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q+ The Honorable Joel T. Broyhill
r House of Representatives

Dear Mr. Broyhill:

This is in response to your September 13, 1973, letter requesting that we look into the Plato Systems, Inc., contract with the Small Business Administration (SBA) to perform services for the Department of Labor. Specifically, you expressed concern over Plato's not meeting its financial obligations and contract performance requirements. p. 2330

Since August 1971 Plato has performed keypunch services for Labor under a series of contracts pursuant to section 8(a) of the Small Business Act (15 U.S.C. 637), which authorizes SBA to enter into contracts with Federal agencies and to subcontract the work to small businesses and others.

We examined pertinent legislation authorizing the section 8(a) program and related SBA policies and instructions. We also reviewed pertinent records and documents relating to contracts involving Plato at both Labor and SBA. Plato gave us financial data which we examined but did not verify.

BACKGROUND

In fiscal year 1968 SBA began using section 8(a) authority to foster and expand business firms owned and controlled by socially and economically disadvantaged persons. It rapidly expanded the program from 8 contract awards totaling \$10 million in fiscal year 1968 to 1,939 awards totaling \$198 million in fiscal year 1973.

The section 8(a) program is to help eligible firms that are unable to compete effectively achieve self-sufficiency.

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Section 8(a) contracts are not intended to support a concern indefinitely but are intended to serve as an adjunct to assist in its development.

Plato Systems, Inc., was incorporated in Maryland in October 1969. Its stated purposes are to provide government and industries with computer, technical communications, graphic arts, education, and training services. Its major client is the Federal Government.

The table below shows selected information on section 8(a) contracts awarded to Plato to provide keypunch services for Labor.

<u>Number</u>	<u>Period</u>	<u>Amount</u>	<u>Payment to Plato as of 1-29-74</u>
L-72-37	8- 6-71 to 6-30-73	\$105,000	\$ 82,760
L-72-126	6-29-72 to 6-30-73	10,000	238
L-73-18	7-29-72 to 6-30-73	120,000	93,620
L-73-133	7- 1-73 to 6-30-74	<u>433,676</u>	<u>137,952</u>
		<u>\$668,676</u>	<u>\$314,570</u>

FINANCIAL OBLIGATIONS

Financial information furnished by Plato showed that, as of September 30, 1973, Plato was in debt to a number of sub-contractors and other third-party creditors. As a general rule, however, the Government has no legally permissible way to enforce payment of such debts because there is usually no privity of contract (joint legal interest) between the Government and third parties which provide supplies and services to a contractor engaged by the Government. According to an SBA official, creditors enter into financial transactions with section 8(a) companies at their own risk and SBA can only encourage such companies to pay their creditors.

In March 1973, under provisions of the Economic Opportunity Act, SBA loaned Plato \$44,000 for debt repayment, equipment purchases, and operating expenses. SBA records show that, as of June 1973, \$27,000 of the loan proceeds had been used for debt repayment. They do not show how the remaining \$17,000 was used.

CONTRACT PERFORMANCE

Labor and SBA officials told us that Plato had performed satisfactorily under its previous, smaller volume contracts. In September 1973, however, Labor notified SBA that Plato was not performing satisfactorily under the contract awarded July 1, 1973.

From July to September 1973, over 80 percent of the key-punch work under the contract was performed onsite at Labor's data processing center by Plato employees; the remaining off-site work was handled primarily by subcontractors, although Plato did perform a limited amount of work at its own facilities.

According to Labor officials, the performance problems pertained only to the offsite work. They said Plato had failed to meet daily workload requirements and had experienced a high error rate due to its limited capability in relation to the volume of work required under the contract.

The contract files contained no record of SBA's or Labor's making a preaward survey to determine whether Plato could handle the increased workload anticipated under the current contract. A Labor official told us the award was based on Plato's satisfactory performance under the previous contracts.

A Plato official told us that several problems affected Plato's ability to perform and its need to subcontract. These problems included (1) the time needed to gear up for the larger volume of offsite work required under the current section 8(a) contract, (2) wide fluctuations in the daily volume of offsite work Labor had given Plato, (3) supervisory problems at Plato, and (4) Plato's lack of control over the error rate of subcontractors.

In September 1973 Labor and SBA reached agreement with Plato to reduce the amount of offsite work to a level Plato could perform satisfactorily without subcontracting. Plato has since performed satisfactorily and has not subcontracted any of the work.

In November 1973 the Labor contract negotiator told us that discussions were underway on possibly eliminating all offsite work under the contract because Plato had been losing money on the work and wanted to discontinue it. Labor planned to contract the difference between Plato's capacity and Labor's requirement to another section 8(a) firm.

SBA SURVEILLANCE, COUNSELING, AND ASSISTANCE

SBA operating procedures state that (1) continuous surveillance over a section 8(a) company's operations is necessary to insure the success of the contract and the survival of the company, (2) unless careful monitoring and surveillance is provided, a new contract conceivably could be a detriment to a section 8(a) firm, (3) problems of credit and cash flow, among other things, should be recognized, and (4) assistance should be given at the proper moment. Various sources of management, counseling, and financial assistance are available when needed.

According to an SBA official, Plato was given management assistance in marketing but no counseling or assistance in proper financial accounting. Also, SBA did not review Plato's recordkeeping and financial reporting practices.

SBA officials told us that section 8(a) firms are monitored, in part, by phoning the firms monthly to discuss their problems and needs and by reviewing financial statements they submit periodically. However, the effectiveness of the monitoring depends largely on the firms' willingness to cooperate and to accept assistance. SBA has had continuing difficulty getting Plato to submit current financial statements on time.

AGENCY ACTIONS

We discussed our findings with SBA officials who said that the Government should maintain careful surveillance over the performance and debt payment capability of section 8(a) companies, since such companies are generally financially marginal. They stressed, however, that understaffing and a need for personnel highly skilled in financial and business analysis have had an impact on the effectiveness of SBA's surveillance efforts.

SBA officials told us that, although there is some doubt about Plato's potential for viability, they plan to continue their assistance to the firm. They agreed, however, to take the following actions and to apprise us of the results.

- Prevail and impress upon Plato the need to meet its obligations.
- Evaluate Plato's progress toward becoming viable with section 8(a) assistance.
- Insure that Plato follows proper accounting procedures.
- Cite in the section 8(a) program operating procedures the Federal procurement regulation governing SBA and procuring agency responsibilities concerning performance capability determinations.

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As your office agreed, we did not obtain written comments on this report from Labor, SBA, or Plato. However, we did discuss its contents with officials of these organizations and considered their views in preparing it. Also as agreed with your office, we are sending a copy of this report to the Administrator of SBA,

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We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "R. F. Keller".

Deputy Comptroller General
of the United States