

119699

BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

## Proposals For Minimizing The Impact Of The 8(a) Program On Defense Procurement

The Small Business Administration's 8(a) procurement program offers noncompetitive Government contracts and other assistance to socially and economically disadvantaged firms to encourage business development. GAO evaluated the impact of the 8(a) program on the Department of Defense--the program's largest participant.

GAO believes that program costs can be made visible by allowing procurement agencies to set 8(a) contract prices through the competitive process. GAO also believes that performance problems could be reduced and procurement leadtimes shortened if procurement agencies contracted directly with selected 8(a) firms.

GAO recommends improvements in DOD's and SBA's regulations and suggests options for the Congress to consider to minimize the likelihood of adverse impacts.



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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report addresses the implementation of the Small Business Administration's 8(a) program from the procurement agency's standpoint. Often, socio-economic programs are evaluated only in terms of their effectiveness in accomplishing a specific mission--in this case, developing small and disadvantaged business firms. In this report we address how the program affects the economy, efficiency, and effectiveness of agency procurement--the principal vehicle for implementation--and what changes are needed to better reconcile the program's objectives with the Department of Defense's procurement needs.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of Defense; and the Administrator of the Small Business Administration.

A handwritten signature in cursive script that reads "Charles A. Bowsher".

Comptroller General  
of the United States



D I G E S T

The Federal Government implements a wide array of socio-economic programs through the Federal procurement process. These programs are supported by Federal agency procurement dollars which are specifically appropriated for goods and services. One such program is the Small Business Administration's (SBA's) 8(a) program, which provides Government contracts to socially and economically disadvantaged firms to encourage business development. Using its authority under section 8(a), SBA contracts with Government agencies and then subcontracts the work to certified 8(a) firms. Participating 8(a) firms are expected to graduate from the program after achieving a competitive position in the open marketplace.

As part of GAO's efforts to inform the Congress of the effects of socio-economic programs on the procurement process, GAO evaluated the impact of the 8(a) program on the Department of Defense (DOD)--the program's largest participant. GAO's principal objectives were to (1) determine if procurement activities received fair market prices, acceptable quality, and timely delivery of goods and services procured through the 8(a) program, (2) identify any negative impacts and their causes, and (3) develop program improvements which would minimize negative impacts while allowing SBA to accomplish the program's mission.

DOES DOD RECEIVE FAIR  
MARKET PRICES?

SBA's business development expense fund can be used to reimburse procurement activities for differences between the price negotiated for an 8(a) contract and the "fair market price" the activity would have received under normal competitive conditions. (See pp. 8 to 10.)

GAO found that sometimes funds for business development expense were not requested or were not available and that DOD paid higher than competitive prices with its appropriated procurement dollars. A much more prevalent problem, though, was the difficulty procurement activities faced in arriving at fair market prices in the absence of

competition and a well documented procurement history. The success of the current reimbursement method depends on (1) a procurement activity's ability to compute and substantiate its fair market price determinations and (2) SBA's ability to provide business development expense when justified. Too often, at least one of these conditions is not met. As a result, adequate information is not available to determine the full cost of the program. (See pp. 10 to 21.)

DOES DOD RECEIVE ACCEPTABLE  
PERFORMANCE FROM 8(a) FIRMS?

Although many 8(a) firms performed satisfactorily, others did not meet delivery schedules or failed to perform required work.

In reviewing terminated contracts and other contracts with performance problems, GAO found that (1) the contractor selections should have been questioned prior to award based on facts known at the time and/or preaward surveys should have been performed in order to assess the firm's capabilities, or (2) promised assistance was not provided by SBA. (See pp. 29 to 32.)

Current impediments to matching agency requirements with appropriate contractors are:

- SBA's competency certification of 8(a) firms which is misunderstood. SBA is not equipped to determine every firm's suitability to perform on a contract-by-contract basis.
- DOD's regulations which discourage preaward surveys.
- SBA's regulations which permit the awarding of 8(a) contracts before SBA assistance is approved. (See pp. 32 to 35.)

While performance problems are not unique to 8(a) firms, the procedures for resolving them are. GAO noted that:

- Some procurement activities delay or avoid taking action when performance problems surface because they are not aware of appropriate termination procedures.
- SBA is not always helpful in resolving 8(a) contractor performance problems in a manner

that minimizes the negative consequences to the procurement activity. (See pp. 35 to 40.)

#### HOW DOES THE 8(a) PROGRAM AFFECT DOD PROCUREMENT?

Although GAO could not measure the full impact of the 8(a) program on DOD procurement, the 8(a) program can result in higher contract prices, lost progress payments, unproductive use of supply center procurement funds, supply shortages, and/or extensive administrative efforts.

Procurement activities took steps to minimize some of the negative impacts from the 8(a) program by (1) screening the requirements offered under the 8(a) program to ensure that entire quantities of high priority items would not be awarded solely to 8(a) firms, (2) borrowing items in short supply from other activities, and (3) making emergency buys to replenish supply. (See pp. 44 to 48.)

#### OPTIONS FOR IMPROVING THE 8(a) PROGRAM

GAO offers two options for changing the 8(a) program to correct specific weaknesses observed in the 8(a) procurement process. The first, introducing competition into the program and permitting awards to 8(a) firms who come within a given percentage of the lowest bid, would resolve the problems procurement activities face in determining fair market prices. This option would provide visibility for costs associated with 8(a) contract prices and allow the Congress to control the size of the investment it wishes to make in minority business development--something that is impossible to do at present. The second, allowing a direct contracting approach between the procurement agency and the 8(a) firm, would encourage a better matching of requirements and 8(a) firms and provide a more timely resolution of performance problems. Under either option, SBA could still maintain its role of selecting 8(a) firms for performance of DOD requirements and monitor and assist the firms according to their business development plans. These options are discussed in greater detail in chapters 2 and 3. (See pp. 21 to 22 and pp. 41 to 42.)

## RECOMMENDATIONS TO THE CONGRESS

If the Congress favors one or both of GAO's options, GAO recommends that authority be provided to the executive branch, permitting the President to designate one or more agencies to implement the option(s) on a trial basis. After a designated period of time, the results of the alternative program could be assessed by the Office of Federal Procurement Policy with SBA and the procurement agencies providing input. If the competitive option is adopted and if the Congress wants to maintain current program levels, the Congress may also want to consider providing a business development expense fund to be used expressly for the alternative program, since GAO believes current funding levels for business development expense would not be sufficient. With experience under this alternative, data can be developed to assist the Congress in determining the level(s) of price differentials needed to support the amount of participation desired. (See pp. 49 and 50.)

## RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

To improve implementation of the existing 8(a) program, GAO recommends that the Secretary of Defense revise the Defense Acquisition Regulation 1-705.5 to:

- Better define the responsibility of the contracting officer and the appropriate procedures for computing fair market price. (See pp. 22 and 23 for detailed revisions.)
- State that if a contracting officer believes a preaward survey is desirable, he/she should request one rather than rely on SBA's competency certification for 8(a) contracts.
- Outline current procedures for resolving 8(a) contractor performance problems and incorporate specific time frames for procurement activity action. (See p. 42.)

## RECOMMENDATION TO THE SBA ADMINISTRATOR

To ensure that 8(a) firms receive adequate assistance under the existing program, GAO recommends that the Administrator of SBA require that SBA provide the necessary assistance before it enters into

a contract with DOD. If adequate assistance cannot be provided and another suitable 8(a) firm cannot be located expeditiously, the requirement should be returned to the procurement activity. (See pp. 42 and 43.)

AGENCY COMMENTS AND  
GAO'S EVALUATION

SBA and DOD generally agreed with GAO's recommendations and proposed action for implementation. However, both SBA and DOD questioned GAO's options for consideration by the Congress.

SBA believes GAO's competitive set aside option does not comply with the spirit of the law, would be objectionable to small non-8(a) firms who would not receive the same preference, and would lessen SBA's ability to assist 8(a) firms with contract support. SBA suggests, instead, testing competition within the 8(a) program itself.

DOD believes the competitive set-aside option would be difficult to implement fairly, would result in fewer awards to 8(a) firms, and would cause 8(a) firms to manipulate bids in certain situations. DOD also believes the current method of computing fair market price is no more complicated than other procurement actions.

While SBA's proposal to test limited competition has many positive aspects, one major drawback of such a program is that it would not ensure that agencies receive fair market prices, and thus, the costs of the program would not be visible. (See pp. 23 to 26.)

In lieu of GAO's direct contracting option, SBA proposes more delegation of its existing authority to the procurement agencies. While SBA's proposal has some merit, GAO believes the Congress can best guarantee improvements through legislation permitting direct contracting, and believes this option warrants consideration. DOD did not specifically address this option. (See p. 43.)

GAO's options for Congressional consideration are intended to provide a broad framework for addressing the problems identified during this review. GAO believes these options are flexible enough to adequately deal with DOD's and SBA's concerns. GAO encourages SBA to work with the Congress, the Office of Federal Procurement

Policy, the procuring agencies, and the small business community to develop the specific approaches and techniques that will overcome the weaknesses GAO observed.

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#### ABBREVIATIONS

ARRCOM	Armament Materiel Readiness Command
BDE	business development expense
CBO	Congressional Budget Office
COC	Certificate of Competency
DAR	Defense Acquisition Regulation
DFSC	Defense Fuel Supply Center
DLA	Defense Logistics Agency
DOD	Department of Defense
DPSC	Defense Personnel Support Center
GAO	General Accounting Office
MICOM	Missile Command
OFPP	Office of Federal Procurement Policy
PCO	procurement contract officer
RFP	request for proposal
SACC	San Antonio contracting center
SADBU	Small and Disadvantaged Business Utilization Office
SBA	Small Business Administration
SOP	Standard Operating Procedure
SPCC	Ships Parts Control Center



## CHAPTER 1

### INTRODUCTION

Much attention is currently focused on the widespread cutbacks in Federal expenditures for socio-economic programs. Not so apparent is the fact that the Federal Government implements a wide array of socio-economic programs through the Federal procurement process and that Federal procurement agency dollars, specifically appropriated for goods and services, are used to support these programs. One such program is the Small Business Administration's (SBA's) 8(a) program.

Using its authority under section 8(a) of the Small Business Act, as amended (15 U.S.C. 637(a)), SBA contracts with other Federal agencies and departments to provide goods and services and then subcontracts the actual work on a sole source basis to small businesses owned and controlled by socially and economically disadvantaged persons.

In authorizing legislation, the Congress addressed the benefits of using the Federal procurement system to develop business ownership among groups that own and control little productive capital, but did not address the program's potential impact on the procurement activities that ultimately implement the program and explicitly recognize the costs which result. To evaluate this aspect of the legislation, we reviewed the impact of the 8(a) program on procurement activities in the Department of Defense (DOD), the largest program participant.

This chapter will discuss (1) how the Federal procurement process is used to accomplish social and economic objectives, (2) why social and economic programs need to be reevaluated and their costs made visible, (3) the historical development and objectives of the 8(a) program and how SBA implements them, (4) longstanding difficulties in achieving the program's objectives, and (5) our objectives, scope, and methodology in conducting this review.

### GOVERNMENT CONTRACTS USED TO FURTHER SOCIO-ECONOMIC GOALS

The Government contract has been used as an instrument to further the socio-economic goals of the Federal Government for many years. In its 1972 report to the Congress, the Commission on Government Procurement identified 39 socio-economic programs which used the leverage of the procurement process to achieve program goals. Through the disciplining effect exerted on its contractors, the Government promotes such goals as fair employment practices, safe working conditions, preference for American products, and rehabilitation of prisoners and the severely handicapped. Since the Commission's report, the Congress and the executive branch have added more socio-economic programs to the

procurement process in such areas as energy conservation, resource recovery, and assistance to small and minority owned enterprises.

WHY SOCIO-ECONOMIC  
PROGRAMS NEED TO BE REEVALUATED  
AND THEIR COSTS MADE VISIBLE

The Congress created the Commission on Government Procurement to review Federal procurement and recommend reforms to increase its efficiency, economy, and effectiveness. The Commission's 1972 report discussed how procurement becomes more costly and time-consuming with the addition of each new socio-economic program implemented through the procurement process, and expressed concern over the individual and cumulative impact of these programs on the Federal procurement process. The Commission did not question the merit of socio-economic programs, but rather wanted to keep the means of accomplishing them from unduly impairing the Government's procurement process. It recommended that program costs, as well as benefits, be made visible and that all existing programs be reevaluated to determine if the procurement process is the best vehicle for achieving the socio-economic objectives desired.

The Congress charged the Office of Federal Procurement Policy (OFPP) with responsibility for implementing the Commission's recommendations but, to date, the Commission's principal recommendations on socio-economic programs have not been implemented. We are encouraged by OFPP's "Proposal for a Uniform Federal Procurement System," submitted to the Congress on February 26, 1982, which addresses the need to review various nonprocurement programs to determine the most effective and productive means of implementation. Early implementation would be beneficial for procurement agencies. (See app. I for further details on the Commission's recommendations and OFPP's efforts to implement them.)

HOW THE 8(a) PROGRAM DEVELOPED

SBA's section 8(a) procurement authority has been a part of the Small Business Act since its passage in 1953, but it was not until after the 1967 civil disturbances that SBA first used the authority. In a test program designed to create jobs for the unemployed, SBA provided noncompetitive contracts to small business firms willing to relocate in depressed areas and hire the unemployed and underemployed. Since few small businesses were willing to relocate, the test program was generally unsuccessful. In 1969 SBA changed the program's emphasis to advance the development of disadvantaged businesses by channelling contracts to them.

In October 1978, the Congress clarified the program's eligibility requirements in Public Law 95-507 and defined the program's mission as minority business development. The Congress believed that the program had lacked any specific mission beyond contract assistance and had not fostered any business development which would permit participating minority businesses to competitively operate in the private sector without a dependency on Government contracts. According to this law, no small business concerns shall be deemed eligible for 8(a) program assistance unless SBA determines that, with contract, financial, technical, and managerial support, the small businesses will be able to perform contracts and have reasonable prospects for success in competing in the private sector.

### THE 8(a) PROCESS

Small business firms owned and controlled by socially and economically disadvantaged individuals may apply to SBA for certification as 8(a) firms. They must submit business development plans, including yearly projections of 8(a) contracts and non-8(a) sales needed to become self-sustaining, profit-oriented small businesses. The business plans are supposed to help SBA pinpoint the types of management, contract, and financial assistance the firms need to overcome business deficiencies. Once admitted to the program, firms are required to submit financial statements depicting actual 8(a) and non-8(a) sales performance so that SBA can measure how well they are developing their commercial market.

Once SBA representatives and agency procurement personnel have identified agency requirements suitable for performance by 8(a) firms, SBA matches 8(a) firms' capabilities with proposed contracts. SBA and the procuring agency then agree on a fair market price for the procurements and SBA subcontracts the work on a sole-source basis to 8(a) firms for a fair and reasonable price. (Apps. II and III outline SBA's and DOD's procedures for selecting requirements and negotiating contracts for 8(a) firms.)

### WHY THE 8(a) PROGRAM HAS NOT ACCOMPLISHED ITS OBJECTIVES

Our previous reports have outlined longstanding difficulties in program administration. On the whole, these reports charge that the program has done too much for too few for too long. Some of the major problems include:

- Too much emphasis on increasing the volume of 8(a) contracts, rather than developing viable competitive disadvantaged business firms.
- Failure to terminate firms that have developed no commercial market after prolonged program participation.

--Inadequate business development plans by which to judge the firms' success or failure.

--Inadequate management assistance and monitoring by SBA.

--Vulnerability to fraud and abuse.

All of these reports highlight the relationship between SBA and the 8(a) firm. (See app. IV for a list of our 8(a) program reports.)

Our most recent comprehensive report 1/ on the program's administration found that the 8(a) program has had limited achievements, but has fallen short of its intended goal. The program spurred the formation of many disadvantaged firms, helped participants gain experience in managing a business, and helped some firms get other commercial and non-8(a) Government work. However, at the time of that report, only 166 of 4,598 participating firms had graduated from the program as competitive businesses. Also, 31 percent of the 8(a) contracts had gone to 50 firms which continued to be active participants. Because SBA was not graduating or terminating firms that had ample time to develop, other disadvantaged firms were denied entry into the program. We concluded that vague program graduation criteria, missing business plan and financial statement data, limited staff resources, and over emphasis on increasing 8(a) contract volume, handicapped the program's effectiveness. This report presented the Congress with four options to revamp the program and more specific recommendations for program improvement by the SBA Administrator.

Little action has been taken by the Congress in response to these options, but SBA has embarked on some new initiatives to improve the internal workings of the program (including new regulations limiting participation to a maximum of 5 years). (See agency comments on pp. 69 to 70 of app. X for SBA's view of its accomplishments in this area.) We believe some significant opportunities for improvement lie in the strengthening of the 8(a) procurement process itself--the principal vehicle for implementing the program and the subject of our study.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

To emphasize the importance of evaluating the impact of socio-economic programs on the procurement process, we assessed the impact of the 8(a) program on DOD procurement activities. Our principal objectives were to

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1/"The SBA 8(a) Procurement Program - A Promise Unfulfilled" (CED-81-55, Apr. 8, 1981).

- determine if procurement activities received fair market prices, acceptable quality, and timely delivery of goods and services procured through the 8(a) program,
- identify any negative impacts and their possible causes, and
- develop program improvements which would minimize negative impacts while allowing SBA to accomplish the program's mission.

The 8(a) program was selected for review because (1) agency procurement officers had expressed concern regarding the program's impact on the procurement system, (2) the number and dollar volume of 8(a) contracts were becoming significant, and (3) we had already performed extensive work evaluating the program's effectiveness.

To meet these objectives, we used the Federal Procurement Data System to identify new 8(a) contracts over \$10,000 awarded in fiscal years 1979 and 1980 and 8(a) contracts terminated in these fiscal years.

Because DOD installations report on a transaction basis (new contracts/modifications relating to current and prior years' contracts/terminations) rather than on a contract-by-contract basis, our universe of new contract awards and terminations will not agree with the contract volume reported in DOD statistical reports. We used SBA's data base to identify contracts in our universe containing business development expense (BDE)--monies provided by SBA to reimburse contracting activities for higher than competitive prices paid to 8(a) firms.

We conducted our review within DOD, the largest participant in the program. The eight procurement installations (two each in the Army, Navy, Air Force, and Defense Logistics Agency) we selected for review were among the most active in our DOD universe. These locations were selected because we believed that they would provide the best indication of the program's impact and that their procurement officials would be most knowledgeable about the program's operation. These eight locations accounted for \$466,242,000, or 50 percent, out of our total universe of \$927,898,000 of 8(a) contracts. These are

- USA Armament Material Readiness Command  
Rock Island Arsenal, Ill.
- U.S. Army Missile Command  
Redstone Arsenal, Ala.
- U.S. Navy Ships Parts Control Center  
Mechanicsburg, Pa.

--Naval Facilities Engineering Command (Northern & Chesapeake Divisions)  
Philadelphia, Pa. and Washington, D.C.

--Warner Robins Air Logistics Center  
Robins AFB, Ga.

--San Antonio Air Logistics Center & San Antonio Contracting Center  
Kelly AFB, Tex.

--Defense Fuel Supply Center  
Alexandria, Va.

--Defense Personnel Support Center  
Philadelphia, Pa.

We reviewed a total of 113 8(a) contracts, which accounted for 46 percent of the total dollar volume of 8(a) contracts in our universe of eight selected procurement activities. Our dollar coverage at each procurement activity appears in appendix V.

Contract selections within each procurement activity were generally based on high dollar values within three categories-- contracts containing BDE, contracts not containing BDE, and contract terminations. Our rationale for selecting contracts within each group was as follows:

- (1) BDE contracts - We selected BDE contracts to determine (1) when activities were successful in justifying the need for BDE, (2) what methodology the activities used to determine a competitive market price, (3) what interaction took place between DOD and SBA on fair market price matters, and (4) whether SBA provided sufficient BDE.
- (2) Non-BDE contracts - Contracts without BDE were selected to determine (1) if procurement activities computed fair market prices as required and if the methodologies prescribed in DOD's regulations were followed, (2) whether the fair market price methodologies accomplished the intent of DOD's regulations, and (3) whether contracts were awarded at higher than competitive prices without reimbursement from SBA, and if so, what was the rationale.
- (3) Contract terminations - Terminations were selected to determine where the system failed, given that this is a business development program and SBA is responsible for

selecting and sponsoring firms. As indicated earlier, firms are not eligible to participate in the program unless SBA determines that it has the requisite contract, financial, and managerial assistance to promote the firms' competitive viability.

In addition to reviewing contract files, we obtained the views of procurement officials at each procuring activity, officials at DOD, and top officials at SBA. We visited the Defense Contract Administration Services Management Area office in Reading, Pennsylvania, and SBA regional and district offices in San Antonio, Texas; Philadelphia, Pennsylvania; Chicago, Illinois; and New York, New York; to obtain further information on specific contracts. However, the focus of the review was on the procurement activity, not SBA.

We asked DOD and SBA officials to respond to a list of written questions to obtain their interpretations of specific aspects of the program. Their responses are included in the report where appropriate. SBA was also asked for further information on two of the contracts we selected. This information was not received in time to be considered in the draft report, but is addressed in our response to SBA's official comments.

SBA's, DOD's, and the Office of Management and Budget's comments and our evaluation are included where appropriate.

Our review was performed in accordance with our current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

## CHAPTER 2

### DOES DOD RECEIVE FAIR MARKET

#### PRICES ON 8(a) AWARDS?

The 8(a) program, as currently designed, cannot ensure that participating DOD procurement activities do not pay higher than necessary prices on 8(a) awards. The principal reason for this dilemma is that these activities often lack the comparative data necessary for determining a "fair market price" on an 8(a) contract.

SBA's BDE fund can be used to reimburse a procurement activity for differences between the price negotiated for an 8(a) contract and the fair market price the activity would have received under normal competitive conditions. When fair market prices cannot be determined, procurement activities usually negotiate contract prices based on the 8(a) firm's cost proposal and absorb higher than competitive contract costs.

Even when comparative non-8(a) contract data is adequate, factors compounding the problem of determining valid fair market prices include

- inadequate guidelines on how fair market prices should be determined,
- misapplication of existing guidelines, and
- the inability of SBA to provide BDE when justified.

This chapter will illustrate the problems procurement activities experience in determining fair market prices on 8(a) contracts and justifying the need for BDE to SBA. Because improvements in DOD's regulations alone will not resolve the principal problem faced by procurement activities in pricing 8(a) contracts, we offer an option that will introduce competition in 8(a) procurements. In addition, we make recommendations to strengthen the program as it currently exists.

#### ARE PROCUREMENT ACTIVITIES EXPECTED TO PAY HIGHER PRICES ON 8(a) AWARDS?

Section 8(a) of the Small Business Act is silent on the issue of how to price an 8(a) contract. Section 8(a)(1)(A) states that "[the procurement] officer shall be authorized in his discretion to let such procurement contract to the Administration upon such terms and conditions as may be agreed upon between the Administration and the procurement officer." But what are acceptable "terms and conditions"? Was it intended that procurement activities award 8(a) contracts at higher prices than non-8(a) contracts?

A discussion of this issue appears in SBA's testimony before the House and Senate Committees on Appropriations. During fiscal year 1972 hearings, SBA requested approval for an \$8 million BDE fund to pay "the difference between the normal contract price and the price negotiated under Section 8(a)." Up until that time, price differentials on 8(a) contracts had to be paid from the procurement activities' normal appropriations. Consequently, agencies faced with reduced budget allocations were reluctant to give up a portion of their appropriated funds to pay differentials on 8(a) contracts. Under this new arrangement, SBA would pay the differential from its business loan and investment fund, with procuring activities only paying the equivalent of the competitive market price.

In appropriating funds to SBA for BDE, the Congress responded to a concern expressed in some detail by the Commission on Government Procurement Study Group on Controls over the Procurement Process. The study group reasoned that, with the use of BDE funds, SBA could pay a fair and reasonable price to 8(a) contractors and that agencies could conserve their limited appropriations. According to the study group, excess costs to the Government of funding, negotiating, and awarding an 8(a) contract should be absorbed by SBA as a necessary cost of the program. The study group also anticipated that the use of BDE funds would smooth the relationships among SBA, the procurement activities, and 8(a) contractors.

This arrangement continues today, with SBA stating in fiscal year 1982 hearings before the Subcommittee on the Departments of Commerce, Justice, and State, the Judiciary and Related Agencies, House Committee on Appropriations that:

"BDE is utilized by SBA to provide 8(a) firms with funds to purchase equipment that is necessary for performance of a specific 8(a) contract, and is also utilized by SBA to pay for material costs, start up, learning and under-absorbed indirect expenses, some or all of which are higher than those normally incurred by viable competitive firms. The higher than competitive contract costs and burden are paid by SBA directly to the procuring agency that awards the 8(a) contract."

SBA proposed a BDE fund of \$20.5 million for fiscal year 1982.

Thus, from the procurement activity's standpoint, the pricing of 8(a) contracts is unique. Rather than determining a fair and reasonable price on 8(a) contracts, procurement officers are expected to determine a "competitive market price," based on what they would expect to pay viable competitive firms. To encourage greater participation, SBA promises to assume all costs in excess of the market price.

HOW SHOULD FAIR MARKET  
PRICES BE DETERMINED?

The Defense Acquisition Regulation (DAR) 1-705.5 policy on BDE generally parallels the policy adopted by SBA in its budget justifications. In contracting with SBA, any costs to DOD which are in excess of the estimated current fair market price anticipated under normal contracting procedures are to be funded by SBA. DOD has also adopted an additional interpretation--that the estimated current fair market price is to be predicated on the basis of "likely costs" under normal competitive conditions rather than on the basis of the "lowest possible cost." We believe this added policy refinement could cause DOD to pay higher prices to 8(a) firms than it would to competitive non-8(a) firms. For purposes of measuring the impact of the 8(a) program, we compared the prices the procurement activity would have paid to the prices offered by the 8(a) firms.

More specific guidance on determining fair market price for supplies, services, and research and development appears in DAR 1-705.5 (c)(1)(L). For acquisitions not having a repetitive purchase history, contracting officers are to use a price or cost analysis, giving consideration to commercial prices for like services and products, available in-house cost estimates, and data submitted by SBA or its subcontractor or obtained from any other governmental agency. For acquisitions having a repetitive purchase history, the contracting officer will consider recent award prices for the same product or services if there is a comparability in quantities, conditions, terms, and delivery. This price should be adjusted to reflect revised specifications, transportation costs, packaging and packing costs, changes in labor or material costs, or special circumstances of previous purchases. No specific guidance is provided for construction contracts except that detailed Government cost estimates are to be prepared in advance of negotiations.

WHEN ARE PROCUREMENT ACTIVITIES  
MOST SUCCESSFUL IN DETERMINING  
FAIR MARKET PRICES?

We found the fewest problems with fair market price determinations when

- the set-aside item is repetitively purchased, and
- the set-aside item is also procured competitively from non-8(a) firms.

The Defense Personnel Support Center (DPSC) generally offers items to 8(a) firms only when identical items are purchased competitively. DPSC does this by splitting off a portion of a larger requirement for award to an 8(a) firm. This procedure

provides procurement activities with up-to-date comparative market information on which they can base their fair market price. Although DPSC's procedure would not have universal applicability, we believe other procurement activities which buy large quantities of identical items could benefit from this approach.

It also is interesting to note that DPSC is generally successful in (1) obtaining BDE when the 8(a) firm cannot perform at a fair market price or (2) not awarding the contract when SBA will not pay the difference. For this reason, DPSC is generally able to follow the intent of DOD's regulation on pricing more closely than other procurement activities we reviewed. However, we are also aware that splitting off requirements may impose other economic penalties on an activity. (See p. 20.)

#### WHAT PITFALLS DO PROCUREMENT ACTIVITIES ENCOUNTER IN DETERMINING FAIR MARKET PRICES?

As stated earlier, DOD's regulations outline a number of techniques that the contracting officer should consider in arriving at a fair market price. However, the contracting officer generally has wide discretion in determining which technique is most appropriate. We believe this discretion is desirable, as long as contracting officers are fully cognizant of the purpose for making the determinations in the first place. The following discussion highlights some pitfalls in arriving at fair market prices that can defeat the purpose of making the determination. We questioned fair market price determinations in 25 of the cases we reviewed, occurring in 7 out of the 8 installations we visited.

#### Arbitrary factor added to fair market price

At one procurement activity, the U.S. Army Armament Materiel Readiness Command (ARRCOM), contracting officers were permitted to add 10 to 20 percent to the fair market prices on 8(a) contracts to account for contractor inefficiencies. We believe costs in excess of fair market price should be paid by SBA.

#### Example

In September 1979, ARRCOM awarded a \$41,435 contract for spare barrel covers for machine guns to an 8(a) contractor. To arrive at a fair market price, ARRCOM used the August 1978 price of a non-8(a) contract with identical specifications and comparable contract terms, adjusted the 1978 price for inflation, and added an additional 10 percent to the price according to an ARRCOM policy for determining fair market price. The policy, which recommended that procurement officials add 10 to 20 percent to the lowest price previously paid to a non-8(a) source, was designed to account for, among other things, "inefficiencies in starting or growth of a small business; plus small business inefficiencies due to learning Government requirements." We

believe that, through this policy, ARRCOM subsidized the 8(a) program by allowing the higher prices to be paid to 8(a) contractors. In this case, the difference between the unit price ARRCOM paid in 1978, adjusted for inflation, and the unit price negotiated with the 8(a) contractor resulted in a total price differential of \$3,762, which should have been funded with BDE.

ARRCOM has since changed its methodology for determining fair market price by deleting the suggestion that a 10 to 20 percent factor be added to the lowest price previously paid to a non-8(a) source.

Fair market price on repetitive buys increased to account for higher 8(a) contractor costs

In some instances, fair market price determinations were increased to specifically address equipment needs or other costs incurred by 8(a) firms. These are precisely the costs SBA's BDE funds were intended to cover.

In such cases, contracting officers believed that a cost analysis was an appropriate substitute for current market indicators in setting a fair market price or could be used to increase an otherwise valid fair market price determination. One stated that a cost analysis is a much more reliable basis for a fair market price than a price analysis based on procurement history.

DAR section 1-705.5(c)(1)(L)(ii), which pertains to repetitively purchased items, makes no reference to a cost analysis. We believe a cost analysis for an 8(a) firm's proposal is not an indicator of competitive market prices and should only be used as a last resort and with full knowledge that the resulting price is not a competitive market price. In cases where adequate market data is available to determine a fair market price, we believe a cost analysis should not be permitted as a substitute or as a means to increase the contract price.

Example

At Redstone Arsenal Missile Command (MICOM) in Alabama, SBA disagreed with the Army's determination of fair market price on a contract for missile system repair parts. While visiting the 8(a) contractor and reviewing the proposal, MICOM learned that several items the contractor needed had some type of minimum buy stipulation, either in the form of a minimum dollar or a minimum quantity on the quote. Accordingly, MICOM increased its fair market price determination, which was based on procurement history, by \$32,357 to allow for the contractor's identifiable

minimum buy quantities. MICOM also increased the estimated amount of the contract by 25 percent--\$46,736--to cover the smaller minimum buy items that could not be identified easily. MICOM revised its total fair market price to \$266,038 and accepted SBA's evaluation of \$261,785.

The \$261,785 price MICOM accepted was \$74,840 over its original fair market price estimate based on recent comparable awards. In accepting a higher than fair market price, MICOM subsidized the 8(a) program by reducing the amount of BDE support required from SBA. According to the MICOM contracting officer, MICOM had negotiated another 8(a) contract at the same time which resulted in a large BDE award and the SBA regional office did not have a lot of BDE available for this contract.

An additional example appears in appendix VI.

Competitive bids and unsolicited proposals not considered in determining fair market prices on repetitive buys

Contracting officers must consider recent award prices in determining fair market prices on repetitive buys. However, the regulations do not address whether contracting officers should consider competitive bids or unsolicited proposals. Under certain circumstances, we believe competitive bids and unsolicited proposals may offer a better indication of current market value than the procurement history.

Example 1

ARRCOM split an award for 17,468 cable assemblies between two 8(a) contracts after it canceled a competitive solicitation for the entire quantity. One 8(a) contract was for 11,729 cable assemblies and was awarded on August 29, 1980, at a unit price of \$17.81. The other contract was for 5,739 cable assemblies and was awarded on September 24, 1980, at a unit price of \$15.65.

In computing the fair market price for the 8(a) awards, the price analyst apparently did not consider the bid prices on the canceled solicitation. The canceled solicitation's three lowest bids, which were opened in April 1980, were \$14.87, \$16.97, and \$16.94.

Based on a September 1979 award, ARRCOM established a fair market price of \$17.81 for the procurement of the 11,729 assemblies and a range of \$18.21 to \$19.56 for the 5,739 assemblies. The 8(a) firm selected for the larger procurement initially proposed a unit price of \$30.13, but later revised its proposal to \$20 and finally to \$17.81. The 8(a) firm selected for the smaller procurement proposed a unit price of \$15.65, which ARRCOM accepted because it was lower than the fair market price of \$17.81.

We believe ARRCOM missed an opportunity to use the best evidence available--a current competitive quotation from a previous acceptable producer--as a basis for determining a fair market price. On the basis of the previous producer's bid price of \$14.87, we estimate that the price differential is \$60,638 on the larger contract (this includes an option quantity exercised on December 29, 1980, at \$17.81) and \$4,476 on the other contract.

### Example 2

At MICOM, the contracting officer determined a fair market price of \$2,773,540 for an 8(a) contract to procure training equipment, apparently ignoring the \$2,523,000 price offered on an unsolicited proposal from a previous contractor. The contract was later terminated for nonperformance. SBA released the procurement from contracting under the 8(a) program on the condition that the 8(a) firm's committed materials and subcontract costs/obligations be picked up by the new contractor. The requirement was then reprocured from the previous contractor, not at the \$2,523,000 price offered under the unsolicited proposal, but at the \$2,773,540 price paid by DOD to SBA for the 8(a) contract.

### Fair market prices changed to accommodate SBA

In some of the cases we reviewed, procurement activities changed valid fair market price determinations in response to objections posed by SBA officials. For example, at ARRCOM in Rock Island, Illinois, 8 of the 18 cases we reviewed were awarded at higher than fair market value prices because the prices negotiated with SBA were substituted for the prices based on previous award history with competitive firms. In this case, SBA did not have BDE funds or refused to pay any price differential and ARRCOM was under pressure to meet its 8(a) goals established by DOD.

### SBA pressures to award 8(a) contracts at higher than competitive prices

DOD contracting officers can be faced with pressures by SBA negotiators to agree to higher than fair market prices. For example, SBA's Standard Operating Procedure (SOP) 80-05 instructs that:

"The purpose of the negotiations, insofar as the 8(a) concern and SBA are concerned, is to negotiate the terms and conditions of the proposed subcontract and agree upon a price which will permit the 8(a) concern to perform and earn a reasonable profit. It may be assumed that the representatives of the contracting officer of the procuring agency will seek to limit the contract price to the amount they consider to be the 'fair market price' or less. If

the price proposed by the procuring agency is not considered sufficient to assure a reasonable profit for the 8(a) concern, the SBA contract negotiator, with the advice and assistance of such price analysis personnel as may be available, will conduct further negotiations for the purpose of obtaining agreement to a higher and more appropriate price."

Thus, SBA, in its instructions for conducting negotiations with procurement activities, encourages its contract negotiators to obtain the activities' agreement to higher prices when the fair market price is not sufficient to assure a reasonable profit for the 8(a) firm.

These pressures can be reinforced by the short supply of BDE funds available to meet a potentially large demand. At ARRCOM, we found numerous instances where the regional SBA offices could not fund the BDE needed to pay the difference between a fair market price and a fair and reasonable price. ARRCOM's solution was to revise the fair market price determinations to reflect the higher costs. We believe the regulations should explicitly state that fair market price determinations are the responsibility of DOD. In the event of disagreement over fair market prices, DOD is not obligated to change its determinations to meet SBA's needs. SBA's exclusive right to determine allowable BDE is already clearly stated, and no refinement is needed.

#### Example

On the basis of previous awards and offers received a month earlier on another solicitation for small business and labor surplus area firms, ARRCOM, in June 1979, established a fair market price of \$265,000 (\$0.0530 a unit) for 5 million tape stiffener assemblies.

In May 1979, the 8(a) firm submitted a pricing proposal of \$378,000 (\$0.0756 a unit), \$0.0226 a unit higher than ARRCOM's fair market price determination. SBA asked for a cost analysis, but the Army negotiator initially resisted, stating that because the tape stiffener assembly was a competitive, repetitively procured item, market forces effectively set the prices. According to the negotiator, the fact that the 8(a) contractor was incurring the costs did not make them correct, fair, or reasonable.

Despite the above statements, the Army agreed to a price of \$314,000 (\$0.0628 a unit) based on additional cost data submitted by the 8(a) contractor. SBA at first opposed even the \$0.0628 unit price, saying that it had no BDE funds available, but later accepted that price and agreed to reimburse ARRCOM \$11,000, based on the difference between the \$0.0628 and the \$0.0650 unit price finally negotiated with the 8(a) contractor.

We believe that SBA should have reimbursed the Army based on the fair market price determination of \$0.0530 per unit. The differential based on this unit price would be \$60,000 rather than \$11,000. Thus, the Army paid \$49,000 more than fair market price on this procurement.

SBA has also chosen to deal with the problem of limited funds by excluding professional and nonprofessional service firms from eligibility for BDE for price differential and by favoring manufacturing firms over construction firms when allocating BDE. SBA's rationale is that professional and nonprofessional service firms':

"\* \* \* output does not require fabrication with capital equipment or inventory acquired in volume or other capital-intensive, equity-consuming outlays, as is generally the case with manufacturers, or at least to the extent as manufacturers. \* \* \* SBA has had to favor firms that experience shows have the greatest possibility of becoming successful, having the greatest staying power, commitment and adaptability to changing economic circumstances. Manufacturers rather than construction firms appear to have the best track record, judged by those criteria."

SBA's policy on allocating BDE may seem reasonable in light of the need to set priorities on scarce resource allocation. However, we believe that given these limitations, procurement officers may liberalize their definitions of fair market price or seek to cover excessive cost elements to accommodate 8(a) program participants. Failing this, it could mean fewer contracts are offered to 8(a) firms in these categories than would otherwise be the case.

Fair market prices  
increased by offsetting

The Defense Fuel Supply Center (DFSC) paid \$44,243 more for an item than the 8(a) contractor initially proposed because it acceded to SBA's request to change the method for calculating BDE.

Under a 1977 Defense Logistics Agency (DLA) 1/ agreement with SBA, SBA would submit sealed 8(a) firms' proposals to DFSC. The proposals would remain sealed until DFSC could set fair market price ranges based on high and low bid prices received on regional solicitations. SBA had the option of supplementing, with BDE, those prices which exceeded the fair market price range or returning

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1/Defense Logistics Agency is the parent organization of DFSC.

the items to DFSC for competitive procurement. The 8(a) firms were not to be permitted to increase any price falling within the fair market price range to a higher price within the range.

On a contract, negotiated under this agreement, for delivery of gasoline, distillates, and residuals, the 8(a) contractor's proposed prices for some items exceeded the fair market price range, but for others fell below the top of the range. In determining BDE, SBA asked that those prices which fell below the top of the fair market price range be increased to the top of the range and be used to "offset" prices above the range, thus reducing the required BDE support. DFSC, recognizing that it would assume additional responsibility for costs if it agreed, requested permission from DLA headquarters. Upon approval, DFSC increased the initial bid of \$0.39044 a gallon for one item to \$0.39540 a gallon (top of the fair market price range). Based on the total estimated quantity of 8,920,000 gallons for this item, DFSC agreed to pay \$44,243 more than initially proposed by the 8(a) contractor. Other item prices on the contract were similarly increased.

The potential for offsetting still exists under DLA's and SBA's revised agreement on fair market price methodology dated December 1979. Under the revised agreement, the fair market price for an item is the highest competitively awarded price in the commercial market area. Although SBA submits the initial 8(a) contractors' offers to DFSC by solicitation closing dates, SBA does not submit final offer prices until it has received fair market prices from DFSC and has completed negotiations with the contractors. Thus, according to several DFSC officials, there is potential for SBA to offset prices while in negotiations with contractors.

#### CAN A FAIR MARKET PRICE ALWAYS BE DETERMINED?

Fair market prices can generally be determined at activities, such as DPSC, where items offered to 8(a) firms are repetitively purchased from non-8(a) firms. In such cases, fair market prices are well documented and are easily defended by agency personnel. However, how can a fair market price be determined on a nonrepetitive item, or a service, when no procurement history is available to rely on? In these cases, we believe fair market prices cannot be adequately determined, despite DOD's regulations which prescribe the methodology contracting officers must use.

Often, a procurement activity's only alternative is to analyze an 8(a) firm's cost proposal, negotiate such proposal with SBA and/or the 8(a) firm, and determine that whatever price results is a fair market price. We believe this process may result in a fair and reasonable price for the 8(a) firm, since it considers what the 8(a) firm needs to successfully complete the requirements of the contract and earn a reasonable profit, as well as the

amount the activity is willing to pay. It is not, however, a reflection of what price would be offered in the market place by viable competitive firms.

This situation is a function of the 8(a) program's design and no regulation can correct it. If market data is not available, contracting officers should not be expected to estimate a market price. In these cases, we believe the regulations should not require a fair market price determination since none is possible. Instead, contracting officers should determine a fair and reasonable price and attempt to identify, through cost analyses, those material, startup, and learning costs and underabsorbed indirect expenses which may be higher than those normally incurred by viable competitive firms and which SBA should cover. This method will not prevent procurement activities from paying more than they would through competition or by comparisons to previous awards, but it does more closely reflect the current procedures used by the procurement activities we visited and it does avoid the use of the term "fair market price" when it is not appropriate.

Nonrepetitive manufacturing, service,  
and construction contracts

Nonrepetitive manufacturing contracts, service contracts, and construction contracts do not lend themselves to fair market price determinations because (1) procurement histories do not exist or do not reflect the same work and (2) often the work cannot be divided into 8(a)/non-8(a) components. The most frequently used methodologies in these cases--independent cost estimates and cost analyses of the 8(a) firms' proposals--do not necessarily reflect the prices procurement activities would have received under normal competitive conditions, but are generally the only techniques available to the contracting officers. We believe the fair market price concept cannot be applied in these cases, and as a result, procurement activities are deprived of their only means of avoiding paying higher than competitive prices.

Example

At the San Antonio Contracting Center (SACC), where each procurement action is generally unique due to its construction or service nature, an independent Government estimate is required for each procurement expected to exceed \$10,000. This estimate is usually made by engineers using the publication "Mean's Cost and Price Index" and the Department of Labor's labor rates. Using this estimate and an independent analysis of the contractor's price, the contracting officer determines the Government's objective for negotiations.

One of the contracts we reviewed at SACC illustrates how Government estimates, which appear reasonable, may not reflect prices obtainable under competitive conditions. The Kelly Air Force Base civil engineers had recommended negotiating a \$50,000

Government estimate for the installation of safety devices and rails on facility ladders. Using the results of the technical evaluation, the contracting officer established a negotiation objective of \$48,878. During negotiations, SBA, SACC, and the 8(a) contractor agreed on a firm fixed price of \$53,337. The increase was attributable to higher wages actually paid by the 8(a) contractor and the use of heavy equipment not anticipated by the contracting officer. After the 8(a) contractor could not obtain bonding, and the Air Force objected to a substitute contractor with a poor performance record, SBA terminated the contract with SACC. SACC subsequently awarded a competitive contract for this work in the amount of \$40,490--a savings of \$12,847 over the negotiated amount of the 8(a) contract.

An additional example appears in appendix VI.

In such cases as these, contracting officers are generally using all available tools to arrive at a fair and reasonable price. However, these tools are not adequate for determining a fair market price since no price comparison to previous awards and bids can be made.

#### Procurement history outdated

We found instances where the procurement history appeared adequate, but concurrent non-8(a) awards were not taking place. In these cases, we believe determining fair market prices based on a previous award history will become increasingly difficult. At the San Antonio Air Logistics Center, some items are now awarded exclusively to 8(a) firms. With each passing year, the competitive award price used as a basis for the fair market price becomes more and more out of date, even with the use of price escalators. For this reason, the value of the previous award history for determining a fair market price is certainly subject to question. With the tremendous growth in the program over the last few years, instances where previous award histories are of little help to the contracting officer should be expected to increase.

#### Example

A contract at the San Antonio Air Logistics Center for engine mount assemblies was awarded in January 1979 to the same 8(a) contractor who had performed five previous contracts for the assemblies. All previous pricing was based on a non-8(a) contract awarded in October 1974.

The 8(a) contractor's previous award prices ranged from \$20.65 a unit to \$22.47, while an in-house engineering estimate indicated a price range of \$12 to \$18 a unit. Although the 8(a) contractor's prices may be reasonable, based on costs incurred, the lack of a recent competitive award price hinders the contracting officer's efforts to establish a fair market price.

DO PROCUREMENT ACTIVITIES SACRIFICE  
BETTER PRICES EVEN WHEN FAIR MARKET  
PRICES ARE OBTAINED?

Sometimes, activities sacrifice a better price by awarding a contract through the 8(a) program, even though a fair market price is received. For example, the regulations state that price adjustments should be made to allow for differences in quantities. When an activity, such as DPSC, sacrifices awarding the entire quantity to its best producer, and instead awards a portion of that quantity to an 8(a) firm, an additional cost may result--the difference between the price DPSC could have obtained versus the price received from the 8(a) firm. This cost is incurred even though the 8(a) firm received a fair market price for the quantity supplied.

Example

DPSC paid \$45,206 more under two contracts because it split off small parts of the total requirements for the items for awards to 8(a) contractors. While DPSC computed reasonable fair market prices, the additional costs resulted because of the small quantities being procured. Had DPSC included these quantities with the remainder of the requirements purchased competitively, it would have saved this amount of money, assuming the competitive contractor would have produced the additional items at the same cost. The basis for the savings is summarized in the following chart.

Item	8(a) contract		Competitive contract		Unit price difference (5)	Potential savings (1) x (5)
	Quantity (1)	Unit price (2)	Quantity (3)	Unit price (4)		
Cartons and dividers	3,763,608	\$ 0.0356	26,345,253	\$ 0.0264	\$ 0.0092	\$34,625.19
Utility shirt	75,000	6.00521	972,080	5.86413	0.14108	<u>10,581.00</u>
Total						<u>\$45,206.19</u>

An additional example appears in appendix VI.

CONCLUSIONS

Despite SBA's agreement to pay price differentials, the concept of determining a fair market price and comparing it to an 8(a) firm's negotiated price does not always work. The success of this reimbursement method depends on (1) a procurement activity's ability to compute and substantiate its fair market price determinations and (2) SBA's ability to provide BDE when justified.

Too often procurement activities cannot compute or substantiate fair market price determinations because recent comparative market information is not available. This is generally the case for services, construction, nonrepetitive manufactured items, and repetitive manufactured items which are awarded solely to 8(a) firms. As shown in the examples, even when adequate data is available, procurement activities sometimes defeat the purpose of determining fair market prices because of (1) inadequate guidelines or misapplication of regulations on the pricing of 8(a) contracts and (2) pressures by SBA to award 8(a) contracts at higher than competitive prices because of limited BDE funds. Only under the best of circumstances, where items are repetitively purchased from both 8(a) and non-8(a) firms, can valid fair market prices be consistently computed.

We believe revised regulations and enforcement only offer the potential for limited improvement in DOD's program. However, a change in program design, as outlined in our Competitive Set Aside Option, could ensure that (1) procurement activities pay only fair market prices, (2) SBA pays all price differentials through BDE, and (3) all costs associated with 8(a) contract prices are made visible.

#### COMPETITIVE SET-ASIDE OPTION

With congressional approval, a modified 8(a) set-aside program could introduce the competitive bidding process missing from the present 8(a) program. Under this option, 8(a) firms would compete with other businesses for procurements. However, offers from 8(a) firms would receive priority for award.

If an 8(a) firm was the low bidder or came within a predetermined percentage (as stated in the solicitation) of the low bid, the 8(a) firm would be awarded the contract, assuming SBA was willing to pay any resulting price differential from its BDE fund, as SBA presently can do. If SBA elected not to fund the price differential, then award would be made to the lowest responsible, responsive offerors, according to the priority system (e.g. labor surplus area concern, small business) stated in the solicitation. The success of this proposal would depend on activities continuing to offer far more contracts than 8(a) firms could complete--the usual case today. Otherwise, few non-8(a) firms would find it worthwhile to bid.

The percentage advantage received by an 8(a) firm could vary according to the type of work performed (e.g. manufacturing, construction, service) or its complexity. Also, consideration could be given to establishing different percentages depending on the 8(a) firm's length of participation in the program. If this option is adopted, SBA would continue to be responsible for certifying program eligibility and providing 8(a) firms with appropriate marketing, technical, and managerial assistance.

We believe this modified set aside approach would benefit DOD, since it would receive bids from the full range of firms willing to do business with it. Consequently, DOD would be assured it was obtaining a true fair market price while avoiding the administrative complexities inherent in the current method of calculating a fair market price. Price differentials between 8(a) and non-8(a) firms' offers would be covered by SBA's BDE funds rather than being absorbed within various categories of procuring activities' budgets. Moreover, DOD would not have to prepare a new solicitation if no 8(a) firm were able to do the work. Thus, procurement administrative leadtime for 8(a) procurements could be shortened.

This approach would also be beneficial to SBA and the 8(a) firms. Under this approach, SBA would become aware of those 8(a) firms not making progress, since they would require more price differential support than SBA would be willing to provide. Further, SBA could then determine what assistance was needed to help the firms develop the ability to compete. Over time, SBA could determine how much BDE it needs to support different levels of 8(a) contracting by analyzing requirements for price differentials. SBA could also develop data on various levels of BDE needed to support firms in different industries.

Finally, this approach would make the costs of using the procurement process to develop small disadvantaged businesses more visible. Without cost visibility, the Congress lacks the data it needs to effectively evaluate the 8(a) program's results and to control the scope of the program.

RECOMMENDATION TO  
THE SECRETARY OF DEFENSE

We believe the option just outlined offers the greatest potential for strengthening the 8(a) program from a procurement standpoint. However, in the interim, we believe DOD's 8(a) program regulation can be improved.

We recommend that you revise DAR 1-705.5 to state that:

1. Fair market price determinations, properly computed, are the responsibility of the procurement activity and are not to be negotiated with SBA.
2. When a fair market price can not be determined, the contracting officer will document the circumstances which prevent such a determination. The contracting officer will then perform a cost analysis of the contractor's proposal, identifying any excessive costs which should be reimbursed by SBA.
3. In determining a fair market price, a contracting officer may consider the lowest price received on previous

procurements, unsolicited proposals, and competitive bids. In considering these and other indicators of a fair market price, the contracting officer's objective will be to reflect the intent of DOD's policy--that higher than competitive contract costs and burdens be reimbursed by SBA.

#### AGENCY COMMENTS AND OUR EVALUATION

SBA and DOD generally concur with our interim recommendations. However, both SBA and DOD take exception to our competitive set-aside option. (See apps. VII and VIII for complete agency comments on our draft report.)

#### DOD

DOD believes that the current method for calculating a fair market price is no more complicated than other actions undertaken in the procurement process and that a percentage factor would be difficult to implement fairly. DOD also believes that the number and value of 8(a) contracts would be reduced if such awards were dependent on SBA's BDE funds and that 8(a) firms that normally would be low bidders would adjust their bids to obtain contracts with contributions from SBA's BDE fund.

Our option is similar, in many respects, to DOD's current methodology for implementing the labor surplus area set-aside program. If our proposal is adopted, prices would be set through the competitive process, as is the case with labor surplus area awards, rather than through an often lengthy and time-consuming negotiation process. Differences in how DOD, SBA, and the 8(a) firm view fair market prices would be moot since prices would be set in the marketplace.

Further, our review demonstrates that the lack of comparative market information hampers effective implementation of the fair market price concept. While negotiating 8(a) contract prices may not be inherently more complex than other procurement actions, competition would help ensure that DOD activities do not pay more than necessary for 8(a) contracts.

With respect to DOD's concern over the fairness of the percentage applied and the availability of BDE funds, we believe our option offers advantages over the current system in that it would permit a rational determination of the resources to be devoted to the 8(a) program and would avoid the use of appropriated procurement dollars to subsidize 8(a) awards. We see no reason why applying a percentage factor would be any less fair than the current method of distributing BDE funds, which has been questioned in numerous hearings, investigations, and audit reports. In fact, one reason we suggested a percentage factor was to establish, in advance, the ground rules for the distribution of BDE funds, an attribute which can only enhance

the program's perceived fairness. In addition, a percentage factor would provide a means of controlling the program's funding needs.

With respect to the potential for adjusting bids to increase the opportunity for BDE, we believe these opportunities exist in the current program. Given sole-source awards, and recognizing the lack of an adequate procurement history on many types of awards, an 8(a) firm has little incentive to offer its lowest price in the current program. An 8(a) firm's ability to participate in "gaming" under our competitive option would depend on its ability to accurately anticipate its competitors' bids and to fine tune its bid to be higher than the lowest competitive bid but within the range permitted by the percentage limit--a not so easy task, unless, as hypothesized by DOD, the firm has no known competitors, in which case, we would question why the firm is in the program.

#### SBA

SBA is concerned that a totally competitive set aside program would not comply with the spirit of section 8(a) of the Small Business Act since the act explicitly provides for sole-source federal contracts as a tool for developing small and disadvantaged business firms. SBA is also concerned that non-8(a) firms, particularly small business firms, would not wish to prepare bids knowing that 8(a) firms would receive a preference and that such business firms might further object if the proposal means fewer requirements will be reserved for the small business set-aside program. <sup>1/</sup> Finally, SBA expressed concern that competition would mean that it would lose its ability to direct contracts to any 8(a) firm, including those firms which are less competitive within the 8(a) program and are more in need of contracts than others. Until these concerns are adequately explored, SBA can not endorse the competitive set-aside option.

SBA will explore, instead, limited competition within the 8(a) program itself. Under this alternative, both competition and sole-source contracting would be used to achieve the business development purposes of the act. SBA is currently developing a test program which will be implemented in the fall.

We agree that introducing competition into the 8(a) program represents a significant departure from current program requirements, and we share SBA's concern that our proposal be fully explored and modified, as appropriate, before adoption.

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<sup>1/</sup>To ensure that the small business community receives a fair proportion of the procurement dollar, Federal agencies set aside procurements, either totally or partially, where there are a sufficient number of qualified small business sources to assure reasonable prices.

We are not questioning SBA's legal right to grant sole-source contracts--the courts have long upheld this authority and the act, as amended, specifically grants this power. In fact, we believe a program change that introduces competition into the process should be mandated by the Congress. Therefore, we offer our proposal as an option for the Congress to consider rather than as an opportunity for administrative action. Moreover, if the option is chosen, we believe it should be implemented on a trial basis at selected agencies. In this way, SBA's concerns can be evaluated adequately and a determination made as to the option's feasibility and desirability, as compared to the present program.

Regarding a potential lack of participation by non-8(a) firms, we believe our option would only be effective if the pool of available requirements was large enough to ensure that both 8(a) and non-8(a) firms can expect a reasonable opportunity for receiving some contracts. Otherwise, few non-8(a) contractors would bid. As long as the percentage factor is stated in the solicitation, non-8(a) firms will know, in advance, the criteria for selection and can assess their opportunities for award, accordingly.

As for the potential concerns of small non-8(a) firms, our proposal allows the Congress to determine the scope of the program based on funding levels it approves, as opposed to the current program where 8(a) goals are set jointly by the agency and SBA. Our proposal does not prejudge whether more or less emphasis will be placed on developing small and disadvantaged business firms versus allocating awards to small business firms.

Concerning SBA's view that it would lose control in directing contracts to 8(a) firms, we believe our proposal addresses SBA's need to assist 8(a) firms through contract assistance, as well as financial and managerial assistance. New, less competitive firms will require a greater degree of all types of assistance than other program participants. Participants who adapt well to the competitive environment can be expected to decrease their reliance on SBA assistance and eventually will graduate. Those that are unable to establish themselves in the marketplace, even with intensive SBA assistance, will raise questions as to their continued viability. Since the ultimate goal is to develop competitive firms, introducing competition into the process, even in the early stages of a firm's development, should not be regarded as an obstacle to its development, but as a realistic challenge similar to the challenges the firm will face when SBA no longer provides assistance. An inability to compete, even with generous price differentials and other forms of SBA assistance, should trigger SBA to reassess whether the firm will ultimately be successful.

We believe there are many positive aspects to SBA's efforts to initiate competition on a limited scale within the 8(a) program itself. However, such a program would not ensure that procurement activities receive fair market prices since only 8(a) firms will be permitted to compete. Further, many of the concerns SBA has expressed about our proposal may also apply to a program which provides for competition within the 8(a) program itself. SBA would appear to be hopeful that these concerns can be minimized.

Our competitive set-aside option is intended to focus Congressional and agency attention on the issues of 8(a) contract pricing and cost visibility. Other approaches for addressing these issues should also be explored. We encourage SBA to work with the Congress, the Office of Federal Procurement Policy, the procuring agencies, and the small business community to develop the specific approaches and techniques that will resolve the problems we observed.

## CHAPTER 3

### DOES DOD RECEIVE ACCEPTABLE

#### PERFORMANCE FROM 8(a) CONTRACTORS?

Although many 8(a) firms performed satisfactorily, others did not meet delivery schedules or failed to perform required work. While performance problems are not unique to 8(a) firms alone, we believe the 8(a) procurement process itself is responsible for many of the deficiencies. We found few problems with the type or quantity of requirements procurement activities reserved for 8(a) firms. However, we did identify deficiencies in the process for matching firms to work requirements and for resolving performance problems after award. We believe a direct contracting approach between the procurement activity and the 8(a) firm would reduce the likelihood of similar problems developing in the future. In the interim, we believe some improvements are possible within the present program framework.

#### CAREFUL SCREENING OF REQUIREMENTS OFFERED TO 8(a) FIRMS LIMITS THE POTENTIAL FOR ADVERSE IMPACTS

Procurement activities generally maintain tight control over the type and quantity of items reserved for 8(a) participants. For example, Warner Robins offers only items that are well supported with complete reprourement data. Items must not be intricate, although moderate complexity will not necessarily preclude an item from being offered. Redstone Arsenal also takes steps to avoid setting aside urgent requirements for 8(a) firms because officials believe that contract negotiation and followup with SBA extend the procurement processing time beyond that necessary for normal competitive awards. Rock Island Arsenal generally purchases noncombat essential items with adequate inventories from 8(a) firms. DPSC, which acquires and distributes wholesale stocks of food, clothing, and medical supplies to the U.S. Armed Forces, usually procures items which are purchased concurrently in a competitive award, from 8(a) firms. This policy not only results in good data for fair market price comparisons but also provides a readily available source if the 8(a) firm experiences delivery problems. Overall, we found few problems with the type and quantity of items selected for 8(a) firms and little negative impact resulting from these selections, other than the extra administrative steps needed to reserve the requirements.

#### INADEQUATE PREAWARD EVALUATIONS OR LACK OF SBA ASSISTANCE CAN RESULT IN POOR CONTRACTOR/ REQUIREMENT MATCHES

Procedures for selecting and evaluating 8(a) firms varied widely from activity to activity. The program gives SBA exclusive

authority to select 8(a) firms. At some activities, SBA selected contractors without consulting DOD officials; at other installations, SBA delegated selection authority to DOD officials and did not provide any input other than that needed to process the paperwork. Regardless of who selects the firm, our concern is that the best firm/requirement match results. Therefore, adequate preaward evaluation--a detailed evaluation of all of the business aspects of a company's operations--is a must. Further, if deficiencies are identified, appropriate financial, managerial, or technical assistance should be arranged at the time of award, or the requirement should be returned to the procurement activity.

Who selects and evaluates  
8(a) firms?

At one end of the spectrum we have procurement activities that take an active interest in the screening and selection of 8(a) firms. For example, at MICOM, the Small and Disadvantaged Business Utilization Office (SADBU) representative recommends a firm to SBA. SBA generally concurs in the recommendation. MICOM told us that, in the past, SBA used to select most of the contractors without assistance from MICOM, but since the firms generally did not meet MICOM's satisfaction, MICOM now recommends most of the 8(a) firms. Once a requirement has been set aside for the 8(a) program, the SADBU office matches the requirement with potential 8(a) firms, evaluates the capabilities of the potential 8(a) firms, and submits the list of firms to MICOM's special review board for selection. The potential 8(a) firm chosen is then forwarded to SBA for its approval.

MICOM officials usually visit the potential 8(a) firm to determine if the firm is capable of performing. Of the eight MICOM contracts we reviewed, only one contract file indicated that a visit had not been made by MICOM. Instead, the Army used references provided from other sources that the 8(a) firm had done work for in the past.

At Robins Air Force Base, the SADBU office matches some requirements with potential 8(a) suppliers and forwards them to SBA for their approval. However, the SADBU office may not recommend a contractor and, in these cases, it forwards the requirement to SBA for a recommendation. On occasion, SBA selects a firm to perform the service or provide the goods. However, we found that SBA is often unable to respond with a selection. For example, we obtained information that showed Robins Air Force Base had forwarded requirements to SBA asking it to select the firm; SBA stated none were available. In such cases, the requirements were withdrawn from the 8(a) program and announced for competitive procurement. Visits to the potential 8(a) firm are not usually performed by Warner Robins. According to base personnel, the certification of the contractor's ability to perform is SBA's responsibility and they rely on SBA's certification.

At both Kelly Air Force Base's Air Logistics Command and SACC, 8(a) contractors are selected almost exclusively by SBA.

Upon notification of proposed 8(a) procurements from activities, the SBA Central Office determines whether or not to accept the procurements for the 8(a) program. If accepted, the SBA San Antonio district office handles the procurement and selects the firm. Neither the Air Logistics Center nor SACC participates in the contractor selection. Officials at both commands did not know how or why SBA made the individual selections, other than, in many instances, the firm had the prior 8(a) contract for the same item or service.

Inadequate screening and follow through  
prior to award can result in poor  
requirement/contractor matches

Out of our sample of 113 contracts, we reviewed 15 contracts that had been terminated in fiscal years 1979 and 1980 to determine why the contracts failed and what preventive measures could be taken to avoid similar situations developing in the future. Ideally, SBA will select a firm according to the firm's needs, as outlined in its Business Development Plan; assess, with DOD, the firm's capabilities; and determine and provide what assistance, if any, is needed to the firm to successfully complete a given requirement. In reviewing terminated contracts and some other contracts not yet terminated, we found that, in almost every case, (1) the selections should have been questioned before award based on facts known at the time and/or preawards should have been performed to assess the firm's capabilities or (2) promised assistance was not provided by SBA.

Selections should  
have been questioned

Example 1

On June 5, 1978, SBA's Central Office requested DPSC to reserve a proposed procurement of 500,000 men's utility shirts for award to an 8(a) firm. The contract was to be awarded through SBA's New York district office. At that time, the 8(a) firm was already delinquent on an existing contract awarded by DPSC to make 300,000 shirts.

On June 26, 1978, DPSC informed SBA that, in view of the firm's performance, it was doubtful that the firm could produce the 500,000 shirts under a follow-on contract in the required 12-month delivery schedule. A capability study, completed in July 1978, confirmed that the firm was continuing to have production problems and did not have the production capability to perform both contracts simultaneously and to meet the required delivery schedules. The study also indicated that the firm had no previous experience in making the item.

On August 8, 1978, DPSC informed the Central Office of the results of the capability study. SBA withdrew its request on August 17, 1978. However, on September 11, 1978, the SBA New York district office, with Central Office approval, requested

that DPSC reconsider award of the follow-on contract because the firm was progressing on its current 8(a) contract. On September 26, 1978, SBA's New York District issued a letter certifying the firm's competency to perform the follow-on contract. DPSC, relying on SBA's certification, awarded the \$2,860,000 contract to SBA on September 29, 1978, to meet 8(a) program goals for the fiscal year. At about the time of this award, the 8(a) firm was delinquent in delivering 125,000 shirts under the initial contract. In December 1978, before SBA consummated the subcontract, the 8(a) firm suspended production and subsequently filed for bankruptcy.

Given the firm's tenuous financial circumstances, unsatisfactory performance under the previous contract, and the results of the capability survey, which disclosed that the firm could not meet the production schedule, we believe SBA should not have awarded the follow-on contract to the 8(a) firm. We also believe that DPSC should have resisted awarding the contract to SBA, since DPSC knew the 8(a) firm that would receive the contract had such a poor performance record. If SBA could not provide adequate assurance that the firm, with SBA assistance, could perform, the requirement should have been returned to DPSC.

This case demonstrates the importance of close cooperation between SBA and DOD. We believe SBA has a special obligation to the procurement activity to select, with reasonable certainty, firms that can perform. In this case, once DPSC challenged the selection of the 8(a) firm, we believe SBA should have acknowledged the risk DOD was being asked to take and returned the requirements, unless SBA could provide the kind of assistance the firm needed to perform. Moreover, we believe SBA has some responsibility for monitoring the firm's performance, both for the procurement activity's protection and its own, not to mention the need to fulfill its role of assisting the development of the 8(a) firm.

#### Example 2

DFSC awarded an 8(a) contract for delivery of gasoline, distillates, and residuals without adequately assessing the firm's capability to perform and later had to terminate the contract. SBA initially requested that \$2,500,000 in items be reserved for the firm, but later amended its request to \$12,022,000. DFSC waived a preaward survey and awarded a contract for \$12,021,954 in April 1979.

By May 1979 the 8(a) firm advised DFSC that it was having difficulty getting gasoline and diesel fuel to supply the various activities under its contract. Fort Benning, Fort McPherson, Fort Gordon, and Robins Air Force Base informed DFSC of the firm's nonperformance and purchased the product locally. In June 1979, SBA requested that all contract items be terminated at no cost, except for six items valued at \$1,411,039, which was

more in line with its initial reservation request. According to SBA, the size of the contract far exceeded the firm's capabilities.

The problems stated in this case could have been avoided had SBA made an adequate background investigation on the firm's financial capability or had the contracting officer requested a pre-award survey from the Defense Contract Administration Service (DCAS).

Additional examples appear in appendix VII.

#### SBA assistance not provided

In a few instances, SBA awarded contracts to 8(a) firms knowing financial assistance was required but failed to follow through. All of these cases were isolated at the San Antonio SBA district office. In each case, problems developed because SBA Headquarters declined to approve BDE, provide bonding waivers, or provide advance payment assistance after the contracts were awarded by the district office. Although these problems did not appear to be widespread, we believe other offices could be vulnerable to the same problems.

#### Example

Because SBA failed to provide requested BDE and advance payments, an 8(a) firm at Kelly Air Force Base Air Logistics Center failed to perform, adversely affecting Air Force requirements for helmet front pads. At the time the firm submitted its proposal, it notified SBA that it would need \$14,000 in BDE to perform the contract and advance payments to finance the contract.

Even with these known conditions, SBA awarded the contract, effective December 15, 1978, for 22,723 helmet front pads. In January 1979, SBA notified the firm that BDE funds would not be available to it. Accordingly, the contractor purchased the equipment without SBA assistance. In February 1979, SBA informed the contractor that advance payments were not being allowed until SBA's updated regulations were available. By May 23, 1979, the firm had not received an official reply to its request for advance payments. Further, the almost year-old material quotes had expired and there were such substantial material cost increases that the contractor could not, even with advance payments, perform the contract without incurring a loss.

On October 10, 1979, SBA notified the air logistics center that the 8(a) firm would not be able to perform the contract for reasons beyond its control and requested a no-cost termination for the convenience of the Government. SBA cited its failure to supply advance payments to the contractor as anticipated and the significant increase in material costs that had occurred while the contractor was attempting to get the advance payments. SBA stated that Government delays and actions had caused the nonperformance of this contractor.

Delivery of this contract had been scheduled for July 1979. When the 8(a) contractor did not deliver within the stipulated time, the air logistics center entered into an emergency procurement contract for 17,571 items.

Why 8(a) firms are not  
evaluated before award or  
assistance is not provided

Current impediments to the proper functioning of the selection and evaluation processes are (1) DOD's regulations which discourage preaward surveys and (2) SBA's failure to supply BDE and advance payments when needed. Another reason is that procurement activities misunderstand SBA's competency certification for 8(a) firms.

Misunderstanding about  
certificates of competency

SBA's competency certification for 8(a) firms should not be confused with its certificate of competency (COC) for small business firms in general. In the case of a COC, SBA is certifying to procurement officials that the firm in question is capable of performing on the proposed contract. Small businesses can use the COC to overcome a negative evaluation of responsibility by the contracting officer. SBA, after assessing the capabilities of the small business in terms of the needs of the specific acquisition in question, is allowed to substitute its judgment for the contracting officer's. SBA is not, however, a party to any contract which may result between a small business firm and DOD.

We believe SBA's competency certification for 8(a) firms has a different meaning. SBA's competency certification takes the form of a contract provision: "SBA certifies that it is competent to perform the requirement as stated in this contract." Both we and DOD headquarters' acquisition policy officials believe that SBA, as the prime contractor, is simply certifying its own competence to perform. However, the Deputy Administrator of SBA, in clarifying SBA's intent to us, suggested that the clause provides two assurances:

"First, that SBA has examined the performance capacities and creditworthiness of the intended subcontractor (the 8(a) firm) and has found them to be an acceptable risk; second, that SBA itself has capacities or can contract them elsewhere for performing the requirement if the 8(a) firm proves to be unable to do so."

While SBA may be providing some level of assistance and monitoring the 8(a) firms' progress in the program, we believe it is not effectively evaluating firms on a contract-by-contract basis, as suggested in the above explanation.

Some contracting officers believe SBA is certifying the firm's competence, not just SBA's competence, when it issues a certificate under the 8(a) program. Further, since SBA would normally evaluate a firm's capabilities before issuance of a COC to a small business firm, contracting officers believe the same type of evaluation is performed on the 8(a) firm to determine the firm's suitability to perform on a given contract. Therefore, these officials see no need to conduct any preaward evaluation on firms selected to perform on 8(a) contracts or to question those selections. Based on our previous reports, discussions with agency contracting officers, SBA officials in the regions, and data contained in the contract files, we are concerned that adequate preaward evaluations are not always performed, by either SBA or DOD, on 8(a) firms.

#### SBA not equipped to perform preawards

Our last report <sup>1/</sup> on the 8(a) program's effectiveness noted that the program's success had been hampered, in part, by insufficient program staff and substantial missing and incomplete data. This study found that the limited and overworked business development specialists found it difficult to even assess the status of many 8(a) firms, let alone identify the firms' management and technical assistance needs. While our review was not intended to study internal SBA issues, we did note, in the SBA regional offices we visited, that SBA officials did not believe they were responsible for evaluating the suitability of an 8(a) firm on a contract-by-contract basis. An SBA Philadelphia regional official said that SBA reviews the type of items the firm has made in the past and submits the contract specifications to the 8(a) firm to determine whether it can make an item. SBA usually accepts the word of the firm that it can perform. Another SBA regional official told us SBA relies on DOD's determinations of a firm's capabilities. Moreover, we noted some instances where SBA had little or no involvement in selecting 8(a) firms. We believe it highly unlikely that SBA is doing any evaluations in these instances. Our concern is that, if SBA is not performing these evaluations, DOD contracting officers take special care to ensure that evaluations are performed in-house.

#### DOD not always performing preawards

Unfortunately, some DOD contracting officers are discouraged from requesting evaluations of 8(a) firms because as noted earlier, they believe SBA's competency certification for (8) awards is assurance that an evaluation has been performed.

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<sup>1/</sup>"The SBA Procurement Program--A Promise Unfulfilled" (CED-81-55, Apr. 8, 1981).

For example, at Rock Island Arsenal, contracting officials routinely accepted the 8(a) firms SBA had selected because SBA provided certification. In some cases, officials were already aware of the firms' capabilities through other sources.

At Robins Air Force Base, Air Force personnel told us that the certification of the contractor's ability to perform is SBA's responsibility and they rely on SBA's certification. As a result, visits to the potential 8(a) firms are not usually performed by the Air Force. This is in sharp contrast to MICOM (Redstone Arsenal) which usually visits the potential 8(a) firm to determine if the firm is capable of performing.

At DPSC, officials frequently accepted SBA's certification even though, on occasion, contracting officers had serious reservations about the firms' capabilities. Despite these reservations, contracts were awarded on the basis of the certification and, as illustrated in the examples on pages 29 to 31 and 60 to 61 (app. VII), results were poor.

Another reason contracting officials are discouraged from requesting evaluations is DAR 1-705. The regulation states that preaward surveys of SBA's firms will not generally be requested by a DOD contracting officer. DOD Headquarters, in clarifying the intent of DAR 1-705.5 (c)(1)(E), told us that a full preaward survey of a proposed 8(a) firm may be performed when the DOD contracting officer must be assured that the designated firm can perform the work. Further, SBA's permission is not required, although DOD officials believe such actions usually occur within an atmosphere of mutual interest and cooperation between the two agencies.

SBA Headquarters reaffirmed DOD's interpretation by stating that:

"The procuring agency can always make whatever preaward inquiry it wants to make, even in situations involving the Pilot Program. [1/] SBA always takes into consideration the results of those inquiries, and, in fact, must do so (except in the Pilot Program). No permission by SBA is needed for any such inquiry, except that in the Pilot Program the inquiry should not unreasonably delay exercise of SBA's authority to take the contract."

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1/In contrast to the "regular" 8(a) program, which calls for agencies to voluntarily offer contract requirements to SBA, the Pilot Program gives SBA the authority to reserve specific contract requirements for award to 8(a) firms.

Failure to provide BDE  
and/or advance payments

We believe that if an 8(a) firm requires BDE or advance payments to perform a contract, commitments for these funds should be firmly established before SBA enters into the contract. SBA's SOP should be revised to emphasize that approval for such funds must be obtained before the contract is awarded.

MONITORING PERFORMANCE AND RESOLVING  
DISPUTES--MORE COOPERATION NEEDED

Many 8(a) firms failed to perform according to the terms of their contracts. For example, we found numerous instances of late deliveries among our selected contracts, excluding those contracts eventually terminated. We also found a few instances where quality was not acceptable. While these types of problems are not unique to 8(a) firms alone, we are concerned about the difficulty contracting officers experienced in resolving problems associated with poor contract performance. Unlike non-8(a) contracts where DOD has a direct relationship with the contractor, DOD must work through SBA to resolve problems encountered with 8(a) firms. Unless SBA cooperates fully, a procurement activity can suffer delays, shortages in supply, loss of progress payments, and extended administrative efforts in trying to resolve its problems.

Many late deliveries

Of the 98 active or completed contracts we reviewed (excluding terminated contracts), 46 failed to meet the original time specifications for delivery. For example, at ARRCOM, 9 of the 12 contracts with deliveries due were over 1 month late. Of the nine, six had deliveries which were over 5 months behind schedule. At DPSC, 11 of the 22 nontermination contracts were over 2 months late; one contract was 1 month late, and four contracts involved defaults. Similar delays existed at the other procurement activities we visited.

Eight of the 46 late deliveries were excused for reasons, such as changes in Government specifications, but the remaining late deliveries were due to such reasons as (1) the 8(a) firms' misinterpretation of drawings, (2) additional test resubmissions for first articles, and (3) problems experienced with vendors.

Quality

Outside our terminated contracts, we found a few instances where quality was unacceptable to the procurement activity. These few cases involved rejection of a first article, rejection of completed units, or dissatisfaction with the services provided.

### Who monitors 8(a) firms?

According to Public Law 95-507, SBA is responsible for establishing regular performance and monitoring systems to assure 8(a) firms comply with their business plans. However, we have reported 1/ that business plans often lack considerable information and are not always updated and that financial data submitted by the firms is incomplete.

For the administration of its DOD 8(a) subcontracts, SBA usually delegates its authority to DOD. The administering activity will notify SBA when it notices that a particular firm is experiencing difficulty performing an 8(a) subcontract. However, we believe this arrangement does not absolve SBA of its responsibilities for monitoring a firm's progress. We believe both SBA and DOD are responsible for monitoring performance.

### How do procurement activities and SBA handle nonperforming firms?

Once a performance problem arises, SBA must determine if it should (1) provide whatever assistance is needed to assure timely performance by the current 8(a) firm, (2) provide another 8(a) firm to complete the contract, or (3) terminate the contract to allow the procurement activity an opportunity to obtain goods and services outside the 8(a) program.

When SBA is monitoring the 8(a) firm's performance and takes steps to remedy identified deficiencies, beneficial effects can result. At the Northern Division of the Naval Facilities Engineering Command, for example, there were initially performance problems with an 8(a) janitorial services contract. The problems were corrected after SBA provided consulting services to the firm. According to the officer in charge of construction, the firm's performance is now good.

However, based on the terminated contracts we reviewed, and other cases involving nonperformance, we are concerned that:

- Procurement activities delay or avoid taking action when performance problems surface because they are not aware of appropriate procedures.
- SBA is not always helpful in resolving an 8(a) firm's performance problems in a manner that minimizes the negative consequences to the procurement activity.

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1/"The SBA 8(a) Procurement Program - A Promise Unfulfilled"  
(CED-81-55, Apr. 8, 1981.)

Procurement activities  
fail to take action

We believe procurement activities are not following the termination procedure provided in their contracts. DAR 1-705.5 mandates the procedure for DOD installations or agencies to terminate an 8(a) contract. Currently, agencies and activities defer too often to SBA's decision not to terminate, either in the mistaken belief that they cannot terminate without SBA's concurrence or because of uncertainty as to the procedure to be employed.

DOD procurement activities often deferred to SBA's decision to continue an 8(a) contract even though they wished to terminate it. For example, DPSC officials did not believe DPSC could terminate 8(a) contracts without SBA's concurrence. Therefore, except where the 8(a) firm has ceased operations, DPSC has been reluctant to initiate termination actions. In addition, DFSC refers its disputes to a higher command, DLA. A DLA official and an SBA official both stated that SBA had final authority to terminate the 8(a) subcontract for default. Similarly, Army officials at an installation at Rock Island, Illinois, were told by an SBA official that they could not terminate an 8(a) contract for default without SBA's consent.

Since the agencies' and activities' actions appeared to be inconsistent with DAR, we asked the Deputy Administrator of SBA and the Deputy Under Secretary of Defense for Acquisition Management to clarify the situation. Both officials stated that DAR should be followed.

DAR 1-705.5 implements DOD's 8(a) program. That regulation describes two contracts--one between SBA and DOD and one between SBA and the 8(a) subcontractor--which the appropriate DOD contracting office is to prepare. The contract between SBA and the 8(a) subcontractor incorporates the standard provisions of Government contracts entitled "default," "disputes," and "termination for convenience of the Government."

These standard provisions are not incorporated in the contract between DOD and SBA. Instead, the contract states:

"It is agreed that the provisions of the 'Termination for Convenience,' 'Changes,' 'Disputes,' 'Default,' and 'Price Reduction' clauses which are included in the contract between the SBA and its Contractor shall be invoked in appropriate cases when requested by the DOD Contracting Officer. If the SBA does not agree with the DOD Contracting Officer's request, the case

shall be referred to the Secretary or his designee for decision." DAR 1-705.5(c)(1)(I)(ii). 1/

Thus, if a DOD activity wishes to terminate an 8(a) contract, it can request SBA to terminate its contract with the 8(a) subcontractor.

According to SOP 80-05, if SBA agrees, and the contract with the 8(a) subcontractor is terminated, SBA still has the right to perform the contract (unless otherwise specified) by locating another suitable 8(a) subcontractor. If it cannot, or if the DOD procurement activity does not accept the new 8(a) subcontractor, the unperformed portion of the contract is returned to the activity for reprocurement. If SBA does not agree with the request to terminate, an appeal is made to the appropriate Secretary or his designee, whose decision is final.

We believe that the procedure in the regulation--an appeal to the Secretary (or his designee)--should also be invoked when SBA and the DOD activity agree that a particular contract should be terminated, but do not agree as to how the termination is to be accomplished; that is, whether the contract should be terminated for convenience or default. This would be consistent with the language of the regulation as well as with the idea that DOD, as the contracting agency, should be able to decide on what basis to terminate.

#### SBA's actions untimely and costly

We found that procurement activities generally provide 8(a) firms every possible opportunity to complete required work before taking some action, if any. Often lengthy delays are encountered in working for a resolution through SBA. As can be expected, SBA attempts to minimize or avoid damage to the nonperforming firm by pressing for "no cost" terminations and/or arranging, with DOD's help, performance by non-8(a) contractors who will pay for materials or accept subcontractors arranged by the 8(a) firm. At the same time, SBA seeks to protect its own investments in the firm. The procurement activity, on the other hand, is sometimes expected to assume costs it would not otherwise incur, as well as suffer the consequences of nonperformance. Almost all the terminated contracts we reviewed were terminated for convenience at no cost to either party, regardless of the circumstances.

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1/The above clause is put in contracts between SBA and DOD for supplies, services, and research and development. Contracts for construction contain basically the same clause. (See DAR 1-705.5(c)(2)(H)(ii).)

### Example 1

At Kelly Air Force Base, procurement of safety devices for ladders was significantly delayed when SBA refused DOD's request to terminate a nonperforming 8(a) firm. The contractor was unable to obtain bonding on its contract, which was awarded by SACC on September 27, 1978.

SBA district officials assured SACC that SBA would waive the bonding requirement if the contractor was unable to get bonding. However, SACC was notified on February 15, 1979, that SBA Headquarters refused to waive the requirement. Up to this point, 141 days had elapsed since the effective date of this contract. Instead of agreeing to terminate the contract at no cost for "the convenience of the Government," SBA attempted to substitute another firm. SACC officials immediately notified SBA that the substitute firm was unacceptable because of prior contract performance and asked SBA to terminate the contract. Again, SBA refused. It was not until April 18, 1979, that SBA terminated the contract, after being informed by SACC that it would forward this contract to the Secretary of the Air Force for final decision. In total, this contract was in effect 203 days (although the effective date of termination was March 27, 1979--181 days) without anything being accomplished.

### Example 2

When an 8(a) firm defaulted on two contracts for chemical protective footwear covers, DPSC could have saved \$1.1 million if it had purchased the covers by exercising an option on a more recent, lower priced, competitive contract. Instead, DPSC accepted SBA's substitution of a non-8(a) firm on the defaulted contracts and paid the outdated, higher unit prices originally negotiated with the 8(a) firm.

When the initial 8(a) firm ceased operations, SBA terminated its subcontracts with that contractor and negotiated reprocurement contracts with a non-8(a) firm. SBA then asked DPSC to modify its prime contracts to reflect the non-8(a) firm in lieu of the initial 8(a) firm. DPSC eventually agreed. In correspondence with DLA, SBA maintained its actions were justified because (1) the non-8(a) firm, that was the 8(a) firm's supplier and production management consultant, had the technical ability, capacity, and credit to complete the contract, (2) the non-8(a) firm would use the defaulted subcontractor's facilities and employees, and (3) while DPSC would lose close to \$1 million on this arrangement, there would be an economic benefit to the Government as a whole, because of SBA's commitments.

DLA still questioned SBA's action because it did not understand clearly SBA's authority to award the subcontracts to the non-8(a) firm. DLA also questioned the economic benefits that would accrue to the Government and, in particular, questioned

why the requirement could not be returned to DLA to afford other small businesses an opportunity to make the footwear covers. Nevertheless, when presented with SBA's analysis of the economic benefits to the Government as a whole, DLA withdrew its objections and made the requested contract changes. DOD officials informed us that while they were unhappy with the outcome, they had simply "acceded to SBA's authority."

On the basis of a cost comparison SBA provided to DLA, we question SBA's conclusion that its action to have the non-8(a) firm complete the work is economically justifiable. However, because of conflicts between the documentation provided by DPSC, DLA, and DOD and some of the unsupported assertions made by SBA, we could not compute an estimate of the costs and savings resulting from SBA's action to award the subcontracts. We did verify that DPSC could have reprocured the remaining footwear covers on the defaulted contracts, under an option on a current competitive contract, and saved \$1.1 million. To this extent, regardless of whether SBA can reduce further losses by transferring completion of the work to the non-8(a) firm, DOD stock funds 1/ are being used to subsidize the 8(a) program.

Moreover, we question the procedures SBA used in reprocuring the defaulted contracts. According to SBA's SOP 80-05 (see p. 38), when a subcontractor is terminated for default, SBA tries to locate another 8(a) concern qualified to complete the subcontract. If a qualified alternative firm cannot be located, or negotiations for completion of the subcontract cannot be consummated, the unperformed part of the subcontract is returned to the procurement activity for reprocurement. However, in this case, SBA negotiated reprocurement contracts without first consulting the procurement activity, DPSC. We believe that DPSC should have been given the opportunity to evaluate the substitute firm and to propose new terms and conditions based on existing circumstances.

Additional examples appear in appendix VIII.

## CONCLUSIONS

Awarding contracts to firms that cannot perform or promising assistance that cannot be provided is a disservice to the 8(a) program and the procurement activities. Adequate preaward assessments are needed to determine if the firm is capable of completing the required work and to determine what assistance, if any, is needed. Financial and technical assistance is SBA's responsibility and should be arranged before award of a contract. Rather than accept a passive role, procurement activities need to actively participate in evaluating the firm's capabilities

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1/A stock fund is a revolving fund used to buy inventory for sale to customers (users).

to ensure good contractor/requirement matches are made. We believe DOD has the best capability for making that determination on its 8(a) contracts.

We also believe it is incumbent upon SBA to provide a timely resolution of problems with 8(a) firms and minimize losses to the procurement activity, whose participation in the program is essential to its success. Since SBA assumes no liability for nonperformance, care should be taken to avoid unnecessary losses to the procurement activity. Once an 8(a) contract is awarded, the procurement activity should expect the same level of performance received from other contractors and should treat 8(a) firms the same as other non-8(a) firms. Therefore, we believe the DOD procurement activities need to be instructed on the 8(a) contract appeal process. Further, the appeal process needs to be strengthened by incorporating specific time frames for procurement activity action. A better understanding of the appeal process and specific time limitations could resolve disputes concerning the termination of 8(a) contracts more quickly.

#### DIRECT CONTRACTING OPTION

The Congress may want to alter the 8(a) program to permit a direct contracting approach between DOD and the 8(a) firm. Such an approach has the advantages of (1) maintaining the integrity of the relationship between buyer and seller, (2) translating to the 8(a) firm that it is accountable for its performance, and (3) permitting timely resolution of contracting problems.

As the program exists today, SBA is technically a prime contractor entering into an agreement with the procurement agency to subcontract work to an 8(a) firm. However, this relationship is essentially an illusion, since, unlike most prime contractors, SBA has no intention of performing any work itself; but it intends for the 8(a) firm to perform all of the work or act as a prime contractor and subcontract limited portions of the work to other firms. Also, unlike other prime contractors, SBA assumes no liability for work not performed according to contract specifications.

We believe the tripartite contractual relationship among the procurement agency, SBA, and the 8(a) firm detracts from the integrity of the normal buyer-seller relationship. We strongly endorse SBA's role of assisting and monitoring 8(a) firms to develop viable and competitive small and disadvantaged firms. However, we believe that direct contracting between the procurement activity and the 8(a) firm would more closely approximate the true relationship that exists between a buyer and a seller and would increase the seller's awareness of its responsibilities as a Government contractor. In addition, the approach would encourage direct communication between buyer and seller and would reduce the delays and paperwork flow that have hampered prompt action when problems arise. SBA could rightfully participate in any and all discussions concerning the contractor's

performance and intercede, on the firm's behalf, to provide maximum opportunity for the firm to meet its obligations.

If procurement activities contracted directly with 8(a) firms, responsibility for preaward surveys would rest with the agencies, not SBA. As with SBA's COC program for small businesses, provision could be made for an appeal process to SBA if a firm believed it was treated unduly harshly. Information developed by the procurement activity regarding the firm's capabilities could be used by SBA to develop an assistance program to meet the firm's needs. Agreement would have to be reached, before award of any contract, as to what monitoring and assistance SBA would provide to ensure performance by the 8(a) firm.

Program participants could continue to be selected and certified by SBA, based upon existing criteria. Also, if combined with the competitive option presented in chapter 2, SBA may want to increase the number of participants to provide a better transition from the 8(a) program to the competitive environment. Allowing longer participation, but with lesser price differential subsidies or direct assistance, would provide the middle ground lacking in the present program, where a firm receives either the full benefits of the program or none at all.

#### RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

We believe DOD can improve implementation of the existing program by making the following changes. To avoid any future misinterpretation by field personnel, we recommend that you revise DOD's regulations on preawards so they are stated in positive terms; that is, if a contracting officer believes a preaward survey is desirable he/she should request one. Further, we recommend that you instruct procurement officials not to rely on SBA's competency certification for 8(a) contracts as evidence of a contractor's suitability to perform. Procurement activities should evaluate prospective 8(a) firms to ensure all parties are aware of any contractor deficiencies and corrective actions are taken by SBA prior to award.

Finally, we recommend that you revise DAR 1-707.5 to specify the steps and time frames DOD contracting officers should follow in resolving performance problems.

#### RECOMMENDATION TO THE SBA ADMINISTRATOR

Since SBA has sole authority for selecting the 8(a) contractor and for providing financial, managerial, and technical assistance to 8(a) firms, we believe SBA officials must be responsive to concerns expressed by the procurement activity. Once contractor deficiencies are identified, by SBA and DOD, we believe SBA is then obligated to reduce the procurement activities' risk and to

provide whatever services are needed to assure performance on 8(a) contracts. We recommend that you revise (SOP) 80-05 to require that SBA (1) commit itself to providing necessary assistance before it enters into a contract with DOD, and (2) if adequate assistance cannot be located expeditiously, immediately return the requirement to the procurement activity.

#### AGENCY COMMENTS AND OUR EVALUATION

Both DOD and SBA generally concur with our recommendations. (See apps. IX and X for complete agency comments on our draft report.)

DOD did not specifically address the direct contracting approach in its comments. However, SBA believes it is possible to achieve most of the objectives sought in the direct contracting approach through more general delegation of its contracting authorities. SBA suggests that through inter-agency working agreements, it can develop procedures to reduce delays, eliminate unnecessary paperwork, and improve communications.

While SBA's proposal for delegating more authority to the procurement agency may have some merit, we cannot fully evaluate its potential for correcting the problems we identified since no specific actions were outlined. In seeking clarification, SBA officials were not able to elaborate on what actions they may take other than to suggest that it may be possible to incorporate this strategy at the time they introduce their competitive set aside option. While delegating more authority to the procurement agencies offers some opportunity for improvement, we believe it has limited potential for improving the integrity of the buyer-seller relationship, since the tripartite contractual relationship would remain unchanged. We believe Congress can best guarantee improvements through legislation permitting direct contracting and that this option warrants consideration. We recognize, however, that SBA, in concert with the Congress, the Office of Federal Procurement Policy, the procuring agencies, and the small business community, may be able to develop other approaches for overcoming the problems we identified.

## CHAPTER 4

### HOW DOES THE 8(a) PROGRAM AFFECT

#### DOD PROCUREMENT?

Although we could not measure the full impact of the 8(a) program on DOD procurement, the 8(a) program can result in higher prices, lost progress payments, unproductive use of stock funds, supply shortages, and/or extensive administrative effort. Procurement activities took steps to minimize some of the negative impacts from the 8(a) program, both before award and after award, but we believe a strengthening of the 8(a) procurement process, as discussed in chapters 2 and 3, would do more to reduce these impacts.

#### PROCUREMENT ACTIVITIES EXPERIENCE NEGATIVE IMPACTS

As a result of contracting under the 8(a) program, DOD procurement activities were faced with the following negative impacts.

##### Higher prices

As discussed in chapter 2, 8(a) contracts can result in higher contract prices if procurement activities do not have sufficient data to determine fair market prices and are not permitted to obtain competition.

##### Unrecouped progress payments

Some procurement activities lost money in unrecouped progress payments made to 8(a) firms that defaulted. Progress payments are payments made as work progresses under a contract, upon the basis of costs incurred, or percentage of completion accomplished, or of a particular stage of completion. Procurement agencies lose money invested in progress payments when a contract is terminated at no cost to either party, as are most 8(a) contracts, or when a contract is terminated for default and the bankrupt contractor has little or no assets.

##### Example 1

On May 9, 1977, DPSC awarded an 8(a) contract for field packs to an 8(a) firm. On May 21, 1979, the firm filed for bankruptcy. When DPSC terminated the contract, it had received one unusable field pack and had lost \$1.4 million in unrecouped progress payments.

##### Example 2

As a result of one 8(a) contractor's default on two contracts and subsequent bankruptcy, SPCC lost \$53,020 in unrecouped

progress payments. SPCC also lost \$95,967 on two 8(a) contracts not in our sample from the same firm for a total of \$148,987.

Stock funds tied up  
for excessive periods of time

DPSC had \$4.5 million in stock funds tied up for an excessive period of time because SBA delayed terminating three 8(a) contracts. The \$4.5 million represents the stock funds DPSC obligated for three contracts it had awarded to SBA for award to 8(a) contractors. SBA never awarded these subcontracts and eventually terminated the contracts with DPSC. However, it took SBA 24 months to agree to terminate one contract, 8 months to terminate the second, and 10 months to terminate the third. During this time, the obligated stock funds were unavailable for DPSC's use.

Supply shortages

As a result of 8(a) firms' delinquencies and defaults, procurement activities had a large number of backorders (unfulfilled customer demands) and had to borrow items in short supply from other activities, as well as make emergency buys to replenish supply.

Example 1

A DFSC 8(a) firm lacked adequate capital to support its fuel delivery contract and the contract was subsequently terminated. DOD activities were without coverage 4 months into the contract period and were forced to purchase the product locally.

Example 2

After several delays in deliveries under an 8(a) contract for aft support assemblies, a Warner Robins Air Force Base contracting officer wrote SBA that the Air Force's supply support position had been seriously affected and that grounding of Air Force and Navy fleets of drone targets was imminent. According to the item manager, as a result of the Air Force borrowing some of the assemblies from the Army and making urgent sole-source procurements to resupply its stock, the fleets were not grounded.

8(a) contract negotiations  
detract from time spent  
on non-8(a) awards

A common concern of contracting officers we spoke with was that excessive time spent on 8(a) contracts detracted from the time available for their other procurements.

At some activities, we were able to compare the length of time to award an 8(a) contract with established procurement

administrative leadtime standards (PALT) 1/ for awarding contracts. At SACC, the majority of 8(a) contracts we reviewed met the PALT standards. However, the majority of 8(a) contracts we examined at ARRCOM, Redstone Arsenal Missile Command, San Antonio Air Logistics Center, and Warner Robins Air Force Base exceeded the PALT standards. Overall statistics from ARRCOM show that from fiscal year 1979 to fiscal year 1981, 72.7 percent of its awards over \$10,000 were awarded within the PALT standards. In contrast, only 32 percent of the 8(a) contracts we reviewed there met the PALT standards.

At DPSC Directorates and the Navy Ships Parts Control Center (SPCC), we compared the average time taken to award all contracts over \$10,000 with the time taken to award the 8(a) contracts we reviewed. Eleven of the 27 contracts we reviewed at the Directorates were awarded within the average leadtime for all contracts over \$10,000. The excess time to award the other 16 contracts ranged from 11 to 190 days above the average leadtime, as shown in the table below.

DPSC Directorate	Fiscal year	Actual average PALT (days)	Excess days over average PALT to award 8(a) contracts	
			No.	Range
Clothing and Textile	1979	74	4	11-83
	1980	73	4	111-190
Medical material	1979	89	3	25-132
	1980	96	2	103-167
Subsistence	1980	53	3	41-132

The table below gives the average time that it took SPCC to award the 13 8(a) contracts we reviewed.

Fiscal year	Average time(days) to award all contracts at SPCC	Average time (days) to award 8(a) contracts reviewed	
		No.	Average
1978	51	2	181
1979	87	5	213
1980	105	6	213

According to procurement officials, the long procurement leadtimes are attributable to the length of time required by SBA to match 8(a) firms with requirements, submission of numerous

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1/PALT is the time interval between receipt of the purchase request in the procurement activity and the award of the contract.

amended pricing proposals by 8(a) firms, extended fair market price negotiations with SBA, and incomplete Government specifications. Although the additional efforts expended by these officials cannot be quantified, we believe and procurement officials agree that time allocated to these efforts is spent at the expense of time on non-8(a) contracts, given a limited staff.

TOTAL IMPACT ON DOD NOT KNOWN BUT  
PROCUREMENT ACTIVITIES TAKE  
ACTION TO MINIMIZE NEGATIVE IMPACTS

Although our review identified certain negative effects of the 8(a) program on DOD procurement, we can not measure the extent, if any, to which our defense posture has been eroded. Of the 113 contracts reviewed, we did not identify any direct impacts on DOD's readiness, such as cancellation of training missions or grounding of aircraft for lack of spare parts. However, we did find that procurement activities were taking steps to ensure that contracting under the 8(a) program was not jeopardizing DOD's readiness. For example, activities screen requirements offered under the 8(a) program to ensure that entire quantities of high priority items will not be awarded solely to 8(a) firms. When faced with late or nonperforming 8(a) contractors, procurement activities borrowed items in short supply from other activities and made emergency buys to replenish supply.

Cannibalization of military equipment may meet immediate defense needs, but what are the long-term effects? To what extent do higher costs associated with noncompetitive awards, unrecouped progress payments, and nonproductive use of stock funds detract from the ability to fund essential Defense missions? These considerations are important, but not easily quantifiable. Although the negative impacts we illustrate can not be completely eliminated, we believe a strengthened 8(a) procurement process would reduce the likelihood of some of the bad results and would lend more credibility to the program.

PUTTING THE PROGRAM'S  
IMPACTS IN PERSPECTIVE

Given that 8(a) awards account for approximately 1.1 percent of DOD's procurement dollars in fiscal year 1980 (on awards over \$10,000), how much impact can the program have on DOD's ability to procure goods and services and achieve its defense mission? Our objective in reviewing this program was not to suggest that DOD's procurement process is collapsing under the weight of a socio-economic program like 8(a). Certainly this is not the case, although 1.1 percent of \$66.7 billion of procurement is still a substantial sum. We believe the costs and impacts of such programs should be evaluated and made visible to provide a reasonable basis for congressional decisionmakers to assess their merit.

Moreover, the 8(a) program is but one of a growing number of programs that affect the procurement process. Today nearly 7 percent of all Federal procurement dollars are devoted to preference programs. There is almost no end to the number and variety of programs that could use the procurement process to achieve selected socio-economic goals. We believe there is reason to be concerned with this trend, for, as the Commission on Government Procurement reported almost a decade ago, procurement becomes more costly and time consuming with the addition of each new socio-economic program. Although the costs cannot be precisely quantified, our study of the 8(a) program demonstrates the possibility of identifying the negative impacts of these programs on the procurement process and recommends program improvements which minimize these impacts.

## CHAPTER 5

### RECOMMENDATION TO THE CONGRESS

Legislative initiatives are needed to make the most meaningful changes to the 8(a) program. In chapters 2 and 3, we presented two options for changing the 8(a) program that represent a significant departure from current program requirements. Each was designed to correct specific weaknesses we observed in the 8(a) procurement process. The first, introducing competition into the program and permitting awards to 8(a) firms who come within a given percentage of the lowest bid, will resolve the difficulties procurement activities experienced in determining fair market prices. (See pp. 21 to 22.) The second, allowing a direct contracting approach between the procurement activity and the 8(a) firm, would encourage a better matching of requirements and 8(a) contractors and would provide a more timely resolution of performance problems. (See pp. 41 to 42.) The Congress could choose to adopt either one option or both.

We believe the program options presented in this report--competitive set asides and direct contracting--would help resolve the 8(a) program's procurement related problems, without harming the program's principal objectives. If the Congress favors these or other options, we recommend that authority be provided to the executive branch, permitting the President to designate one or more agencies (including at least one service branch of DOD), to implement the option(s) on a trial basis. The alternative program would be implemented in lieu of the existing 8(a) program at the selected agency or agencies. After a designated period of time, the results of the alternative program would be assessed to determine:

- (1) How well the program's objectives were being achieved, and any factors which hindered their achievement.
- (2) How much the program costs, including the estimated amount of BDE needed to accommodate varying levels of contracting.
- (3) The extent to which burdens on the procurement process were reduced (including a determination as to whether procurement-related contracting problems were minimized).

OFPP could be the focal point for this assessment, with SBA and the procurement agencies each providing input. If the competitive option is adopted, the Congress may also want to consider providing a designated amount of BDE expressly for use in the alternative program. Since the amount of funding needed to

conduct the alternative program cannot be precisely estimated if present contracting levels are to be maintained, the Congress would need to be flexible enough to permit interim changes in the funding level based on the agencies' experience with the alternative program. Over time, data could be developed to assist the Congress in determining the level(s) of price differentials needed to support the amount of participation desired.

ACTIONS NEEDED TO REDUCE THE BURDEN OF  
SOCIO-ECONOMIC PROGRAMS ON THE  
PROCUREMENT PROCESS - RECOMMENDATIONS OF  
THE COMMISSION ON GOVERNMENT PROCUREMENT

The Congress created the Commission on Government Procurement to review Federal procurement and recommend reforms to increase its efficiency, economy, and effectiveness. The Commission's 1972 report discussed how procurement becomes more costly and time consuming with the addition of each new socio-economic program implemented through the procurement process. Budgets of the procurement agencies were hiding much of the incremental cost by covering both in-house costs of administration and contractor performance costs in the form of higher overhead and prices. Contracting officers were being confronted with numerous obligations and administrative complexities as they tried to reconcile socio-economic goals with the Government procurement policy of obtaining quality products and services at the lowest reasonable price available. The Commission questioned how much of the extra costs and other burdens of socio-economic programs should be absorbed in the procurement process and how much should be supported by more explicit means such as direct grants, tax benefits, licenses, etc.

The Commission did not question the merit of socio-economic programs, but rather wanted to keep the means of accomplishing them from unduly impairing the Government's procurement process. The Commission addressed socio-economic programs in the following recommendations:

Recommendation 43. Establish a comprehensive program for legislative and executive branch reexamination of the full range of socio-economic programs applied to the procurement process and the administrative practices followed in their application.

Recommendation 45. Consider means to make the costs of implementing socio-economic goals through the procurement process more visible.

WHY THE COMMISSION'S RECOMMENDATIONS  
HAVE NOT BEEN IMPLEMENTED

Although the Commission on Government Procurement's report is now over 9 years old, the Congress still recognizes the importance of implementing needed reforms in Federal procurement. The Office of Federal Procurement Policy Act Amendments of 1979 (P.L. 96-83, October 10, 1979), for example, task the OFPP Administrator to review the Commission's recommendations to determine those recommendations that should be completed, amended, or

rejected and to propose the priority and schedules for completing the remaining recommendations.

Despite this congressional mandate, until recently, OFPP has not been totally responsive in addressing the socio-economic concerns identified by the Commission. OFPP's October 1980 "Proposal for a Uniform Procurement System" followed through on recommendation 43 by suggesting that the short-and long-term impacts of socio-economic provisions be analyzed. However, the proposal failed to suggest a means of carrying out recommendation 45, concerning cost visibility. In fact, OFPP, in its October 1980 report to the Congress on the Commission's recommendations, stated that recommendation 45 had been completed. According to OFPP, the congressional requirement to analyze the economic and regulatory impacts of proposed legislation, along with the executive branch steps to minimize regulatory burdens, sufficiently implements recommendation 45. OFPP's assertion is not persuasive, however, since none of these requirements specifically relate to the costs of achieving socio-economic goals through the procurement process.

OFPP's "Proposal for a Uniform Federal Procurement System," dated October 1981, suggested that the potential for achieving national goals is far greater in the economy as a whole than through Federal procurement, which accounts for only 5 percent of the gross national product. While one cannot argue with this analysis, the proposal failed to suggest what would become of the dozens of programs currently tied to the procurement process and how these programs could be implemented more efficiently and effectively.

On the basis of our review of the 8(a) program, we believe the Commission's recommendations for reevaluation and cost visibility are as valid today as they were when first proposed. For example, in our 1981 analysis <sup>1/</sup> provided to the Chairman, Committee on Government Operations, House of Representatives, and in informal comments to OFPP, we suggested that OFPP adopt the Commission's recommendations. Although an OFPP Associate Administrator expressed concern that not all costs and benefits could be quantified, he agreed that these programs should be evaluated to determine their impact on the procurement process and to determine ways to minimize their burden. To this end, OFPP has proposed to the Congress, in its February 26, 1982, "Proposal for a Uniform Federal Procurement System," that a review of various nonprocurement programs be made to determine the most effective and productive means of implementation.

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<sup>1/</sup>"Analysis of the Office of Federal Procurement Policy's October 29, 1981 Draft Proposal for a Uniform Federal Procurement System" (B-206262, July 6, 1982).

WHY EXISTING REQUIREMENTS TO  
ANALYZE COSTS AND BENEFITS  
ARE NOT SUFFICIENT

Existing requirements to analyze impacts of proposed legislation and regulations have not resulted in the identification of the costs and benefits of using the procurement process to achieve national goals.

The Congressional Budget Act of 1974 (31 U.S.C. 1353) directed the Congressional Budget Office (CBO) to develop 5-year cost estimates for carrying out any public bill or resolution reported by congressional committees. CBO's cost estimates do not detail the costs of implementing socio-economic programs through the procurement process. For example, the CBO estimate on a bill to extend the 8(a) pilot procurement program included only consultant costs, staff time, and overhead and travel expenses necessary to conduct technical reviews. The CBO estimate did not address the possibility that contracts awarded under the 8(a) program are priced higher than contracts obtained under other procedures or require longer periods for award.

The Regulatory Flexibility Act (5 U.S.C. 601-612), enacted in 1980, requires Federal agencies to consider a range of alternatives that would substantially reduce the economic impact of proposed regulations on small businesses, small organizations, and small governmental jurisdictions while meeting the goals and purposes of the governing statute. The act does not, however, require consideration of the economic impact on Government procuring agencies that use Government contracts to further social and economic goals.

Executive Order 12291, issued February 17, 1981, requires agencies to perform cost-benefit analyses of each major regulatory proposal and to submit the analyses to the Office of Management and Budget for review. However, agency procurement regulations and OFPP Government-wide policy directives are exempted from the order's requirements. Moreover, recent SBA 8(a) regulations, defining how long a firm can receive program support, were also not subject to the order's requirements because SBA determined they were not major rules.

SBA PROCEDURES FOR SELECTING REQUIREMENTS AND  
NEGOTIATING CONTRACTS FOR 8(a) FIRMS

SBA's September 4, 1979, SOP 80-05 outlines procedures for selecting requirements and negotiating contracts for 8(a) firms. According to the SOP, SBA procurement center representatives, in consultation with Government agencies, select proposed procurements capable of being performed by 8(a) firms. The SBA business development specialist reviews the capabilities of available approved 8(a) firms and selects a firm with which negotiations will be initiated by the contract negotiator.

It is SBA's policy to submit formal requests to DOD agencies in the form of an acquisition letter nominating a particular 8(a) firm for a specific requirement. The DOD agency may then commit itself to negotiate the contract by notifying SBA in writing.

The procurement activity is supposed to provide SBA with technical requirements for a proposed procurement and a request for proposal (RFP). SBA then gives the RFP to a selected 8(a) firm and helps the firm identify areas where it may need technical and managerial assistance so that appropriate assistance may be provided by SBA at the earliest possible time.

After receiving the 8(a) firm's proposal, SBA reviews it, recommends any necessary revisions, and determines whether the price proposed is reasonable by comparing it to the estimated current fair market price of the procurement activity, although such a comparison is not suitable for determining a fair and reasonable price. If the proposal is adequate, the SBA contract negotiator sends it to the procurement activity and negotiates with the agency and representatives of the 8(a) firm.

A procurement activity may be authorized to conduct negotiations directly with the 8(a) subcontractor, but this is only supposed to occur on rare occasions, such as when tight time constraints are involved and only when the 8(a) subcontractor is experienced in negotiating with that particular activity. Authorization for this negotiation is made in writing to the procurement activity. Any agreement between the activity and the 8(a) firm is subject to SBA's approval.

Once contract negotiations have concluded and the 8(a) subcontractor, procurement activity, and SBA agree as to terms, conditions, and price, the activity prepares both the contract with SBA and the proposed contract with the 8(a) firm. The contract and subcontract are reviewed and approved by the SBA negotiator, business development specialist, and counsel before execution by SBA.

DOD PROCEDURES FOR SELECTING REQUIREMENTS AND  
NEGOTIATING CONTRACTS FOR 8(a) FIRMS

DOD's procedures for selecting requirements and negotiating contracts for 8(a) firms are stated in DAR 1-705.5. On contracts for supplies, services, and research and development, SBA is supposed to furnish the appropriate Director of Small and Disadvantaged Business Utilization (within DOD), or a designee, with its request for a commitment to support the business development plan of an 8(a) firm. The request must identify the requirements sought from DOD. DOD small and disadvantaged business utilization specialists will help SBA representatives develop information for requirements being sought from the contracting office.

After evaluating the commitments sought by SBA, the appropriate Director of Small and Disadvantaged Business Utilization, or a designee, will notify SBA of the contracts DOD envisions placing with SBA and will notify the appropriate contracting offices to reserve the requirements for 8(a) awards. Within 10 working days after notification, SBA is supposed to initiate negotiation of the 8(a) contracts with the contracting office. If SBA does not start negotiations within the 10 days, the contracting activity is required to notify the Director of Small and Disadvantaged Business Utilization, or a designee, of the intent to proceed with the acquisition without further regard to section 8(a) procedures, unless additional time is requested by SBA and such additional time can be granted considering the urgency of the requirement.

DOD contracting officers will not generally request a pre-award survey of the SBA's contractor. SBA is held responsible for including in its contract a written certification of SBA's competency to perform the contract. After agreement with SBA on satisfactory terms and conditions, including an estimated current fair market price and receipt of the SBA's commitment to business development expense (if appropriate), the contracting officer shall proceed with the award of a contract to SBA.

DOD's regulations for the award of construction contracts are similar to those just described. They add, however, that SBA has stated that it does not generally expect to assume BDE for construction. If SBA elects not to fund BDE, award will not be made to SBA, unless the proposed contract price is reduced by the amount of such expense.

GAO REPORTS ISSUED ON SBA'S 8(a) PROGRAM

Misuse of SBA's 8(a) Program Increased Cost for Many ADP Equipment Acquisitions (AFMD-82-9, Oct. 16, 1981)

SBA's 7(j) Management Assistance Program: Changes Needed to Improve Efficiency and Effectiveness (CED-81-149, Sept. 29, 1981)

The SBA Procurement Program--A Promise Unfulfilled (CED-81-55, Apr. 8, 1981)

Reservation and Award of Section 8(a) Small Business Act Contracts to Arcata Associates (AFMD-81-33, Mar. 23, 1981)

The 8(a) Pilot Program for Disadvantaged Small Businesses Has Not Been Effective (CED-81-22, Jan. 23, 1981)

An Analysis of How Eligibility Criteria Are Applied For Participation in the 8(a) Program (CED-78-92, Mar. 13, 1978)

Ways to Increase the Number, Type, and Timeliness of 8(a) Procurement Contracts (CED-78-48, Feb. 1, 1978)

Information on Activities of Smithville, Tennessee, Sponsor in the 8(a) Program (Nov. 5, 1975)

Information on Activities of Dunn, North Carolina, Sponsor in the 8(a) Program (July 10, 1975)

Award of an 8(a) Contract to Western Technical Associates (B-164497(1), May 5, 1975)

Questionable Effectiveness of the 8(a) Procurement Program (GGD-75-57, Apr. 16, 1975)

Answers to Questions Regarding Arcata Investment Company and SBA's Section 8(a) Procurement Program (B-132740, Nov. 21, 1973)

DOLLAR AMOUNT OF 8(a) CONTRACTS  
REVIEWED AT SELECTED INSTALLATIONS

	<u>Installation universe (\$)</u>	<u>Amount selected</u>	<u>Percent selected</u>	<u>No. of contracts reviewed</u>
	(000)	(000)		
USA Armament Materiel Readiness Command Rock Island, Ill.	\$ 19,748	\$ 18,961	96	18
U.S. Army Missile Command, Redstone Arsenal, Ala.	10,640	6,531	61.4	8
U.S. Navy Ships Parts Control Center Mechanicsburg, Pa.	3,869	3,270	84.5	13
Naval Facilities Engineering Command Northern Division, U.S. Naval Base, Philadelphia, Pa.	7,886	3,317	42	3
Chesapeake Division, Washington Navy Yard, Washington, D.C.	6,163	1,644	26.7	7
Warner Robins Air Logistics Center, Robins Air Force Base, Georgia	4,685	2,437	52	9
Kelly Air Force Base, San Antonio Air Logis- tics Center, Texas	4,100	1,086	26.5	9
SACC	5,207	1,898	36.5	6
DFSC Cameron Station Alexandria, Va.	385,043	157,484	41	13
DPSC 2800 South 20th Street Philadelphia, Pa.	<u>18,901</u>	<u>18,775</u>	99.3	<u>27</u>
Total	<u>\$466,242</u>	<u>\$215,403</u>	46.2	<u>113</u>

ADDITIONAL EXAMPLES OF PITFALLS PROCUREMENT ACTIVITIES  
ENCOUNTER IN DETERMINING FAIR MARKET PRICES AND PRICES  
SACRIFICED EVEN WHEN FAIR MARKET PRICES ARE OBTAINED

FAIR MARKET PRICE ON REPETITIVE  
BUYS INCREASED TO ACCOUNT FOR  
HIGHER 8(a) CONTRACTOR COSTS

Example

ARRCOM paid \$63,814 more for an 8(a) contract to manufacture signal flares than it would have had to pay by exercising an option on a current contract. After initially determining a fair market price based on a recent procurement, and then learning SBA had no BDE funds for price differential, ARRCOM increased its fair market price determination, including \$1.25 a unit for tooling gages and equipment and a \$0.32 inflation factor, and awarded the contract for \$523,273. We believe the unit price on the option represented a fair market price and the difference between this price and the negotiated price should have come from SBA as BDE. The contracting officer agreed that ARRCOM paid more for this contract than was allowable under DOD's regulations.

NONREPETITIVE, SERVICE, AND  
CONSTRUCTION CONTRACTS

Example

The 8(a) janitorial and construction contracts we reviewed at the Chesapeake Division of the Naval Facilities Engineering Command were negotiated based on Government estimates. These Government estimates were computed by a planning estimator from the Public Works Office of the installation the contract will be performed at. Industry publications and standards are used to assist in the computation of the estimate. Although each uses the same industry publications as guidelines, the Government's and the 8(a) contractor's proposals may differ (e.g., a different estimation in the amount of time to complete a segment of the work to be performed will result in differing labor cost).

The contracting officers interviewed at the division believed the prices negotiated for 8(a) contracts were fair and reasonable, but may have been a little bit more than fair market price. In the absence of any similar competitive procurements to compare to 8(a) awards, neither we nor the contracting officers can tell if the division was paying higher than necessary prices for 8(a) awards.

BETTER PRICES SACRIFICEDExample

When SPCC split a requirement for 19,400 volt frequency indicators between contracts awarded competitively and under the 8(a) program, it may have paid \$40,080 more than if it had awarded the whole requirement competitively. The unit price under the competitive award for 13,400 indicators was \$14.82; the fair market unit price for the 8(a) award of 6,000 indicators was \$21.50. While the \$6.68 difference in unit prices is not unreasonable, considering that procurements of smaller quantities usually result in higher unit prices, the difference does represent an opportunity cost to SPCC.

ADDITIONAL EXAMPLES OF POORCONTRACTOR/REQUIREMENT MATCHESEXAMPLE 1

Based on the 8(a) contractor's poor performance under contracts awarded by SPCC in 1976, we believe SPCC should not have awarded additional 8(a) contracts to the same firm in March and May 1978. The firm had been awarded two contracts in fiscal year 1976, one competitive and the other 8(a). The firm had only delivered 15 of 33 items under the competitive contract by March 1977. None of the items scheduled for delivery between March and June 1978 under the 8(a) contract were ever delivered. Moreover, the firm had not completed performance on several contracts awarded by the Army in fiscal years 1976 and 1977. The 8(a) contractor defaulted on both the contracts we reviewed and SPCC had to make interim buys for one of the contracts.

SPCC officials stated that the 8(a) award was made because SBA had certified the firm's competence to perform the contract. We believe the award was questionable because of the firm's past performance, which was known to SPCC officials at the time. We believe a competency certification provided by SBA on an 8(a) award does not relieve the procurement activity of its responsibility to award contracts to firms that can perform. Given the circumstances at the time of award, SPCC should not have proceeded unless SBA was able to demonstrate its commitment to the firm by providing all necessary assistance to assure performance. Otherwise, the requirement should have been returned to SPCC.

EXAMPLE 2

In March 1979, SBA requested DPSC support for award of a contract for spectacle parts to an 8(a) firm just starting in business. A capability survey of the firm's facilities by the Defense Contract Administration Service disclosed that the firm did not have the required facilities, equipment, material, or personnel to satisfactorily produce the items. Despite these deficiencies, DPSC awarded a contract to SBA, who subcontracted with the firm on April 11, 1980, to make 306,248 spectacle parts (frames, fronts, and temples). The items were required for delivery between October 1, 1980, and August 1, 1981. Shortly after starting work, the firm encountered production problems. It was delinquent in making deliveries of the items and, in July 1981, suspended operations after delivering 84,118 items. As a result of the 8(a) company's default, DPSC accumulated backorders (unfulfilled customer demands) for 5,760 spectacle frames and initiated an emergency buy for 53,388 frames.



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

MAY 19 1982

Mr. Henry Eschwege  
Director  
Community and Economic Development  
Division  
U.S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Eschwege:

Thank you for forwarding the Draft of the Comptroller General's Report to the Congress entitled "Proposals for Minimizing the Impact of the 8(a) Program on Defense Procurement." I must compliment GAO on the scope of the work undertaken to produce the report and am very much appreciative of the opportunity to comment upon the findings and recommendations.

This letter contains a general response to the Report together with this Agency's specific response to the recommendations made not only to me, as the Small Business Administration's Administrator, but also to those suggestions made for the consideration of the Secretary of Defense and the Congress insofar as such suggestions affect SBA. In addition, this letter will set forth additional comments in an attempt to provide clarification to certain sections of the report as well as to point out some misperceptions which are incumbent upon us to correct for the record.

As stated in the Digest to the report, GAO intended to assess the impact of SBA's section 8(a) program on the defense procurement process. However, the report concludes that "we could not measure the full impact of the 8(a) program on Defense procurement," that the "total impact on DOD [is] not known," that GAO was unable to "measure the extent, if any, to which our defense posture has been eroded," and that "the costs [of the program] cannot be precisely quantified." Although we have no objection to the overall intent of lending visibility to the costs of the 8(a) program, the lack of quantifiable and explicit cost information dilutes the value of the report.

In the report, GAO relies heavily upon The Report of the Commission on Government Procurement. I have further examined that document, particularly as it relates to the 8(a) program. The report lists some 39 social and economic programs which are implemented through the procurement process. We question whether any of these other programs have been examined by GAO in the same context as the 8(a) report.

ADDITIONAL EXAMPLES OF UNTIMELY  
AND COSTLY SBA ACTIONS

EXAMPLE 1

On a DPSC 8(a) contract for \$2,860,000, SBA failed to award a subcontract to the 8(a) firm. After repeated requests to SBA/ New York had gone unanswered, DPSC received information that the firm's real property was being repossessed. DPSC notified SBA on April 5, 1979, that it intended to terminate the contract on April 10. SBA did not concur with DPSC's request to terminate until October 23, 1979, over 6 months later, and notified DPSC that it never awarded the subcontract. Further, DPSC subsequently learned that the firm had closed its plant and was out of business since December 1978. Therefore, it appears stock funds were unnecessarily tied up for at least 10 months.

EXAMPLE 2

SPCC awarded a contract to SBA on September 30, 1980, for the manufacture of 610 shipboard berths at a cost of \$518,000, excluding BDE. Because SBA and its proposed subcontractor could not agree on price, the subcontract was never consummated.

Instead of terminating its contract with SPCC, SBA attempted to find another 8(a) supplier but had not done so after more than 10 months later. Although there is no current supply deficiency for this item, we believe that SBA should terminate its contract when 8(a) suppliers cannot be found within a reasonable period of time, so as not to jeopardize the procurement activities' supply readiness or to tie-up funds for prolonged periods of time.

At the time SPCC was negotiating this contract for a unit price of \$850 FOB origin, it could have exercised an option provision under another contract and acquired the shipboard berths at a unit price of \$730 FOB destination. SPCC has thus incurred an opportunity cost of \$73,200 (\$120 x 610 units) by procuring this item through the 8(a) program.

We believe it was an acute awareness of the "negative effects" that caused the Commission to explore this issue, identify the causes, and recommend a policy of improving cost visibility. However, we would agree with SBA's observation that most social and economic programs have not been evaluated in this context. This report was our first attempt to address the Commission's concerns over the impact of social and economic programs on the procurement process. Action on the Commission's recommendations is the Office of Federal Procurement Policy's responsibility. We are hopeful that OFPP will follow through on its proposal for evaluating social and economic programs, as stated in the "Proposal for a Uniform Federal Procurement System."

## I. COMMENTS ON GAO RECOMMENDATIONS

### Competitive Set Aside Option

The recommendation to alter the 8(a) program by requiring all 8(a) contracts to be let only pursuant to competition is a radical proposal which raises many concerns. Those concerns must be adequately explored prior to our endorsement of such a proposal.

In the first place, although the legislation appears on its face to authorize competition within the 8(a) program, Congress recognized explicitly that "the power to let sole source Federal contracts pursuant to section 8(a) of the Small Business Act can be an effective procurement assistance tool for development of business ownership among groups that own and control little productive capital..." (15 U.S.C. 631) (emphasis added) Thus, in our opinion, an 8(a) program which is totally competitive as envisioned by GAO would not comply with the spirit of the Act as presently drafted in that SBA would not be using the power specifically granted by Congress.

Moreover, it is doubtful whether competition with non-8(a) companies would attract sufficient participation with such companies to make the program work. Many non-8(a) companies would not wish to expend their resources in the preparation of bids knowing that 8(a) firms would receive the percentage preference. In fact, small businesses, in particular, might find this proposal of particular concern if it meant the withdrawal of requirements under the small business set aside program. As an agency, we must always measure the impact of our actions upon all of our constituent groups.

program would be inoperable during the major portion of each fiscal year. Its annual period of operation would be directly proportionate to the amount of funds appropriated for the Small Business Administration's business development expense fund. Finally, it would provide a mechanism for "gaming" the competitive procurement process. This "gaming" could occur when an 8(a) company that may normally be the low bidder for the requirement would price his offer to obtain the contract with a contribution from the SBA's business development expense fund.

The DoD has long supported the goals and objectives of the 8(a) program because it has contributed to the growth of the small disadvantaged business community and strengthened the defense industrial base. We appreciate the opportunity to work with you concerning your final assessment of the DoD performance under this important program.

Sincerely,



NORMA B. LEFTWICH  
Director, Office of Small and  
Disadvantaged Business Utilization

We feel the objectives in this proposal can be substantially achieved within existing statutory authorities and regulations.

#### Interim Recommendations to the Secretary of Defense

We generally agree with the interim recommendation to DOD. However, the guidance on the intent and use of SBA's competency certification for 8(a) contracts should be carefully worded to ensure it is not misconstrued. We will be glad to provide assistance in this regard as necessary.

#### Interim Recommendation to the SBA Administrator

We concur with this recommendation. In fact, we are currently revising our SOP 80-05 to improve our responsiveness to procurement agencies and improve the overall administration of the 8(a) Program.

SBA has also recently designated an 8(a) Program liaison person to effect improved communications. This individual is making periodic visits to procurement installations. His function is to inform procurement agencies of current changes in the 8(a) Program, to identify procurement problems, and initiate development of corrective actions to solve those problems.

#### GAO RESPONSE

GAO addresses these comments on pp. 23 to 26 and p. 43 of the report.

#### II. COMMENTS ON UNCLEAR STATEMENTS

In order to provide complete understanding of the issues, I herewith submit my comments on certain portions of the Report which may be somewhat unclear and/or misleading:

##### P. 7

The problems that GAO identifies as "continuing" have been largely overcome by not only the existence of fixed terms of participation as required by Public Law 96-481 but also by the institution of new program procedures such as the following:

GAO note: Page references in this appendix refer to pages in draft report.

There is a recognition throughout the Report of the Commission on Government Procurement that the 39 social and economic procurement-related programs cost money. Never in the report are these costs characterized as having a "negative effect" on the procurement process. The attainment of social and economic goals necessarily involves the expenditure of funds. The question raised by the Commission was whether the value of the programs justified their costs. In that regard, they recommended that means be considered simply to make the costs of these programs more visible in order that cost-benefit analyses could be performed to better assist the government in assessing whether the best measures are being used to implement the goals.

#### GAO RESPONSE

Our report discusses why 8(a) program costs are not visible and recommends program changes to enhance cost visibility, in line with the Commission's recommendations. We disagree with SBA's assertion that the Commission's report did not characterize social and economic program costs as having a "negative effect" on the procurement process. Chapter 11 of the Commission's Report, entitled "National Policies Implemented Through the Procurement Process," states:

The problems engendered by use of the procurement process in the implementation of national goals are that procurement becomes more costly and time-consuming with the addition of each new social and economic program. The cumulative effect of programs already imposed on the procurement process and the addition of those contemplated could overburden it to the point of threatening breakdown. At the very least, the imposition of national goals and objectives on the procurement process, as beneficial as they may be, add numerous obligations and administrative complexities for Government contracting officers. Legitimate questions arise as to how much of the extra costs and other burdens of social and economic programs should be absorbed in the procurement process and how much should be supported by more explicit means.

P. 9.

The objectives identified are too narrow in their scope. A true evaluation should include a control element. Conclusions which are based on isolated examples fail to recognize the universe of federal procurements and the experience outside the 8(a) program. The report fails to address a critical component of any valid evaluation - a comparison with the norm.

That fact, of course, does not make the problems identified in the instant report any less important. The point is, however, that the report suffers from lack of a comparative analysis and, hence, a lack of perspective.

GAO RESPONSE

As SBA has observed, we did not compare the development of small and disadvantaged business firms participating in the 8(a) program versus the development of similar firms not participating in the program in order to determine if the program has a beneficial effect. From a program standpoint, such an evaluation could be useful, and SBA itself may want to undertake such an evaluation.

However, we should add, that the principle objective of our study was to determine if participating Federal procurement agencies suffered any negative impacts as a result of awarding contracts through the 8(a) program. Given this objective, we compared the procurement agency's experience participating in the 8(a) program, with norms experienced outside the program. We believe our coverage, in terms of installations visited, number of contracts reviewed, and dollar value of contracts reviewed was extensive, as was the amount of attention each contract and installation received.

Another concern we have regarding the proposal is the total loss of control SBA would have in directing 8(a) contracts to its firms. The law has, as one of its many purposes, to "promote the competitive viability" of 8(a) firms by providing available contract support as may be necessary. Further, the Act requires SBA to assist the firms to develop business plans "with specific business targets, objectives and goals for correcting the impairment of such concern's ability to compete..." Thus, SBA approves targeted goals for 8(a) contract support levels for each of the years of the firms' now limited period of participation. If all 8(a) contracts were to be awarded on a competitive basis as outlined by GAO, SBA would have no ability to direct contracts to any 8(a) firm including those firms which are less competitive within the 8(a) program and are more in need of those contracts than others. Thus, the program would not be achieving its purposes and the same criticisms as voiced in the earlier GAO Report, "The 8(a) Program ---A Promise Unfulfilled" might be repeated. (i.e., too many contracts would be awarded to too few firms.)

SBA recognizes, however, that limited competition within the 8(a) program itself is an idea which should be explored. Accordingly, we are currently developing a test program of competition which should be implemented in the Fall. In such a program, competition would be used together with sole source contracting to achieve the business development purposes of the Act.

#### Direct Contracting Between Procurement Agency and 8(a) Firm

SBA currently delegates authority for procuring agencies to negotiate directly with the more mature 8(a) firms. We also delegate authority for procuring agencies or their service units to perform most of the contract administration functions. Obviously, SBA representatives are available to participate in negotiations or in solving contract administration problems upon request from the 8(a) firm or procurement officials.

It may be possible to achieve most of the objectives sought in the proposed direct contracting approach through more general delegation of our contracting authorities. We would be happy to work with OFPP and DOD procurement officials in developing broader delegations of these authorities.

Perhaps through inter-agency working agreements we could also develop procedures designed to reduce delays, eliminate unnecessary paperwork and improve communications. However, for SBA to maintain its role in fostering business development, it is essential that we retain our current contractual relationship with procuring agencies and 8(a) firms. Removal of SBA from this tripartite arrangement would severely dilute our ability to influence business development.

If prices were set through the competitive process (as in our competitive option) we believe price differentials would become visible, and SBA would have little choice but to compensate procurement activities for the price differentials incurred. Likewise, SBA would have the means to inform the Congress of how much business development expense money it needs to support the program at its present level.

P. 24

We question whether unsolicited proposals should be considered at all in determining fair market prices. Such proposals may not be responsive and/or may not come from responsible offerors.

GAO RESPONSE

In the situations SBA highlights, unsolicited proposals would clearly be inappropriate to use as a basis for determining fair market price. The same would be true of competitive bids. However, there may be other circumstances where unsolicited proposals or competitive bids provide useful information to the contracting officer and we believe the regulations should provide that this information at least be considered, if it is appropriate to do so.

Pp. 27-28

It should be recognized that SBA's Standard Operating Procedures do not direct contracting negotiators to coerce procuring agencies into offering higher prices to section 8(a) firms. The procedures merely reinforce the fact that, if our agency is to assist disadvantaged businesses, it must negotiate contracts which are fair and reasonable. Obviously, reasonable people can differ as to what constitutes "fair and reasonable." Since our procedures specifically reference reliance upon our "price analysis personnel," SBA, acting as an advocate for its clients, is simply seeking to negotiate its view of a fair and reasonable price. That, indeed, is the essence of negotiation, and to merely accede to DOD's definition would hardly be appropriate.

- a. Procurement Dollar Goals for Fiscal Year 1982 were based on the aggregate dollar volume of approved levels of support contained in the firms' business plans, thus addressing the "competing goals" issue.
- b. New business plans and procedures for conducting annual reviews to judge the firms' success or failure have been established.
- c. Management assistance provided by SBA should hardly be characterized as inadequate since some 74% of the responding firms contacted by GAO in its report on the 7(j) program found that the management assistance obtained through SBA was helpful.

It is suggested that the language on page 7 introducing the problems state "Some of the major problems identified in such reports were as follows:"

#### GAO RESPONSE

We have not evaluated the extent of implementation of the above procedures. However, we question SBA's characterization of our findings on the 7(j) program, as reported in "SBA's 7(j) Management Assistance Program: Changes Needed to Improve Efficiency and Effectiveness," CED 81-149, September 29, 1981. GAO found that the "call contracting" program of management assistance had not been effectively administered. Further, small business owners had varying opinions regarding the value of the advice call contractors gave them. SBA agreed with GAO's recommendations for improving the management of the 7(j) program and stated that it was initiating action on several recommendations and would take additional action during fiscal year 1982. Another GAO report, "The SBA 8(a) Procurement Program -- A Promise Unfulfilled," CED 81-55, April 8, 1981, expressed serious concern over the ability of SBA's Business Development Specialists to adequately monitor and assist participating 8(a) firms.

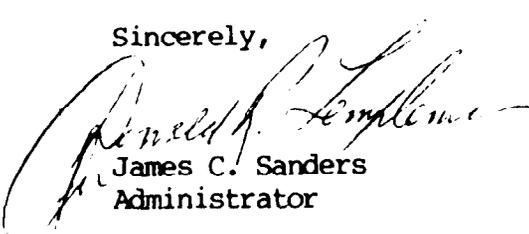
--Although SBA states that DPSC notified them that reprocurement could be expected at a higher price, DPSC had similar contracts that were being performed for less, and prices industry wide were dropping.

Our purpose in illustrating this case is to (1) demonstrate the complexity of resolving contract issues with SBA, (2) demonstrate how the outcome can affect the procuring agency, and (3) see what lessons can be learned and propose a course of action to prevent future misunderstandings.

We continue to believe that the procedure we outlined would ensure that once an 8(a) contractor has defaulted, the procurement agency is treated fairly. We think it is already implicit in SBA's SOP that the agency should have the right to reevaluate and renegotiate, with SBA, any new 8(a) contractor selected. This isn't a matter of allowing the Government to "terminate all contracts that reflect a higher price than currently opened bids which may be lower," but of placing the procurement agency in the same position it would have been in, if, for example, a non-8(a) contractor were involved in the default. In that case, the contract would be terminated and the procurement agency could reprocure however it chooses. All we suggest with respect to 8(a) contracts, is that once an 8(a) contractor has defaulted, the procurement agency have the opportunity to evaluate any new 8(a) contractor SBA selects, and set a fair market price based on circumstances existing at the time. We do not think this procedure unreasonable.

In conclusion, let me again express to you my appreciation for the opportunity you have given us, not only to comment upon this report, but also to take advantage of your agency's constructive criticisms so that we may improve the functioning of this very important program for the benefit of all participants.

Sincerely,



James C. Sanders  
Administrator

Pp. 13-17

Regulations contained at 13 C.F.R. § 124.1-4 state that "Business Development funds (BDE) are funds made available by SBA for the purpose of assisting a section 8(a) business concern in connection with the performance of a specific section 8(a) subcontract." The rules further authorize SBA, in its discretion, to use such funds for price differential, capital equipment deemed essential to the performance of the contract, or other items delineated in 13 C.F.R. § 124.1-4(b).

In a proper exercise of its administrative discretion, SBA has determined that less emphasis is to be placed upon the use of BDE for price differential. As part of our business development mission, SBA feels that 8(a) firms must be price competitive if they are to develop beyond the 8(a) program. Thus, we have allocated less than 10% of our BDE Budget for price differential. SBA has not promised to assume all costs in excess of the market price.

Of far greater importance to a firm's development is the acquisition of capital equipment which, while needed to perform a particular 8(a) contract, materially enhances that firm's capability to perform other non 8(a) contracts thus increasing its competitiveness. In light of that fact and in the absence of legislative history directing us to do otherwise, SBA has encouraged the use of BDE funds for capital equipment such that some 90% of our BDE budget is targeted for capital equipment acquisition.

GAO RESPONSE

We recognize that SBA has full discretion in how it uses its available business development expense funds. However, we believe that, to the extent that SBA does not pay the difference between a competitive fair market price and an 8(a) firm's fair and reasonable price, procuring activities are subsidizing the 8(a) program with their appropriated procurement dollars. Further, we know of no evidence to support SBA's assertion that 8(a) firms are "price competitive." We found instances where higher than competitive prices were paid to 8(a) firms, and many other cases where prices were negotiated with 8(a) firms based on their costs. It is widely understood that competition usually produces the most favorable prices for the procurement activity. Since 8(a) firms are awarded contracts on a sole source basis and the costs incurred by 8(a) firms may not be reflective of the costs incurred by viable competitive firms, we think it is more plausible to suggest that procurement activities could receive better prices outside the 8(a) program.



GAO RESPONSE

SBA appears to equate a "fair and reasonable" price with a "fair market price." No price differentials would ever arise if "fair and reasonable" prices were identical to "fair market prices." We believe a fair market price which reflects what the procurement activity would pay a competitive viable firm may very well be different than a "fair and reasonable" price which reflects a developing 8(a) firm's costs under sole-source conditions. Chapter 2 discusses our views on fair market prices. We believe the procurement activity is responsible for setting the "fair market price" while SBA is responsible for assuring that the 8(a) firm receives a "fair and reasonable" price. When these two prices differ, business development expense can be used, at SBA's discretion, to make up the difference.

Pp. 72-75

SBA has submitted the data requested by GAO in a 17 page response dated March 19, 1982. We would hope that, prior to the finalization of the report, an analysis of the transmittal be made and appropriate changes included in the final report.

At the time the determination was made, program officials and top agency management had studied the issue diligently. They relied in good faith upon a determination by the Office of General Counsel that cited authority for SBA's ability to contract with a non 8(a) company in a situation where the government was about to lose substantial money. At the time of the determination, the dollar figures for the award to the company were scrutinized and, according to our analysis, a cost savings to the government was projected to be realized. Thus, in a good faith effort to protect the interests of the government, the action described in the example was indeed taken.

GAO RESPONSE

We received SBA's response too late to be considered in our draft report but considered their views prior to issuance of this report. We found some conflicts between the documentation provided by DPSC, DLA, and DOD, and some of the assertions made by SBA, but did not have time to seek further verification. Some of the major discrepancies are as follows:

- Although SBA maintains that DLA did not object to the Miners contract until after award, documentation obtained from DPSC and DLA indicates otherwise.
- One of the 8(a) firms SBA states it considered for award claims it was never notified about the availability of the contract and subsequently submitted a letter to DLA protesting SBA's actions.



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL  
PROCUREMENT POLICY

JUN 7 1982

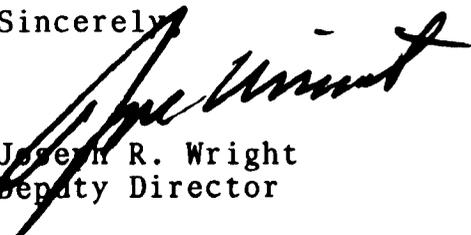
Honorable Charles A. Bowsher  
Comptroller General of the United States  
Washington, D.C. 20548

Dear Mr. Bowsher:

You have requested our comments on your draft GAO report "Proposals for Minimizing the Impact of the 8(a) Program on Defense Procurement."

As its title suggests, the Report contains a detailed evaluation of the impact of the 8(a) program on its largest participant - the Department of Defense. The Small Business Administration (SBA) and the Department of Defense will respond directly on your findings and recommendations. We have asked both to send us copies of their comments. If appropriate we will respond further upon receipt of their comments.

Sincerely,



Joseph R. Wright  
Deputy Director

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