Figures in percent

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(continued)
### Appendix I
Federal-Aid Highway DBE Goal Achievement Statistics Fiscal Years 1984-1987

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*aIncludes awards to women-owned businesses.

*bA state that wants to have an annual DBE participation goal of less than 10 percent must request and obtain a waiver from the Administrator of the Federal Highway Administration.

Source: Federal Highway Administration, U.S. Department of Transportation.

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<th>Percent total dollar awards%</th>
<th>Number awards</th>
<th>Value</th>
<th>Percent total dollar awards%</th>
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<sup>a</sup>These percentages represent the proportion of the total funds awarded to minority-and women-owned disadvantaged businesses in each year.

<sup>b</sup>Awards in 1st quarter.

Source: Federal Highway Administration, U.S. Department of Transportation.
## Appendix III
### States Reassessment of DBE Eligibility

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</tr>
<tr>
<td>Oregon</td>
<td>Annual</td>
<td>30 to 60 days</td>
<td>Affidavit or updated schedule</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>Annual</td>
<td>90 days</td>
<td>Application w/affidavit</td>
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</table>

(continued)
### Appendix III
States Reassessment of DBE Eligibility

<table>
<thead>
<tr>
<th>State</th>
<th>Reassessment cycle</th>
<th>Notification of DBEs before expiration of certification</th>
<th>Documentation requested from DBEs</th>
</tr>
</thead>
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<tr>
<td>Puerto Rico</td>
<td>Annual</td>
<td>No</td>
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</tr>
<tr>
<td>Rhode Island</td>
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<td>30 days</td>
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</tr>
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</tr>
<tr>
<td>South Dakota</td>
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<tr>
<td>Tennessee</td>
<td>Annual</td>
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<td>Application w/affidavit</td>
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<td>Annual</td>
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<td>Affidavit or updated schedule</td>
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<tr>
<td>Utah</td>
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<td>Application w/affidavit</td>
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<td>Annual</td>
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<td>Affidavit or updated schedule</td>
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<td>Affidavit or updated schedule</td>
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<tr>
<td>Washington</td>
<td>Annual</td>
<td>30 to 60 days</td>
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<tr>
<td>Wyoming</td>
<td>Annual</td>
<td>30 days</td>
<td>Application w/affidavit</td>
</tr>
</tbody>
</table>

*States determine on a sampling basis which DBEs will undergo in-depth reassessments based on such factors as whether information submitted suggests that a business may not still qualify for the program, or whether complaints have been filed challenging the eligibility of a business.*

*According to FHWA, some states require businesses to submit new applications and supporting documentation annually. Other states require businesses to annually submit (1) notarized affidavits that the information on file is still accurate or (2) schedules that detail any changes that have occurred.

*As of November 1987, these states had reassessment backlogs that ranged from 1-1/2 to 6 months.

*As discussed in chapter 3 of this report, New York has a DBE reassessment backlog that officials estimate will take several years to clear.*

Source: Federal Highway Administration, U.S. Department of Transportation.
Synopses of Selected DOT Office of Inspector General DBE Investigation Case Files

Appendix IV

These DBE investigation synopses are intended to help the reader gain a broader perspective on the nature, complexity, and results of investigations.

Case 1

A DBE was involved in a 17-count state grand jury indictment that charged a combined total of 17 companies and individuals with fraud. It was alleged that the company knowingly served as a front for various highway prime and subcontractors over a 3-1/2 year period. Since the company pled guilty to conspiracy to commit fraud and cooperated in the grand jury's investigation, it was not named as a defendant in the indictment. The company was, however, cited as a co-conspirator in 5 of the 17 counts. As a result, the state decertified the business and mandated that the company not engage in highway contracting for 2 years.

Case 2

An Office of Inspector General investigation of a DBE specializing in highway guardrail construction disclosed that the woman majority stockholder was not, in fact, exercising adequate control over the company's financial and management decisions. At the close of the investigation, the company and woman majority stockholder pled guilty to making false statements in order to gain admission to the DBE program. As a result, the state levied a $10,000 fine against the company and assessed a $2,000 fine against the woman stockholder. The state also sentenced her to one year probation and required her to perform community service. In addition, the company agreed to repay $325,000 to the federal government.

Case 3

The DOT Inspector General conducted a joint investigation with a state attorney general's office into allegations that a prime contractor provided funds to a DBE for functioning as a front. The investigation disclosed that the prime contractor had used its own employees and equipment to do the DBE's work, and then submitted false documentation to the state highway agency claiming credit for the work against the project's DBE goals. Eventually, the prime contractor agreed to pay the state $237,291 in compensatory damages, court costs, and legal fees. In addition, the subcontractor agreed to appoint a special DBE compliance officer and to periodically conduct compliance seminars for its employees.
Case 4

Information from a state highway department led to an Office of Inspector General investigation into allegations that a prime contractor used another contractor as a front company to circumvent program requirements. The DBE had been decertified. Because the allegations were eventually substantiated, the state also withheld $93,000 in liquidated damages from its final payment to the prime contractor for the project under investigation.

Case 5

A third-party complaint led to an Office of Inspector General investigation into allegations that a prime contractor submitted DBE documentation during the bid process that enabled it to win a contract by intentionally overstating the amount of work to be done by a particular DBE subcontractor. A detailed review of state records disclosed that the prime contractor substituted the specific DBE listed on the bid documentation with another DBE during the project. This practice was not necessarily indicative of a problem, according to program officials, since it is not unusual for a contractor to substitute one DBE for another during the course of a project. Although the Inspector General referred the case to the Justice Department for prosecution, the case was declined because of insufficient evidence that the prime contractor intentionally made misrepresentations to the state. The Inspector General administratively closed the case by forwarding information to FHWA.

Case 6

The Office of Inspector General received a third-party complaint alleging that a prime contractor set up two women to serve as the owners of a DBE. An investigation revealed that the DBE was not, in fact, an independent business since it was financially and managerially dependent upon the prime contractor. The investigation also disclosed that one of the women was the wife of the owner of the prime contracting company involved in the allegation and that she served as secretary for both companies. Also, it was determined that the DBE shared office space with the prime contractor without a lease and used the prime contractor's attorney. The complaint against these companies had initially been referred for prosecution to the Justice Department but was declined because there was insufficient evidence of wrongdoing. The DBE was decertified by the state.
These select synopses are based on our review of investigation case files and discussions with state transportation officials in New York and Pennsylvania.

Case 1

A state highway district engineer requested an investigation as a result of rumors that a DBE was not owned and controlled by a disadvantaged individual. Based on reviews of legal and financial documents and discussions with the minority president and two white males associated with the business, state investigators wanted to decertify the DBE because it appeared that the minority owner (1) had willingly accepted front monies from two white males to capitalize the business, (2) did not possess managerial control of the business, and (3) had received less compensation than the foreman and superintendent who were both white males.

Although investigators could not trace the company’s capitalization, they found that the minority owner had made misrepresentations on his certification application by claiming that the capitalization funds came from a joint account he maintained with his wife. Although there was no evidence that the white males financially benefitted from the arrangement, all parties involved eventually admitted verbally to the scheme.

The state transportation agency’s certification appeal committee eventually decertified the DBE based upon information developed by certifying officials during the reassessment process. However, the committee also requested that agency officials counsel the business’ minority owner to buy out the two white males so that the business could again qualify for the program. Although investigators considered referring the case for prosecution, they believed winning the case was remote because of insufficient evidence and because they only had oral, off-the-record admissions concerning the scheme. Information on the case was sent to the Internal Revenue Service because investigators believed that the scheme was also an attempt at tax evasion.

Case 2

A DBE filed a complaint alleging that another DBE trucking company engaged in work it was not certified to perform, serving as a middleman between a prime contractor and non-DBE manufacturers/suppliers. It was also alleged that the prime contractor obtained credit for the transaction against project DBE participation goals. An investigation disclosed a program control weakness, since state program officials were not
closely checking documentation submitted by prime contractors concerning their intended or actual use of DBE contractors.

Although no judicial or administrative actions were taken against the contractors because of insufficient evidence, investigation officials requested an administrative change whereby program officials closely check the documentation submitted by prime contractors concerning their intended and actual use of DBEs. The procedural change was designed to minimize the possibility that prime contractors receive goal credit for work DBES were not certified to perform or did not actually do.

**Case 3**

An anonymous letter alleged that the president of an engineering DBE did not oversee the firm’s day-to-day management and that the firm was controlled by the vice president, who was a white male. It was also alleged that the president was Iranian-born and thus not eligible to participate in the program. The investigation disclosed that there was no apparent problem with control since the president drew the largest salary, signed all company checks, and was the only person in the firm with an engineering degree. It was also determined that the DBE president was raised in Iran and held Iranian citizenship, but that his parents were of Indian descent.

During the reassessment process, the state transportation agency requested an advisory opinion from DOT concerning whether a person born in Iran to Indian parents is Iranian or Indian for purposes of DBE program participation. The state agency eventually recertified the DBE based on the DOT ruling that the controlling factor was a person’s heritage not citizenship.

**Case 4**

A contractor alleged in a complaint to the state transportation agency that a DBE subcontractor failed to complete its responsibilities on a contract and that the DBE and the prime contractor were sharing employees. An investigation disclosed several suspicious occurrences including: (1) the DBE president never appeared at work locations, (2) DBE employee paychecks were distributed by the prime contractor’s general superintendent, (3) the prime contractor advanced the DBE cash to cover its payroll, materials, and equipment in excess of the subcontract amount, and (4) the prime contractor did not have any canceled checks showing payments to the DBE.
Although investigators were not able to determine whether DBE or prime contractor employees actually did the work on one of the contracts, it appeared to investigators that the contractors shared employees on a second contract. In addition, investigators were not able to determine whether the DBE, which apparently was a bona fide business, was acting as a front for the prime contractor on the second contract or simply became overextended and had others do the work.

Case 5

A state transportation agency initiated an investigation of a DBE because a suspicious pattern of activities were noted during compliance monitoring efforts. Officials were concerned that a DBE may not have performed meaningful work on several highway construction projects, with some of its work being done by other contractors. An investigation of various project documentation—including payroll records—indicated that the DBE had relinquished operational and managerial control of its operations. State investigators decertified the DBE. Although the case was referred for judicial action, state prosecutors refused to accept the case citing insufficient evidence and other case priorities.

Case 6

The activities of a prime contractor were investigated as a result of information that came to light about other state highway contractors. State investigators determined that the contractor had engaged in activities to circumvent program requirements such as by apparently setting up a bogus company to meet DBE project goals and permitting non-DBE subcontractors to do a DBE's work. The state transportation agency attempted to exclude the contractor from its highway program for 2-1/2 years. This action was overturned, however, by a state court ruling that the agency did not have authority under the state's Administrative Procedures Act to take such action. As an alternative, the state agency disqualified the contractor each time it submitted a construction bid claiming that it was a non-responsible bidder. To settle the case, the contractor agreed to pay the agency a $300,000 fine.

Case 7

An investigation was initiated into the activities of a non-DBE subcontractor by a state transportation agency because the payroll records of one contractor indicated that its employees were also listed on the payroll reports submitted by a DBE. To investigators, it appeared that this non-DBE subcontractor, along with several others, had supervised and performed the work that was the contractual responsibility of a DBE.
Because the contractor admitted to engaging in wrongful activities, the state prevented the contractor from obtaining highway contracts for 1-1/2 years. Although no monetary penalties were imposed, the contractor signed a written agreement with the state that it would refrain from such activities in the future.
Appendix VI

Comments From the Department of Transportation

OCT 5 1988

Mr. Kenneth M. Mead
Associate Director
Resources, Community, and Economic Development Division
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: Addressing Fraud and Abuse in the Disadvantaged Business Enterprise Program."

Thank you for the opportunity to review this report. If you have any questions concerning our reply, please call Bill Wood on 366-5145.

Sincerely,

[Signature]

John H. Seymour

Enclosures
DEPARTMENT OF TRANSPORTATION

Reply to GAO Report of September 13, 1988 on Highway Contracting:
Assessing Fraud and Abuse in FHWA's Disadvantaged Business Enterprise Program

SUMMARY OF GAO FINDINGS AND RECOMMENDATIONS

The General Accounting Office (GAO) found that: (1) the extent of fraud and abuse nationwide is not known, primarily because the Federal Highway Administration (FHWA) does not have data needed to measure the extent of such problems; (2) the Department of Transportation's Office of Inspector General, New York and Pennsylvania, have investigated alleged program fraud and abuse, and most cases were resolved by administrative action; but several were resolved by legal action; (3) the FHWA and the States that GAO reviewed have strengthened the procedures used to certify new program applicants, monitor contractors' compliance with program requirements, and sanction those not complying; (4) New York was not complying with the requirement that States annually assess the continued eligibility of certified businesses; and (5) while steps have been taken to improve the program, FHWA does not have information on the results of all investigations, certifications and reassessment actions and monitoring reviews.

The GAO recommended that the Secretary of Transportation direct the FHWA Administrator to: (1) expand the FHWA's information system to annually obtain and compile pertinent summary information on the results of key program activities, such as the results of all investigations, certifications and reassessment actions, and FHWA and the States' monitoring reviews, as detailed in chapters 2 and 3 of the report; and (2) work in conjunction with New York's Department of Transportation (NYDOT) on the development of a certification reassessment plan and, until all due reassessments can be completed and the agency can begin adhering to the required annual cycle, require that the State give reassessment priority to examining those certified businesses being awarded contracts.

SUMMARY OF DEPARTMENT OF TRANSPORTATION POSITION

The Department has no significant disagreement with GAO's report findings. However, we are disappointed that GAO chose to field review the State DBE programs in only two large eastern States (New York and Pennsylvania). At the entrance conference with GAO, FHWA conveyed its belief that for the study to be truly representative of how the program is being implemented nationwide, GAO should plan to field review a number of States in different geographical parts of the country.
With respect to the report's recommendations, we generally agree with the recommendation dealing with the reassessment by the NYDOT of the eligibility of certified businesses, and FHWA will take appropriate implementing action. However, we should point out that FHWA does not believe that the NYDOT's problem in reassessing eligibility of DBE's is due to the lack of a formal plan. Rather, we believe it is more likely due to insufficient financial and personnel resources necessary to conduct annual assessments. Also, with respect to that part of the recommendation that would have FHWA require that at a minimum New York give reassessment priority to assessing the eligibility of certified businesses at the time they are actually awarded highway contracts, FHWA field offices were notified to implement such a process in a memorandum from the Federal Highway Administrator dated August 27, 1984.

The Department does not agree with the recommendation that FHWA expand its information system to annually obtain and compile information on all DBE investigations, certification and reassessment action and FHWA and States' monitoring reviews. Based on FHWA's past experiences in obtaining nationwide data and assuring its reliability, the system recommended by GAO would impose a tremendous administrative burden upon the States and FHWA from the perspective of both costs and personnel resources required. Imposing further burdens upon NYDOT and other States such as this will make situations such as the one in New York worse because of the additional resources needed to report all this information to FHWA. Moreover, the usefulness of this proposed action in assessing the extent of fraud and abuse in the FHWA DBE program is questionable. It will not provide any information on shams and fronts that go undetected and continue to receive contracts and subcontracts as DBE's. At best, we can see only limited value in adopting this recommendation and do not believe that it would be cost-effective.

As with other aspects of the Federal-aid Highway Program, FHWA Division Administrators are in the best position to identify and detect DBE program problems in their particular States and are able to respond in a more efficient and effective way to resolve those problems. Division Administrators may, and often do, request advice from the Region and Washington Headquarters before taking action on major or unusual problems. Therefore, the FHWA Washington Headquarters is aware of major problems and can take appropriate action to clarify or interpret those provisions of the DBE regulation which may be misunderstood.

More detailed comment on the report is attached.
Appendix VII

Comments From the New York Department of Transportation

STATE OF NEW YORK
DEPARTMENT OF TRANSPORTATION
ALBANY, N.Y. 12232

FRANKLIN E. WHITE
COMMISSIONER

OCT 4 1988

Mr. Kenneth A. Mead
Associate Director
United States
General Accounting Office
Washington, D.C. 20548

Dear Mr. Mead:

We are in receipt of your draft pertaining to the assessment of fraud and abuse in FHWA's Disadvantaged Business Enterprise Program.

The New York State Department of Transportation has put a great deal of emphasis on monitoring and investigative effort. We are pleased that your report is complimentary of New York on these issues.

Your recommendation that we seek legal enforcement through the judicial system is noteworthy. However, as you noted "Disadvantaged business fraud cases are difficult to get accepted for prosecution" and "as a result, FHWA has been encouraging states to expand their use of various administrative sanctions...". This has been the New York experience and we understand it is the experience of the other states as well. While less complex and time consuming than prosecution, administrative action is also a long, arduous process. However, we believe it has been proven effective. We believe New York has probably pursued more fraud and abuse investigations and administrative sanctions than any other state.

We fully concur with the recommendation that FHWA expand its information system to annually obtain and compile pertinent summary information on the results of key program activities pertaining to fraud and abuse. We look forward to working with FHWA to contribute information for such an endeavor.

We have already discussed with FHWA steps to jointly pursue avenues toward obtaining FHWA approval of reassessment procedures for DBE's. However, it should be understood that during the period in question, there existed a statewide certification program in New York State, of which the Department of Transportation is a component, with approval from FHWA. This program contains provisions for a thorough recertification effort of firms certified by this Department, including DBE's, on a
bi-annual basis (at present this Department's roster of certified firms is in excess of 750 and increasing!). The recertification program is very detailed and comprehensive in that it constitutes a full review of the firms' eligibility as DBE's.

In addition, the Department's reorganized Office of Equal Opportunity Development and Compliance is regularly engaged in updating its DBE files as workload permits. You further noted that this Department placed priority on and dedicated staff to processing new certification requests (518 new applications were submitted over the 1985-87 period). The Department thus has had a most thorough certification process to minimize the possibility of ineligibility or fraud, which would reduce the need for frequent reassessment. In addition, we believe this Department's compliance monitoring program in fact best addresses the issues of the potential for fraud and abuse.

Under these circumstances, our bi-annual recertification effort under the statewide certification program should be considered as constituting an effective tool to weed out firms that do not meet program eligibility criteria.

In that regard, your report noted: "FHWA regional officials believe that New York has established a well-run monitoring program and, as a result, have on occasion requested that officials from other states in the region observe how New York officials do their monitoring reviews."

This Department's policy of "genuine opportunity for genuine entrepreneurs" remains resolute. To that common end, let me assure you that we look forward to working with USDOT/FHWA to resolve any deficiencies in our DBE Program.

Sincerely,

F. W. TAYLOR
Executive Deputy Commissioner
October 3, 1988

Mr. Kenneth M. Mead  
Associate Director  
U.S. General Accounting Office  
Washington, D.C. 20590

Dear Mr. Mead:

Thank you for the opportunity to review and comment on your draft report, "Highway Contracting: Assessing Fraud and Abuse in FHWA's Disadvantaged Business Enterprise Program."

The draft report has been reviewed by our Bureau of Equal Opportunity, Bureau of Construction and Materials and the Office of the Inspector General. All three offices commended the Accounting Office field personnel for the manner in which they conducted their review and prepared their report. Although the draft report fairly represents Pennsylvania's DBE Program, we are providing the following comments to assist in the finalization of your report.

GENERAL COMMENTS

1. The report is voluminous and could be condensed. Much of the same material is repeated time and time again.

2. Denial of certification is not necessarily a measure of fraudulent applications as the report infers. Many applications are denied for reasons other than fraud.

3. A recurring theme within the report is the use of administrative sanctions over legal actions and the relative ease and low cost of the former. Yet, since Pennsylvania is a state that has specifically passed legislation making DBE fraud a felony, we intend to pursue legal remedies in order to take the issues out of the agency setting and into a neutral arena. Successful DBE convictions of majority and minority firms receive more media coverage than do agency decertifications. They also result in fines and restitution and therefore, hopefully, act as more of a deterrent to those contemplating such fraudulent actions.
4. Although Pennsylvania may not have undertaken a large number of DBE fraud investigations, it is our contention that our intense initial reviews of new applicants, coupled with our recertification reviews, serve to inhibit and minimize fraud within our program. The very design of this type of affirmative action program provides constant opportunities for minority and female contractors to fall into fraudulent business patterns. Those who choose to do so usually benefit monetarily to a small degree but not to the extent they would if they were truly controlling. Moreover, if a DBE provision ceases to be in our national highway bill, these types of businesses are likely to cease as well. Nevertheless, Pennsylvania considers the DBE Program a worthwhile endeavor and hopes to expand its DBE list to meet the needs of the FHWA highway building program.

Here attached are also some technical comments for GAO considerations.

Sincerely,

Howard Yerusalim, P. E.
Secretary of Transportation

Attachments
## Major Contributors to This Report

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