

January 2012

FEDERAL CONTRACTING

Monitoring and Oversight of Tribal 8(a) Firms Need Attention



G A O

Accountability * Integrity * Reliability

Why GAO Did This Study

Tribal firms—those owned by Alaska Native Corporations, Native Hawaiian Organizations, and Indian tribes—are afforded special advantages within the Small Business Administration's (SBA) 8(a) business development program. GAO was asked to (1) identify trends in government 8(a) contracting with tribal firms; (2) determine why the government awarded sole-source contracts to tribal 8(a) firms and the methods used to make price determinations; (3) assess the procuring agencies' oversight of contracts for compliance with subcontracting requirements; and (4) examine SBA's new 8(a) regulation, intended to clarify program rules, to determine how the changes could affect oversight of tribal 8(a) firms. GAO reviewed non-generalizable samples of 87 contracts (based on dollar value and location) and 62 tribal 8(a) firms' SBA files and spoke with SBA headquarters and district officials as well as officials from 9 agencies.

What GAO Recommends

GAO recommends that the Office of Federal Procurement Policy (OFPP) amend acquisition regulations and provide guidance (including data collection) on monitoring the limits on subcontracting. OFPP generally agreed with the recommendations. GAO's recommendations also include that SBA include specific capabilities in its 8(a) database to improve tribal 8(a) tracking and that it examine tribal participation to determine whether certain practices align with the 8(a) program's business development goal. SBA questioned GAO's methodology, which GAO continues to believe is appropriate, but did not address GAO's recommendations.

View [GAO-12-84](#). For more information, contact John Hutton at (202) 512-4841 or huttonj@gao.gov.

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What GAO Found

Federal dollars obligated to tribal 8(a) firms grew from \$2.1 billion in fiscal year 2005 to \$5.5 billion in 2010, a greater percentage increase than non-tribal 8(a) obligations (160 percent versus 45 percent). Obligations to 8(a) firms owned by Alaska Native Corporations (ANC) represented the majority of tribal obligations every year during the period, rising to \$4.7 billion in 2010. While tribal 8(a) firms comprised 6.2 percent of total 8(a) firms, their obligations accounted for almost a third of total 8(a) obligations in fiscal year 2010. Over the 6 years, the percentage of competitively awarded obligations to tribal 8(a) firms rose; however, sole-source contracts remained the primary source of growth, representing at least 75 percent of all tribal 8(a) obligations in a given year.

Consistent with GAO's 2006 review of ANC 8(a) contracting, contracting officials said that awarding contracts to tribal firms under the 8(a) program allows officials to award sole-source contracts for any value quickly, easily, and legally, and helps agencies meet their small business goals. However, the officials added that the program offices' push for awarding follow-on contracts to the same firm also plays a role. GAO's review of noncompetitive tribal 8(a) contracts shows the methods used to determine price reasonableness in a sole-source environment. In some cases, when agencies moved away from sole-source tribal 8(a) contracts toward competition, agency officials estimated savings as a result.

To ensure that 8(a) firms do not pass along the benefits of their contracts to their subcontractors, regulations limit the amount of work that can be performed by the subcontractors. Of the 87 contracts in GAO's review, 71 had subcontractors. GAO found that required monitoring of limitations on subcontracting by procuring agencies was not routinely occurring. Similar to what GAO reported in 2006, some contracting officers do not understand that ensuring compliance is their responsibility under partnership agreements with SBA, and the regulations do not make this clear. Further, agency officials did not know how to monitor subcontracting limitations, particularly for indefinite-quantity contracts, as the data are not readily available. Not monitoring the limits on subcontracting can pose a major risk that an improper amount of work is being done by large firms.

In March 2011, SBA revised 8(a) regulations to clarify program rules, correct misinterpretations, and address program issues. Although a positive step, SBA will have difficulty enforcing new regulations pertaining to tribal 8(a) follow-on contracts and joint ventures given the information currently available. SBA told GAO it is currently in the process of developing the requirements for a new 8(a) tracking database. Further, the new regulations do not address some issues GAO has previously raised, such as ANC 8(a) firms under the same parent corporation generating a majority of revenue in the same line of business. SBA regulations do not allow a tribal organization to have more than one 8(a) subsidiary perform most of its work under the same primary business line. GAO also discusses practices that highlight how some tribal 8(a) firms operate, in effect, as large businesses because of their parent corporation's backing and interconnectedness with sister subsidiaries. SBA has not reviewed these practices to determine whether they are congruent with the business development purpose of the 8(a) program.

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Abbreviations

ANC	Alaska Native Corporation
ANCSA	Alaska Native Claims Settlement Act
BOA	basic ordering agreement
DCAA	Defense Contract Audit Agency
DOD	Department of Defense
DUNS	Data Universal Numbering System
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System-Next Generation
GSA	U.S. General Services Administration
NAICS	North American Industry Classification System
NHO	Native Hawaiian Organization
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget
SBA	Small Business Administration

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United States Government Accountability Office
Washington, DC 20548

January 31, 2012

Congressional Requesters:

The federal government obligates hundreds of billions of dollars in contracts for goods and services each year—about \$537 billion in fiscal year 2010. That year, about \$18.5 billion was obligated to firms participating in the Small Business Administration’s (SBA) 8(a) program. The 8(a) program is one of the federal government’s primary means for developing small businesses owned by socially and economically disadvantaged individuals. Congress has repeatedly emphasized in legislation that the purpose of the 8(a) program is business development, with a goal of enabling these businesses to compete on an equal basis in the mainstream American economy. Over two decades ago, Congress expanded participation in the 8(a) program to include not just firms owned by disadvantaged individuals, but also firms owned by tribal entities. In this report, “tribal entities” refers to Alaska Native Corporations (ANC), Indian tribes, and Native Hawaiian Organizations (NHO). We use the term “tribal 8(a) firm” to refer to a firm that is majority owned by an ANC, Indian tribe, or NHO.

Firms owned by tribal entities have been afforded special advantages in the 8(a) program. For example, they can receive sole-source 8(a) contracts for any amount, whereas sole-source awards to other 8(a) firms generally must be made under certain competitive dollar thresholds (\$6.5 million for manufacturing or \$4 million for all other acquisitions). ANCs, created in 1971 through the Alaska Native Claims Settlement Act (ANCSA), were established to distribute land and monetary benefits to Alaska Native shareholders in lieu of a reservation system.¹ Relevant legislation defines the term Indian tribes to include bands, nations, or other organized groups of communities of Indians, which are recognized as eligible for the special programs and services provided by the United States because of their status as Indians. NHOs are not-for-profit community service organizations controlled by Native Hawaiians whose business activities are to principally benefit Native Hawaiians. These tribal

¹ The goal of the Act was, in part, to resolve long-standing aboriginal land claims and to foster economic development for Alaska Natives. ANCs are eligible to participate in federal procurement programs, such as the 8(a) program, pursuant to ANCSA. See 43 U.S.C. §§ 1602, 1626(a) and (e).

entities generally provide, to varying extents, economic and community development for their native populations through different programs.

In a 2006 report, we noted that the legislative history leading to the procurement advantages for ANCs was sparse and confusing.² We also reported on the challenge SBA officials cited in overseeing ANC activity in the 8(a) program. The officials attributed this challenge to the fact that the program's business development goals can be in conflict with ANCs' charter under ANCSA—economic and community development for Alaska Natives. We made a number of recommendations, focused on the need for improved SBA oversight of the special advantages afforded to ANCs under the 8(a) program. The Small Business Act does not provide tribal entities a purpose in the 8(a) program that is different from the program's stated goal of business development. In fact, in a 1989 revision to the 8(a) program regulations, SBA stated that the 8(a) program is intended to be used exclusively for business development purposes to help small businesses owned and controlled by socially and economically disadvantaged individuals, Indian tribes, ANCs, and NHOs to compete on an equal basis in the mainstream of the American economy.³ We also reported in 2006 that agencies were not effectively monitoring compliance with required percentages of work to be performed by 8(a) firms versus their subcontractors. While our 2006 report focused on 8(a) firms owned by ANCs, the scope of this report includes 8(a) firms owned by Indian tribes and NHOs as well.

SBA revised the 8(a) regulations, effective in March 2011, to clarify and refine certain provisions in the program, with some revisions specifically focused on tribal participation. Also in March 2011, the Federal Acquisition Regulation (FAR) was amended,⁴ on an interim basis, to

² GAO, *Contract Management: Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight*, [GAO-06-399](#) (Washington, D.C.: Apr. 27, 2006). For example, legislative language suggests that 8(a) businesses owned by Indian tribes and ANCs were exempt from sole source dollar thresholds because such businesses are located on reservations and account for the major employment of the workforce. ANCs, however, do not have reservations.

³ 13 C.F.R. § 124.1. (1989) The regulations were revised in 1998 to restate the business development purpose of the program for "small disadvantaged business concerns," which include tribal 8(a) firms.

⁴ FAR 6.303-1(b). The written justification must be approved in writing by the appropriate official depending on the dollar value (see FAR 6.304) and made publicly available (see FAR 6.305).

implement a provision in the National Defense Authorization Act for Fiscal Year 2010 that required a written justification prior to awarding sole-source 8(a) contracts over \$20 million.⁵ Previously, no justification was required for any dollar amount for 8(a) contracts, including those awarded to tribal 8(a) firms.

In response to your request, we (1) identified trends in federal obligations under 8(a) contracts with tribal firms; (2) determined the reasons federal agencies awarded sole-source contracts to tribal 8(a) firms and the methods used to make price determinations; (3) assessed the procuring agencies' oversight of tribal 8(a) contracts for compliance with subcontracting requirements; and (4) examined SBA's new 8(a) regulations to determine how the changes could affect oversight of tribal firms and the extent to which previously identified problems are addressed. During the course of our work, we also discussed with procuring agency officials the potential impact of the recent FAR requirement for written justifications for sole-source 8(a) awards over \$20 million. This requirement was not applicable to the contracts we reviewed. We evaluated the administration of the tribal 8(a) program; the scope of our work did not include an evaluation of the program's merits.

To identify trends in 8(a) contracting with tribal firms, we analyzed data from the Federal Procurement Data System-Next Generation (FPDS-NG) for fiscal years 2005 through 2010 (the last year of complete information at the time of our review). We found the FPDS-NG data fields that identify firms owned by ANCs, NHOs, and Indian tribes to be unreliable because these data were not available during the entire time period. We therefore obtained from SBA tribal 8(a) firms' Data Universal Numbering System (DUNS) numbers and used this information to obtain the FPDS-NG data, which we determined was sufficiently reliable to identify trends in tribal 8(a) contracting. To address our second and third objectives, we used a stratified purposeful, selected sampling approach to identify 87 contracts for review.⁶ This nonprobability sample included contracts over the competitive 8(a) threshold amounts (\$6.5 million for manufacturing and \$4

⁵ National Defense Authorization Act for Fiscal Year 2010, § 811 (2009).

⁶ Our initial sample included 90 contracts; however, we excluded 2 from the sample because they had been incorrectly coded in FPDS-NG as being awarded through the 8(a) program to tribal 8(a) firms. A third contract was excluded because obligations under one indefinite quantity contract had been listed in FPDS-NG as being under two separate contracts.

million for other acquisitions), focusing on those with large dollar value obligations in fiscal year 2009 (the latest data available at the time we selected our contract sample). We also focused on contracting activities that had higher levels of sole-source tribal 8(a) activity. The majority of the contracts in our sample (62) were awarded by defense agencies, and 25 were awarded by civilian agencies, including the departments of Agriculture, Energy, Health and Human Services, Homeland Security, Justice, Labor, and State, and the Social Security Administration. Most (75) of the contracts were with ANC 8(a) firms; 10 were with firms owned by Indian tribes and 2 were with firms owned by NHOs. Of the 87 contracts, 7 were competitively awarded, and 79 were sole-source procurements. For the one remaining contract we could not confirm whether it was awarded competitively or not because the entire pre-award file was missing. We reviewed the contract files and spoke with contracting and program officials and small business advocates at the agency locations. The results of our contract file analysis are not generalizable to the population of tribal 8(a) contracts.

To address the potential effect of the new SBA regulations on oversight of tribal firms and the extent to which previously identified problems were addressed, we visited SBA headquarters as well as district offices in Anchorage, AK; Philadelphia, PA; and Washington, DC. We also spoke with SBA district officials in Hawaii, New Mexico, and Oklahoma. We selected these particular district offices primarily based on their relatively higher level of involvement with tribal 8(a) firms. In addition to the 87 contract files we reviewed, we also reviewed a sample of 62 SBA files for tribal 8(a) firms' application information, annual reviews, and business plans. In selecting the firms for this portion of our work, we focused on those that had relatively high representation in our contract sample as well as those that had relatively low representation. The results of our review of the firms' SBA files are not generalizable to the universe of tribal 8(a) firms. We did not assess the extent to which benefits from tribal 8(a) contracts flow to the parent entity.

To understand the potential impact of the new FAR requirement for written justifications of 8(a) sole-source awards over \$20 million, we reviewed the FAR and public comments on the new rule: interviewed agency small business advocates, Office of Federal Procurement Policy (OFPP) officials, and contracting officers for the contracts we reviewed;

and drew from the findings in our prior report on ANC 8(a) contracting.⁷ The Administrator of OFPP serves as chair of the Federal Acquisition Regulatory Council; the council oversees development and maintenance of the FAR.

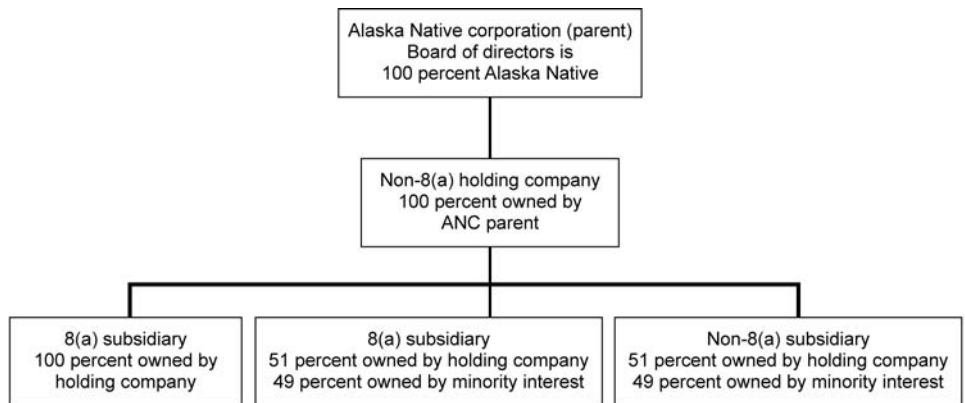
Appendix I contains more information on our scope and methodology. We conducted this performance audit from October 2010 to January 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

ANCs, Indian tribes and NHOs—i.e., the parent entities of tribal 8(a) firms—can be large, with worldwide operations and revenues in the hundreds of millions of dollars. They can own 8(a) and non-8(a) subsidiaries and sometimes form complicated corporate structures. Figure 1 illustrates a notional corporate structure of an ANC with a holding company—a non-8(a) subsidiary that provides shared administrative services to other subsidiaries for a fee. The figure depicts a mix of 8(a) and non-8(a) subsidiaries that may be only partly owned by the ANC.

⁷ [GAO-06-399](#).

Figure 1: Notional ANC with Holding Company and Multiple Subsidiaries



Source: GAO analysis.

Note: Only the 8(a) subsidiaries would be eligible for 8(a) contracts.

According to SBA, in fiscal year 2010, there were over 8,400 firms in the 8(a) program, 354 of which were owned by a tribal entity. For any firm (including tribal firms) to be eligible to participate in the 8(a) program, it must qualify as small under a primary industry size standard as measured by the number of employees or average revenues from the previous 3 years. In addition, the firm must be, among other things, majority-owned by one or more socially and economically disadvantaged individuals or a qualified entity, such as a tribal entity. Firms approved as 8(a) participants can receive business development assistance from SBA and are eligible to receive contracts that agencies offer to SBA for the 8(a) program. All 8(a) firms, including tribal 8(a) firms, are subject to a 9-year limit on participation in the 8(a) program. During the last 5 years in the program, known as a transitional period, firms are required to obtain a certain percentage of non-8(a) revenue to demonstrate their progress in developing a viable business that is not solely reliant on the 8(a) program. SBA's district offices are responsible for tracking this business mix on an annual basis. If a firm does not meet its required business mix during one of the last 5 years, SBA invokes a plan of remedial action for the next year, in which the firm is to report to SBA on its progress. Until the required mix is demonstrated, the firm will generally not be eligible for sole-source 8(a) contracts.

Congress has provided tribal 8(a) firms with distinct advantages over other 8(a) businesses, in addition to the ability to receive sole-source 8(a) contracts for any amount. In some cases, there are also differences

among the advantages provided to firms owned by ANCs, Indian tribes, and NHOs. Table 1 provides more details.

Table 1: Differences in Requirements for Tribal 8(a) Firms and Other 8(a) Firms

Requirement	Firms owned by an ANC	Firms owned by an Indian Tribe	Firms owned by an NHO	Other 8(a) firms
Number of firms a participant may own	No limit as long as each business is in a different primary industry.			Only one in a lifetime.
Size determination for eligibility in 8(a) program	Other affiliated companies not considered in size determination; however, the SBA Administrator may find the existence of affiliation if, for example, SBA determines that the tribal 8(a) firm or firms have a substantial unfair competitive advantage within an industry.			For-profit, nonprofit, domestic, and foreign affiliates considered in size determination.
Competitive threshold	No threshold. Procurements need not be competed before being accepted on a sole-source basis.		No threshold for DOD contracts only. DOD procurements need not be competed before being accepted on a sole-source basis.	Can receive sole-source contracts for up to \$6.5 million for manufacturing or \$4 million for all other acquisitions.
Dollar limits on amount of sole-source 8(a) contracts	No limits on the amount of sole-source contracts.			May not receive sole-source 8(a) contract awards if the combined total of competitive and sole source 8(a) contracts received is above (1) \$100 million where a firm's size is based on its number of employees, or, (2) the lesser of \$100 million or five times the size standard for the industry where a firm's size is based on revenues. ^a

Requirement	Firms owned by an ANC	Firms owned by an Indian Tribe	Firms owned by an NHO	Other 8(a) firms
Demonstration of social and economic disadvantage	Deemed in legislation as socially and economically disadvantaged.	Defined as socially disadvantaged, but must demonstrate that the tribe is economically disadvantaged in connection with the application for one tribally-owned firm. ^b The tribe need not reestablish its economic disadvantage to have other businesses it owns certified for 8(a) participation, unless requested to do so by SBA.	Deemed socially disadvantaged but must establish economic disadvantage and that its business activities principally benefit Native Hawaiians. Economic disadvantage for an NHO is determined when the majority of an NHO's members—or if no members, the board of directors—qualify as economically disadvantaged individuals. Economic disadvantage must be determined for every 8(a) applicant.	Must (1) be a member of a group deemed as socially disadvantaged or prove social disadvantage by meeting certain standards and (2) must prove economic disadvantage.
Management background	President/chief executive officer need not be a disadvantaged individual.	Management and daily operations must be controlled by the tribe. The concern may be controlled by the tribe through one or more individuals who possess sufficient management experience to run the firm or through management, which can be a non-tribal member. ^c	President/chief executive officer need not be a disadvantaged individual.	President/chief executive officer must be a disadvantaged individual.
Potential for success	(1) Must be in business in primary industry classification for at least 2 years before 8(a) application date; or (2) generally, the individuals who will manage and control the daily business operations of the firm have substantial technical and management experience; the applicant has successful past performance on contracts from government and non-government sources in its primary industry, and the applicant has adequate capital to sustain its operations and carry out its business plan as a participant; or (3) the tribal entity made a firm written commitment to support the operations of the applicant concern and it has the financial ability to do so.			Must be in business in primary industry classification for at least 2 years before 8(a) application date. SBA can waive the requirement if certain conditions are met, such as substantial business experience, adequate capital, and past success on contracts.

Source: GAO analysis of SBA 8(a) laws and regulations.

^a8(a) contracts awarded under \$100,000 will not be considered in the \$100 million limit.

^bThis includes consideration of available data such as present tribal unemployment rate, the per capita income of tribal members, and percentage of local Indian population below the poverty level.

^cManagement is provided by either (1) committees, teams, or Board of Directors controlled by at least one economically disadvantaged tribe member; or (2) non-tribal members if the tribe can hire and fire those individuals, retains control of all management decisions, and a written plan exists which shows how tribal members will develop managerial skills sufficient to manage the 8(a) firm or similar tribally-owned firms in the future.

For tribal 8(a) firms, SBA has specific oversight responsibility for

- accepting the firm into the program, which includes ensuring that the tribal entity owning the firm does not have more than one 8(a) firm in the same primary line of business, defined by a North American Industry Classification System (NAICS) code⁸ and
- annually reviewing 8(a) firms to track their progress in the 8(a) program, including their mix of 8(a) and non-8(a) revenue in the last 5 years in the program and any changes to the firms' business targets, objectives, and goals.

The procuring agency offers, and SBA may accept, a procuring agency's requirement into the 8(a) program either as a competitive procurement—to be competed among all eligible 8(a) firms—or as a sole-source procurement. The agency's offer letter must identify the requirement, any procurement history, the estimated dollar amount, and NAICS code, among other things.⁹ Before accepting a procurement as an 8(a) sole-source contract, SBA is to verify the proposed firm's size status to ensure that it qualifies as small under the identified NAICS code. Once accepted into the program, 8(a) firms may pursue contracts in additional lines of work, called secondary NAICS codes. Once a requirement is awarded as an 8(a) contract, it must remain in the 8(a) program unless the procuring agency decides it would like to fulfill the follow-on requirement outside of the program and requests approval from SBA to do so. Procuring agency contracting officers also have responsibilities under the 8(a) program. For

⁸The NAICS assigns codes to all economic activity within 20 broad sectors, and the codes reflect the industry in which the firm operates, e.g., wireless telecommunication carriers or industrial building construction. SBA has designated a small business size standard for every NAICS code. Applicants to the 8(a) program must qualify as small under their primary NAICS code at the time of application and SBA's certification date. SBA regulation requires that at least 2 years lapse after a tribal firm exits the 8(a) program before another firm owned by the same parent entity can enter the program with the prior firm's primary NAICS code.

⁹ FAR 19.804-2.

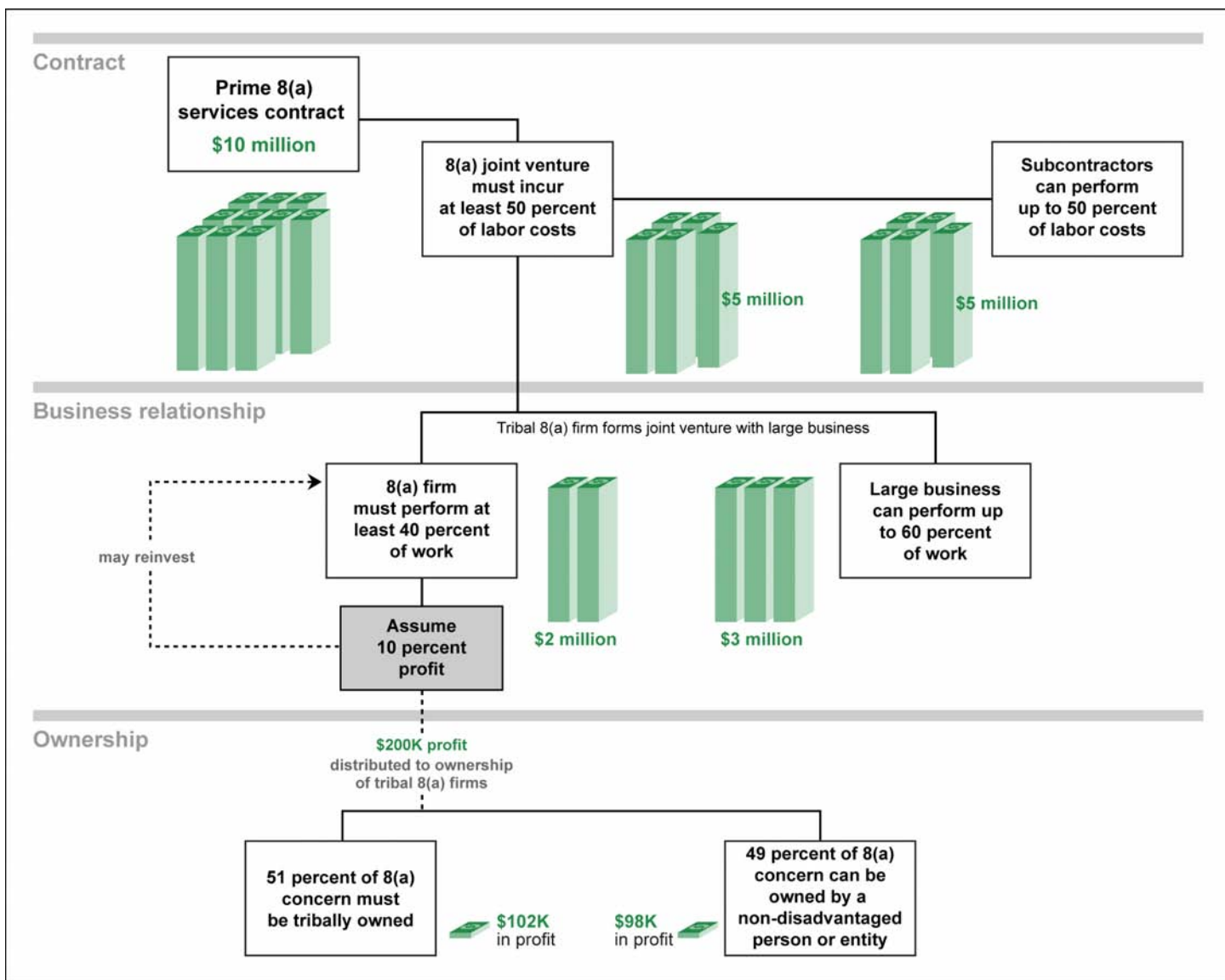
all of the agencies in our review, SBA has delegated responsibility for contract administration to the contracting officers through partnership agreements.¹⁰ These responsibilities include, for example, ensuring compliance with the limitations on subcontracting requirements under 8(a) contracts.

SBA's 8(a) program regulations allow for involvement of other businesses and non-disadvantaged individuals as a way of helping the 8(a) business grow and develop. For example, 8(a) firms can hire outside agents to assist them in obtaining 8(a) contracts; however, SBA's revised regulations now prohibit agreements in which agents receive a percentage of the contract value as compensation for their assistance. In addition, large businesses can create a mentor-protégé joint venture with an 8(a) firm to win 8(a) prime contracts or can act as a subcontractor under an 8(a) contract.¹¹ Certain limitations apply regarding the percentage of labor costs that 8(a) firms and non-8(a) partners may incur under service and construction contracts. For service contracts with subcontracting activity, the 8(a) firm must incur at least 50 percent of the personnel costs with its own employees (15 percent for construction contracts). Further, a non-disadvantaged individual can own up to a 49 percent interest in an 8(a) firm, retaining his or her percentage of ownership in the profits the firm generates. These arrangements with other businesses or non-disadvantaged individuals can result in a relatively small percentage of contract profits being retained by the tribal entity that owns the 8(a) firm. Figure 2 is an illustrative example of how these arrangements could occur when a tribal 8(a) firm forms a joint venture with a large business under the mentor-protégé program, as allowed by SBA regulations.

¹⁰ For agencies where there is no partnership agreement in place, SBA is generally responsible for the contract administration function.

¹¹ SBA must approve the mentor/protégé agreement before the two businesses submit an offer as a joint venture to receive exclusion from affiliation. 13 C.F.R. §§ 124.513(b)(3) and 124.520(b) and (d)(1)(i).

Figure 2: Flow of Work and Profits As Allowed in the 8(a) Program under an Illustrative Contract for Services



Source: GAO analysis of SBA regulations.

Notes: In our example, the joint venture is unpopulated—meaning it merely exists through a written agreement and uses the employees of the firms in the joint venture. The profits from an unpopulated joint venture are distributed commensurate with the work performed; thus, in this example the 8(a) firm receives 10 percent in profit from the 40 percent of the work it performed.

For 8(a) construction contracts, the prime contractor must incur at least 15 percent of the personnel costs with its own employees. Thus, if our illustrative example above were a construction contract, the tribe that owns a 51 percent interest in the firm would receive \$31,000 in profit distribution.

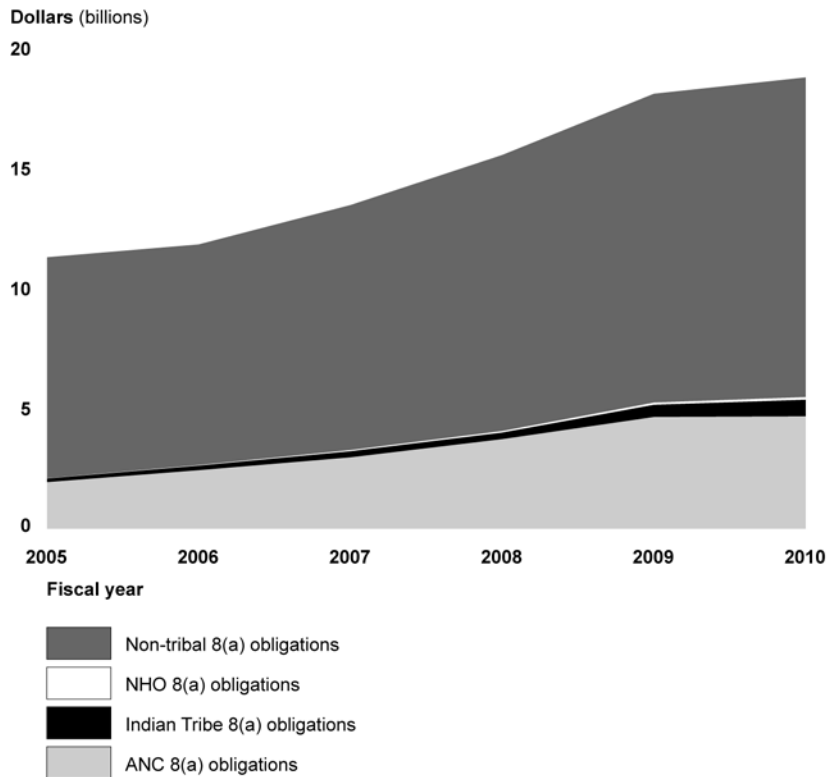
In 2006, we reported that ANCAs used the 8(a) program as one of many sources of revenue (which could include revenue generated outside of government contracts) to provide benefits to their shareholders.¹² We also found that there was no explicit link between the revenues ANCAs generated from the 8(a) program and the benefits they provided to shareholders, because ANCAs only tracked benefits generated from their consolidated revenue sources. The recently revised 8(a) regulations require tribal 8(a) firms to report annually to SBA on the benefits they are providing their members or community from their participation in the 8(a) program.

Obligations to Tribal 8(a) Firms Have Grown Steadily, with Most under Sole-Source Contracts

From fiscal year 2005 through 2010, federal dollars obligated to tribal 8(a) firms grew from \$2.1 billion to \$5.5 billion. Obligations to 8(a) firms owned by ANCAs—which represented the majority of these tribal obligations during each fiscal year—rose steadily, from \$1.9 billion to \$4.7 billion. Obligations to 8(a) firms owned by Indian tribes and NHOs also grew steadily during this time frame, to \$690 million and \$109 million, respectively, in fiscal year 2010. Total 8(a) obligations (to tribal and non-tribal 8(a) firms) increased from \$11.3 billion to \$18.8 billion during the six-year period. Obligations to tribal 8(a) firms represented a 160 percent increase over this time, while obligations to non-tribal 8(a) firms increased 45 percent. Figure 3 shows the growth of non-tribal and tribal 8(a) obligations.

¹² [GAO-06-399](#).

Figure 3: Obligations to Non-Tribal and Tribal 8(a) Firms, Fiscal Years 2005 through 2010 (dollars in billions)



Source: GAO analysis based on information from FPDS-NG.

Note: Obligation amounts are inflation adjusted to 2010 dollars.

Tribal firms represented a very small percentage of all 8(a) firms, but accounted for almost 30 percent of 8(a) obligations—about \$5.5 billion—in fiscal year 2010, as shown in table 2.

Table 2: Number of Tribal and Non-tribal 8(a) Firms and Obligations in Fiscal Year 2010

	Number of 8(a) firms	Percentage of total number of 8(a) firms	8(a) obligations (in millions)	Percentage of FY 10 8(a) obligations
Non-tribal 8(a) firms	5,340	93.8	\$13,310	70.8
Tribal 8(a) firms	353	6.2	5,480	29.2
Total	5,693	100	18,790	100

Source: GAO analysis of FPDS-NG data.

The percentage of obligations under competitively awarded tribal 8(a) contracts increased from fiscal year 2005 to 2010. In fiscal year 2010, sole-source obligations to ANC 8(a) firms decreased slightly, for the first time since 2005. Table 3 compares the percentage of obligations under competitively awarded contracts for ANC, Indian tribe, and NHO 8(a) firms in fiscal year 2005 and 2010.

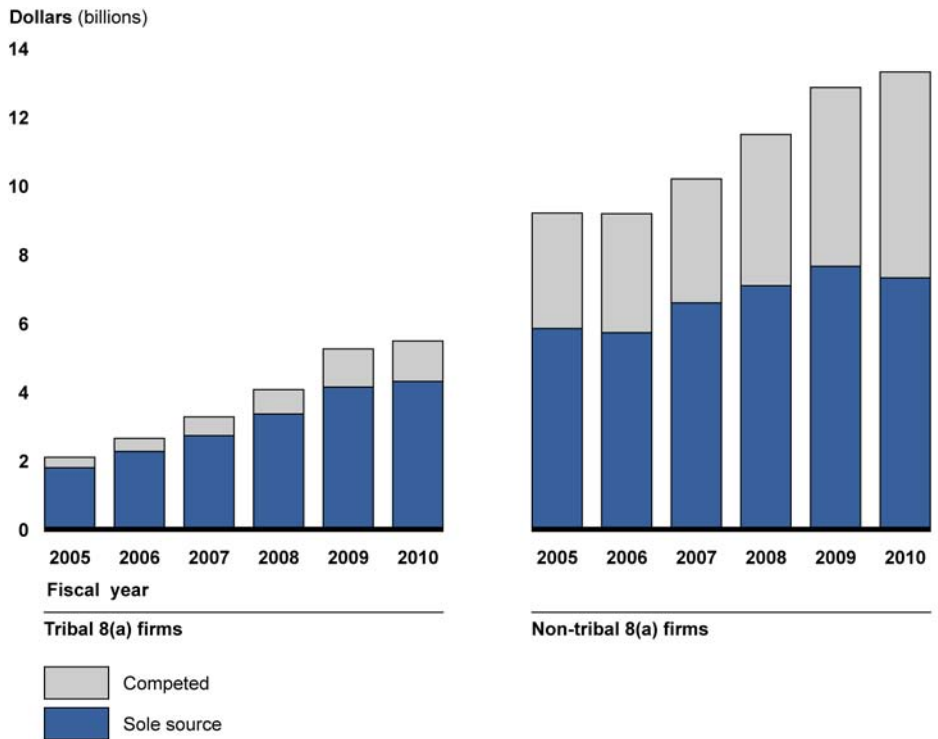
Table 3: Percentage of Obligations under Competitively Awarded Contracts to Tribal 8(a) Firms for Fiscal Year 2005 and 2010

8(a) firms owned by	Fiscal year 2005 (percent)	Fiscal year 2010 (percent)
ANC	14.8	21.8
Indian tribe	10.2	18.1
NHO	4.2	26

Source: GAO analysis of FPDS-NG data.

Even with this increase in obligations under competitively awarded contracts to tribal 8(a) firms, sole-source contracts still accounted for at least 75 percent of all tribal 8(a) obligations annually. In terms of obligations, in fiscal year 2010, sole-source awards to tribal 8(a) firms accounted for \$4.3 billion of the total \$5.5 billion in tribal 8(a) obligations. Figure 4 shows the breakdown of sole-source and competitive 8(a) obligations for tribal and non-tribal 8(a) firms from fiscal years 2005 through 2010.

Figure 4: Competitive and Sole-Source Obligations to Tribal and Non-Tribal 8(a) Firms, Fiscal Years 2005 through 2010 (in billions)



Source: GAO analysis based on information from FPDS-NG.

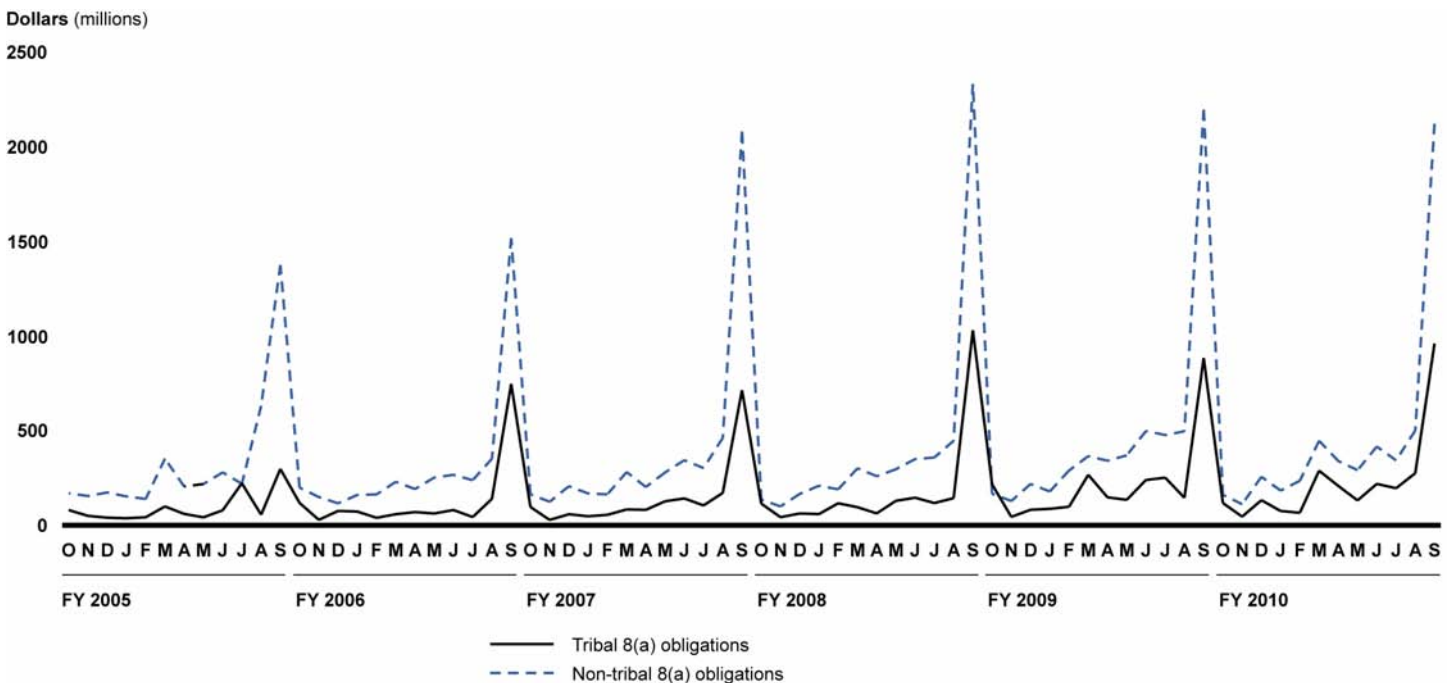
Note: Obligation amounts are inflation adjusted to 2010 dollars.

As shown in figure 4, the percentage of competitive obligations for non-tribal 8(a) firms—about 45 percent in fiscal year 2010—still far outpaces those of tribal 8(a) firms.

Further, our analysis of FPDS-NG obligation data for new sole source awards under the 8(a) program, issued from fiscal years 2005 through 2010, reveals that for both tribal and non-tribal 8(a) firms, obligations on sole-source 8(a) awards increased during the last month of each fiscal

year.¹³ Figure 5 shows the dramatic spike in 8(a) obligations in September of each year.

Figure 5: Monthly Sole-Source Obligations for New Awards to Tribal and Non-Tribal 8(a) Firms, Fiscal Year 2005 through 2010



Source: GAO analysis based on information from FPDS-NG.

Note: Obligation amounts are inflation adjusted to 2010 dollars.

One tribal 8(a) firm’s business plan we reviewed, submitted to SBA, alluded to increased obligations at the end of the fiscal year and noted that it changes its marketing strategy accordingly during that time. The plan noted that “[Our] business is not seasonal with the exception of the end of fiscal year spending for the U.S. Government. During this period, we concentrate our efforts directly at the government by increasing our

¹³ Interestingly, this trend is the opposite of what we reported in 2010 regarding obligations under all contracts (not just those awarded to 8(a) firms). We found that the majority of noncompetitive obligations from fiscal years 2006 to 2009 occurred in the first quarter of the fiscal year. GAO, *Federal Contracting: Opportunities Exist to Increase Competition and Assess Reasons When Only One Offer is Received*, [GAO-10-833](#) (Washington, D.C.: July 26, 2010).

visits and solicitations at the locations where we have the most successful and loyal contacts.”

Sole-Source Contracts to Tribal 8(a) Firms Viewed as Expedient, but Could Lead to Missed Opportunities for Savings

Contracting officials at the agencies we reviewed, similar to what we reported in 2006, told us that using tribal firms under the 8(a) program allows them to award sole-source contracts for any value quickly, easily and legally.¹⁴ They further stated these awards help procuring agencies to meet their small business goals, but added that the program offices’ preference for using the same firms for follow-on contracts also plays a role.¹⁵ Our review of 79 sole-source tribal 8(a) contracts revealed some of the methods used by contracting officials to determine price reasonableness in a sole-source environment. However in several cases we found that contracting officers were moving away from sole-source tribal 8(a) contracts toward competition. We also found examples where tribal 8(a) contracts that had previously been awarded on a sole-source basis were competed, resulting in savings.

Tribal 8(a) Sole-Source Contracts Viewed as Quick and Easy and Contributing to Small Business Goals

Contracting officials viewed sole-source contract awards to tribal 8(a) firms as a way to expedite the federal acquisition process, avoid some potential bid protests, and help them meet their agencies’ small business goals. Prior to SBA’s acceptance of any sole-source requirement into the 8(a) program, the procuring agency need only identify a qualified 8(a) firm and obtain approval from SBA to award a contract. It is the procuring agency’s responsibility to conduct market research, including determining whether offers can be obtained from two or more firms at fair market prices. However, SBA also considers market research requirements to be satisfied when a participant in the 8(a) program self-markets its abilities to a procuring agency and is subsequently offered a sole-source 8(a) requirement.¹⁶

¹⁴ [GAO-06-399](#).

¹⁵ The federal government has an annual agencywide goal of awarding not less than 23 percent of all prime contract dollars to small businesses. See 15 U.S.C. § 644(g)(1).

¹⁶ SBA may not accept a procurement into the 8(a) program under certain circumstances and if the contract pricing exceeds a fair market price.

Award of Sole-Source Tribal
8(a) Contracts Allows
Expedited Acquisition Planning
and Market Research

Acquisition planning activities are intended to ensure that the government meets its needs in the most effective, economical, and timely manner possible. Some contracting officers awarded sole-source 8(a) contracts to tribal firms because this approach allowed them to avoid lengthy acquisition planning and market research procedures, thereby expediting the procurement process.¹⁷ For example, documentation in a Department of Homeland Security contract revealed that the contracting official awarded a \$96 million sole-source contract to a tribal 8(a) firm because this was the most streamlined approach to obtain services. According to the contract file, the agency saved considerable time in the acquisition process and thereby ensured a timely award. In another example, one contracting officer told us that she sees many more sole-source contracts to tribal 8(a) firms at the end of the fiscal year, likely because of poor acquisition planning. Recalling a time when a program office needed to award a contract quickly during the fourth quarter of the fiscal year, she said she was able to award the contract on a sole-source basis to a tribal 8(a) firm within 2 weeks. She estimated that to award the contract competitively would have taken 60 to 90 days.

In another scenario, DOD contracting officials used the expedited procurement process of sole-source contracts to tribal 8(a) firms to maintain the quality of critical services. They awarded two contracts—each valued at over \$500 million for a 10-year period (base period plus 9 option years)—for base engineering support at two different military installations. A large part of the justification for this acquisition strategy was that annual DOD appropriations acts permitted the department to avoid using the Office of Management and Budget’s *Circular No. A-76* competitive sourcing process by contracting with tribal 8(a) firms.¹⁸ The purpose of the competitive sourcing process is to determine whether the

¹⁷ We recently reported on opportunities to strengthen acquisition planning. See GAO, *Acquisition Planning: Opportunities to Build Strong Foundations for Better Service Contracts*, [GAO-11-672](#) (Washington, D.C.: Aug. 9, 2011).

¹⁸ The A-76 process is a federal government policy which subjects commercial activities to competition and requires agency officials to identify all activities performed by government personnel as either commercial or inherently governmental. OMB, *Circular A-76 (Revised), Performance of Commercial Activities* 4, (May 29, 2003). The provisions in these appropriations acts allowed DOD to avoid the A-76 process when contracting with tribal 8(a) firms. DOD used the authority in section 8(a) of the Small Business Act to make the sole source awards. See, for example, Consolidated Security, Disaster Assistance, and Continuing Appropriations Act, 2009, Pub. L. No. 110-329 § 8016, 122 Stat. 3623-24 (Sept. 30, 2008).

government should be performing a function with its personnel or contracting those functions to private sector firms. DOD officials believed awarding the sole-source contracts was necessary, since concerns about the time frames to conduct the A-76 process—which officials at one base estimated could take up to 3 years—were causing the government employees performing the work to become increasingly concerned about their job security and to seek employment elsewhere.

In some cases, as allowed, contracting officials awarded sole-source contracts to tribal 8(a) firms even though market research had revealed other firms capable of performing the work. For example, Army contracting officials' request for information for medical services resulted in six firms' submitting comments. However, citing the current contract's expiration time frame, the contracting officer stated that a successful competition would require a great deal of acquisition planning and, as such, would likely result in a break in services. In another example, market research identified 93 potential contractors for a base engineering support requirement; several of which were known to possess the capabilities to handle the requirement if it were competitively solicited. In fact, the previous contract for this requirement had been competitively awarded in the 8(a) program, with seven offers received. Our review of the acquisition plan and discussion with the contracting officer revealed that the reason for awarding the sole-source follow-on contract was because of the significant delay in obtaining the statement of work from the program office. Because the requirement was critical and the new contractor would have to "hit the ground running," a sole-source contract was awarded to a tribal 8(a) firm that had subcontracted with the incumbent contractor.

At one Army Corps of Engineers location we visited, contracting officials told us that they put basic ordering agreements (BOA) in place—such as the one we reviewed for design and construction services with a tribal 8(a) firm—because BOAs can be quickly set up, sometimes in only a matter of hours. The regulations require that an agency offer, and SBA accept, each order under a BOA to the 8(a) program prior to award, because the BOA itself is not a contract.¹⁹ As part of this process, SBA

¹⁹ A BOA is a written instrument of understanding between an agency and contractor that generally contains terms and clauses applying to future orders, a description of supplies and services to be provided, and methods for pricing future orders under the BOA. FAR 16.703(a).

would ensure that the tribal 8(a) firm still meets the size standard for the NAICS code for the requirement at the time the order is offered to SBA. However, we found that the contracting officer was not offering each order under this \$10 million BOA (which had been awarded in June 2009) to SBA, in violation of FAR and SBA regulations. The DOD contracting official in this case sent notices of the orders to the SBA district office after the award. SBA district officials did not follow up to determine why these orders had not been offered prior to the award. By not offering each order under the BOA, there is a risk that a tribal 8(a) firm could outgrow the size standard and be improperly awarded a sole-source contract through the 8(a) program. In subsequent discussions, SBA and an Army Corps of Engineers legal representative confirmed that all orders under BOAs in the 8(a) program should be offered to SBA. According to the legal representative, the contracting office is no longer using BOAs to meet its requirements and is instead using indefinite quantity contracts.²⁰

Reduced Likelihood That Tribal 8(a) Sole-Source Contracts Will Be Protested

Tribal 8(a) sole-source contracts are also attractive because there are limitations on their ability to be protested. Although 8(a) sole-source awards have been protested, the following issues may not be challenged of any 8(a) participant by any party, either to SBA or any administrative forum as part of a bid or other contract protest: (1) the eligibility of the participant for a sole-source or competitive 8(a) requirement, (2) the NAICS code assigned to a sole-source 8(a) requirement, or (3) the size status of a nominated participant for a sole-source 8(a) procurement.²¹ According to contracting officials, bid protests can result in significant and costly delays and potentially disrupt critical services. Moreover, the officials stated that responding to bid protests absorbs their already limited time and resources. One tribal 8(a) company, in its marketing materials to the government, mentioned that one of the many benefits of a sole-source award to their company was that it would not be subject to a bid protest.

Competitive 8(a) awards can be protested by other 8(a) firms, and we found an example of this in one of the seven competitively awarded

²⁰ This type of contract provides for an indefinite quantity, within stated limits, of supplies or services during a fixed period. The government places orders for individual requirements. Quantity limits may be stated as number of units or as dollar values.

²¹ As examples, 8(a) sole-source awards to tribal 8(a) firms have been protested in *Mission Critical Solutions*, B-401057, May 4, 2009 and *JMX, Inc.*, B-402643, June 25, 2010.

Sole-Source Tribal 8(a) Contracts Can Help Agencies Meet Small Business Goals

contracts we reviewed. After an 8(a) contract was awarded competitively to a tribal firm, the incumbent firm's sister subsidiary, who had competed under the solicitation, protested the award.²² This sister subsidiary did not receive the award because its proposal relied on the past performance of its sister firm (the incumbent). According to the solicitation's instructions, past performance of sister firms would not be considered as highly as the firm's own past performance.²³ Further, its offer was 86 percent higher than that of the winning tribal 8(a) contractor. As a result of the protest, the expiring contract was extended 5 months, resulting in over \$800,000 in additional revenue for the incumbent firm.

Officials Also Award Sole- Source Contracts to Tribal 8(a) Firms for Continuity

Another reason contracting officials gave for awarding sole source tribal 8(a) contracts is to help their agencies meet their small business prime contracting goals. Some tribal 8(a) firms also recognize that this is an attractive feature and promote it in their marketing materials. However, at one location we visited, agency officials told us that they chose to compete a follow-on procurement outside of the 8(a) program even though they knew it would significantly affect their ability to meet their small business goals. The previous 8(a) contractor had been awarded a 5-year, \$250 million dollar contract. Obligations under this contract had helped the agency meet its small business goals. Nevertheless, agency officials, including the small business advocate, thought the potential to obtain a better price and service through full and open competition was more important at that time.

Contracting officials we spoke with noted that some program officials prefer to continue working with specific tribal 8(a) firms, especially when program officials had established a working rapport with the incumbent contractors. Our prior work has shown that program officials generally have a preference for working with incumbent firms.²⁴ Program officials play an important role in the contracting process—developing

²² A sister subsidiary is another tribal 8(a) firm that is owned by the same parent entity.

²³ GAO bid protest decisions have established that an agency may consider the experience or past performance of an offeror's parent or affiliated company under certain circumstances, for instance where the proposal demonstrates that the resources of the parent or affiliate will affect contract performance. However, reliance on a third party's experience, even if otherwise permissible, could be precluded from consideration by a solicitation provision.

²⁴ [GAO-10-833](#). We also recently reported on the program offices' roles in acquisition planning ([GAO-11-672](#)).

requirements, performing market research, and interfacing with contractors. For one Army contract we reviewed to provide direct healthcare services at military medical-treatment facilities, program officials had decided that a follow-on sole-source 8(a) contract award to one of the incumbent firm's sister subsidiaries was the best option because there was a potential for risk if the procurement start date was not met. Additionally, in its proposal, the incumbent's sister subsidiary highlighted the fact that SBA regulations permitted it to share senior management with the incumbent and that as a result, their services were provided under the same team.

We found instances in which contracting officials awarded bridge or follow-on sole-source contracts to incumbent tribal 8(a) firms or to their sister subsidiaries for continuity.²⁵

- Forest Service contracting officials had a history of awarding sole-source bridge or follow-on contracts for similar requirements to the same incumbent 8(a) firm or one of its sister subsidiaries. The contracting official responsible for the three contracts in our sample explained that the program office pressured her to continue awarding to this particular firm because the program office believed that awarding the requirement to a new contractor would cause a disruption in services. One of these contracts—a \$125-million sole-source 8(a) contract for computer hardware and enterprise software—was awarded to a firm's sister subsidiary when the incumbent was no longer eligible to receive 8(a) contracts. An email from an official from the sister firm to the contracting officer, in suggesting that the new contract be awarded to the sister firm, told the agency that all incumbent personnel working on the contract, as well as equipment, would be transferred over and that essentially the agency “will see only a name change in the firm providing the service.”
- A contracting official at the Department of Energy told us that she awarded a sole-source contract for facility maintenance and support services to the sister subsidiary of a tribal 8(a) firm because the incumbent firm had graduated from the 8(a) program, thus making it ineligible for the follow-on contract. Further, she stated that this made

²⁵ All of the contracts in our sample were awarded prior to the March 2011 effective date of SBA's new regulations, which now prohibit the award of a follow-on sole source 8(a) contract to an Indian tribe or ANC sister subsidiary under the same tribal entity.

the transition very easy to manage, since nearly 100 percent of the incumbent's staff transferred directly to the sister firm.

We also found examples where bridge contracts to tribal 8(a) firms were used to ensure continuity while competing the follow-on requirement; however, it was not always a smooth transition. In one case, a contracting officer at an Army acquisition activity awarded a one-year bridge contract to the incumbent tribal 8(a) firm to avoid unnecessary delays and provide sufficient time to compete the requirement in the future. The incumbent's contract—awarded out of a different Army contracting office—had been terminated after one and a half years on the grounds that it was legally insufficient. However, when awarding the bridge contract, contracting officials learned that the incumbent contractor's employees had assisted the Army in developing the follow-on requirement. The contracting officer had the contractor put in place a plan to mitigate this conflict of interest, but still awarded the sole-source bridge contract to meet the immediate need. In another case, Army officials tried to award a task order under an existing contract as a bridge contract to maintain the service while they competed the follow-on award. According to Army officials, the tribal 8(a) firm refused to negotiate, stating it would only agree to a 6-month bridge contract with three 1-year option periods. The contracting officer told us that they believed they were in a bind, agreed to the terms, and ended up exercising all 3 option years. The follow-on requirement is currently being competed.

Potential Impact of New Sole-Source Justification Requirement Unclear

In March 2011, the FAR was revised to incorporate a new rule, pursuant to section 811 of the National Defense Authorization Act for Fiscal Year 2010, which requires a written justification for sole-source 8(a) contracts over \$20 million. The justification must be approved by the appropriate officials—dictated by dollar thresholds—and be publicly posted within 14 days of award. This provision may have an impact on how quickly and easily sole-source tribal 8(a) contracts are awarded. The new justification must include, at a minimum

- a description of the needs of the agency that will be addressed by the contract,
- specification of the statutory provision allowing for the exception to competition,
- a determination that the use of a sole-source contract is in the best interest of the agency concerned,
- a determination that the anticipated cost of the contract will be fair and reasonable, and
- other matters the head of the agency would like included.

While these requirements were not in effect for the contracts we reviewed, we discussed with the contracting officials the potential impact on future sole-source tribal 8(a) awards. Their opinions varied. Several officials stated that it will be more difficult to award sole-source contracts to tribal 8(a) firms, and in some cases these officials said they were pleased to have a tool to encourage program offices to increase competition. Others thought it would make no difference, stating that the justification is simply additional paperwork for the contract file. Still others stated that the new requirement will not affect them because their office had already moved away from awarding sole-source 8(a) contracts to tribally owned firms toward more competition. Some officials attributed this change in attitude in part to congressional and media attention on large dollar, sole-source awards to tribally owned firms.

Various Methods Used to Negotiate Prices for Sole-Source Awards, and Some Savings Realized through Subsequent Competition

When awarding an 8(a) contract, contracting officers are required to determine that the overall price is a fair market price, which can be done through a cost or price analysis. The fair market price does not have to be the lowest price. However in a sole-source environment, there are increased concerns that the prices may not be the best for the government, as competition is the cornerstone of the acquisition system and a critical tool for achieving the best possible return on investment for taxpayers. These concerns would be no different under non-tribal 8(a) sole-source contracts. We found that contracting officials used various methods to determine price reasonableness of contractors' proposed costs or prices. We also found examples where the follow-on requirements were subsequently competed and agency officials estimated savings.

In finding a fair market price, contracting officers must first determine that the costs or prices proposed are fair and reasonable. According to the FAR, price analysis shall be used when certified cost or pricing data are not required. Price analysis is the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit. One of the preferred price analysis techniques is comparing proposed prices from more than one contractor in response to a competitive solicitation, as adequate price competition establishes a fair and reasonable price. The other preferred price analysis method is a comparison to historical pricing for the same or similar items. When using this method, however, the contracting officer must ensure that the pricing is a valid basis for comparison, such as ensuring that significant time has not lapsed between the prior acquisition and the present one. In addition, the prior price must be adjusted to account for materially differing terms

and conditions, quantities, and market and economic factors. If contracting officers determine that these two techniques are unavailable or insufficient, they are encouraged to use other methods appropriate to the circumstances, such as comparison with competitive published price lists or independent government estimates. The FAR also states that cost analysis shall be used to evaluate the reasonableness of individual cost elements when certified cost or pricing data are required (however, price analysis is used to determine that the overall price offered is fair and reasonable). Cost analysis is the review and evaluation of any separate cost elements and profit or fee in an offeror's or contractor's proposal. Some cost analysis techniques include evaluating the government's need for proposed cost elements, verifying labor rates, or comparing proposed costs to actual costs previously incurred by the same offeror. Cost analysis may also be used to determine cost reasonableness or cost realism when a fair and reasonable price cannot be determined through price analysis alone.

Comparison to Historical Pricing or Published Price Lists

For many of the sole-source contracts in our review, agency officials compared contractors' proposed prices to the prices on the prior contract, U.S. General Services Administration (GSA) schedule prices, or pricing data from other sources. The following cases indicate the complexities of this price analysis technique. For example:

- A price analyst at the Social Security Administration found that a tribal 8(a) firm's proposed prices for a \$100-million sole-source contract were generally 5 to 192 percent higher than the prior, non-8(a) contractor's prices. As a result, the price analyst recommended negotiating price reductions with the tribal firm. The contracting officer then performed an additional analysis of the same proposal and noted that the tribal firm's proposed rates were 8 to 51 percent *lower* than the prior firm's GSA schedule rates and were at or below the schedule rates of a subcontractor. The documented analysis noted that comparing the proposed rates to the incumbent contractor's rates could be potentially misleading because performance problems also needed to be taken into account and that the incumbent contractor had not always provided qualified personnel, among other things. The tribal 8(a) firm's proposed prices were accepted.
- For another Social Security Administration contract, the contracting officer evaluated the tribal 8(a) firm's proposed prices for a sole-source, fixed-price contract based on pricing information from the current contract and noticed a significant increase in the tribal 8(a) firm's price for installation and storage of the equipment being purchased. Upon further investigation, the contracting officer learned

Independent Government Cost Estimates Are Another Tool to Assess Price Reasonableness

that the previous pricing had not accounted for substantial government delays that had added to the costs; the new proposal was attempting to appropriately include those costs. The contracting officer noted that the government would work to improve the inefficiencies that were causing this increase in cost, and based on these circumstances, the proposed higher price was determined fair and reasonable.

Independent government cost estimates were also used to determine price reasonableness for the sole-source contracts in our review. The examples below illustrate some challenges faced when the estimates relied in part on outdated costs or inaccurate assumptions. For example:

- In one Army contract, the initial independent government estimate had to be revised from about \$49 million to about \$100 million, because it had not taken into account many different factors, such as travel and overtime for subcontractors. The contract was awarded for about \$113 million.
- In another example at the Army, an independent government estimate was \$2.7 million, compared to the contractor's proposal of \$4.7 million. The price negotiation memorandum noted that the government's estimate was found to have several missing items, outdated estimates, and inaccurate assumptions. The estimate was used as the primary basis for conducting negotiations with the contractor and to determine that the contractor's higher price was fair and reasonable. The contract was ultimately awarded for about \$4.0 million.

For one Army contract we reviewed, the contracting officer told us that she stopped using a competed, single-award indefinite quantity contract to a tribal 8(a) firm because the firm's proposals for two of three task orders were significantly over the government estimates and the government officials did not believe they were getting a fair market price. In this case, the Army had simultaneously competed and awarded the base contract and the first task order. The contractor's proposed price for the second task order, however, was almost \$6 million, whereas the initial government estimate was just below \$4 million. Contracting and program officials pushed back on the contractor's proposed price, but the firm would not negotiate. The government ultimately awarded the second task order at the contractor's proposed price. The contracting officer told us that the same thing happened on the third task order, so the Army officials canceled the procurement and stopped using that contract.

Contracting Officers May Use
Audits to Negotiate Lower
Overall Prices

Some officials told us that developing independent government estimates can be challenging, as the pricing environment can change and the estimate—which may be prepared 6 months to a year prior to contract award—can become outdated before negotiations begin. For example, when construction work is in high demand, prices for those services can increase over the course of a year, according to contracting officers. Other contracting officials told us that they question how independent the government estimates are when the tribal 8(a) incumbent works closely with the program staff who develop the estimates.

For many of the sole-source awards we reviewed, contracting officials requested support from the Defense Contract Audit Agency (DCAA) to evaluate the reasonableness of the proposed costs.²⁶ Some contracting officials effectively used this support to negotiate a lower overall price. For example, in our review of one DOD contract, DCAA submitted findings to the procuring agency 3 months prior to the award date, citing, among other things, \$6.9 million in unsupported costs. Consequently, the contracting officials negotiated a 15 percent reduction of the proposed price, which amounted to a savings of nearly \$9 million. In an Army contract, contracting officials agreed with the lower rates suggested by DCAA for certain cost categories and ultimately negotiated those rates with the tribal 8(a) firm, reducing the contract price by over \$6 million.

In another instance, agency officials awarded a sole-source contract to a tribal 8(a) firm quickly to ensure that critical services were maintained, but asked DCAA to audit the proposal with the understanding that the officials would further negotiate the costs after award based on the findings. DCAA's assessment of the firm's proposed costs was provided 2 months after the contract's award. The audit questioned some of the contractor's proposed costs, such as duplicative labor positions and staff positions that were vacant but for which salaries, wages, fringes, and retirement contributions were included in the final cost of the contract. The contracting officers faced challenges negotiating the contract's price, as they were still negotiating some of these costs with the contractor nearly a year and a half after contract award.

²⁶ DCAA provides services that can help DOD and other federal agencies by performing audits and providing financial advisory services in connection with the negotiation, administration, and settlement of contracts and subcontracts.

Some Contracting Officers Used Alpha Negotiation Procedures

For sole source procurements, the government and contractor may use what is known as “alpha” procedures, where they work as a team during negotiations to define or refine requirements and come to agreement on prices. A number of contracting officers had used this method to work with a tribal 8(a) contractor to agree on a fair market price. One contracting official told us that negotiating prices face-to-face with the contractor using alpha procedures is easier and less time intensive, primarily because he can tell the 8(a) contractor how much funding he has to spend. From there, the contractor can explain to him what the government needs to “take off the table” and what items in the scope of work the contractor can provide at that price. Another contracting official told us that he used alpha procedures because the program office had failed to set all of the contract requirements prior to commencing negotiations with the tribal 8(a) contractor.

Contracting officials at one location we visited noted that alpha contracting in a sole-source environment can lead to the best deal for the government for a variety of reasons, such as leveraging the insight of technical experts throughout the price negotiation process and providing a forum for the contractor to ask for additional clarification about the government’s requirements. At another location we visited, one contracting official told us that he believed the government got a better price using alpha procedures than by using full and open competition when contracting for construction of identical buildings. He attributed this in part to the fact that the contractor in the alpha process had a better understanding of the government requirements and the government did not have to go back and correct or make adjustments to the contract.

With Focus on Competition, Some Estimate That Savings Occurred

Several contracting officers we spoke with noted that they are moving away from sole-source contracts to tribal 8(a) firms and towards competition. We recently highlighted the benefits of competition in federal government contracting, including that it can save money, improve contractor performance, and promote accountability for results.²⁷ We recommended appropriate actions, including that both program and contracting officials encourage competition, so that federal agencies would have greater opportunities to take advantage of the effectiveness of the marketplace and potentially achieve billions of dollars in cost

²⁷ [GAO-10-833](#) and GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, [GAO-11-318SP](#) (Washington, D.C.: Mar. 1, 2011).

savings. Recent policy and guidance from agencies, most significantly the Office of Management and Budget (OMB) and DOD, have also emphasized the importance of competition.²⁸ With regard to ANCs, the Acting Deputy Assistant Secretary of the Army (Procurement) issued a memo in January 2011, stating that high-dollar sole-source awards to 8(a) ANC firms should be the exception rather than the rule, and laid out the expectation that these awards be scrutinized to ensure they are in the government's best interest. Further, in November 2011, DOD's Director of Defense Procurement and Acquisition Policy called for a review of all active sole-source contracts to ANCs that were awarded prior to the new requirement for a written justification for awards over \$20 million. As part of the review, DOD services, agencies, and activities must review the justifications (if any) that support the contract awards and describe actions to ensure there is no abuse of these types of contracts.

In the sole-source contracts we reviewed, we found examples where the follow-on requirements were subsequently competed, resulting in savings according to agency officials.

- The Air Force awarded a contract competitively for base operation support and, according to officials, saved about \$17 million for a requirement that was valued at over \$100 million. Officials stated that the previous contractor had high management costs.
- At the Army, we reviewed an approximately \$8.9 million sole-source contract with a tribal 8(a) firm for one year of medical services. The contracting activity recompeted the follow-on requirement, and the contracting officer estimated savings of \$2.3 million annually, for a total of \$11.5 million over the life of the contract.
- At the Federal Emergency Management Agency, the contracting officer told us that when the follow-on to the sole-source tribal 8(a) contract in our review had been competed among small businesses, the labor rates on the new contract were, with one exception, between 5 and 46 percent lower than the previous sole-source contract.
- Department of Energy officials told us that they competed a requirement that was previously awarded sole source to a tribal 8(a)

²⁸ See GAO, *Federal Contracting: OMB's Acquisition Savings Initiative Had Results, but Improvements Needed*, [GAO-12-57](#) (Washington, D.C.: Nov. 15, 2011) for our observations on an OMB initiative to reduce spending under high-risk contracts, including noncompetitive awards and awards receiving only one offer.

firm, and while they could not estimate dollar savings, they believed they were getting better performance as a result of the competition.

Agency Oversight of Subcontracting under Tribal 8(a) Contracts Continues to Be Lacking

To ensure that 8(a) firms do not pass along the benefits of their contracts to their subcontractors, regulations limit the amount of work that can be performed by subcontractors. Specifically, for service contracts with subcontracting activity, the 8(a) firm must incur at least 50 percent of the personnel costs with its own employees (for general construction contracts, the firm must incur at least 15 percent of the personnel costs).²⁹ In 2006, we reported that procuring agency contracting officers were not monitoring compliance with the limitations on the percentage of work performed by subcontractors as required—largely because they were confused about whose responsibility it was to do so.³⁰ Based on our recommendations, SBA took some actions to clarify this issue, including providing training to contracting officers and revising its partnership agreements with procuring agencies. Nevertheless, we have continued to find that monitoring of subcontracting limitations is not routinely occurring due to a lack of clarity as to who is responsible for the monitoring and uncertainty on the part of contracting officers about how to conduct the monitoring. Of the 87 contracts in our review, 71 had one or more subcontractors. We found no evidence of regular and systematic monitoring of the limitations on subcontracting.³¹ Some of these contracts had large dollar values, up to \$500 million. When the subcontracting limitations are not being monitored, there is an increased risk that an inappropriate degree of the work is being done by large business subcontractors rather than the 8(a) firm. These risks can be significant given the large dollar value contracts awarded to tribal 8(a) firms.

²⁹ 13 C.F.R. § 125.6(a)(1); FAR 52.219-14, “Limitations on Subcontracting.”

³⁰ [GAO-06-399](#).

³¹ In one contract file we reviewed at the Department of Energy, the contractor’s invoices reflected the amount of work that was subcontracted; however, there was no evidence that agency officials were actively monitoring the subcontracting limitations. For an Army contract in our sample, contracting officials told us they started monitoring the amount of work that was subcontracted after their Principal Assistant Responsible for Contracting directed them to do so; until that time, the limitations on subcontracting had not been monitored.

Confusion Remains about Accountability for Monitoring Subcontracting Limitations

In response to our 2006 recommendations, SBA clarified in its partnership agreements with the procuring agencies that it is the contracting officer's responsibility to monitor compliance with the limits on subcontracting under 8(a) contracts.³² In addition, SBA standardized language in its 8(a) acceptance letters to state that contracting officers are responsible for the monitoring.³³ SBA also provided additional training and guidance for agency contracting officers about this responsibility, among other 8(a) contracting requirements. Even with these actions, however, we still found that some contracting officers do not understand that ensuring compliance with the limitations on subcontracting is their responsibility. Some stated that it was SBA's responsibility as part of the annual review process for tribal 8(a) firms, and officials for one agency thought that it was ultimately the prime contractor's responsibility.³⁴ A contracting official from the State Department told us that he did not have the time or staff to monitor compliance, but he believed that the prime contractor self-monitored because the firm was hiring some subcontractor employees to work for it to ensure that the required work percentages were met.

We found situations where there is an increased risk that the subcontractor may be performing more than the limitations allow. In some cases, these subcontractors were large firms or firms that had graduated from the 8(a) program, yet the government was not monitoring compliance with the limits on subcontracting. For example, in one case, the subcontractor to a tribal 8(a) firm under a base engineering support contract had held the prior contract for the requirement, and the

³² In another report, we recommended that SBA incorporate regular assessments of 8(a) contracting into its surveillance reviews that monitor small business contracting at federal agencies. This would include assessing how agencies administer and oversee 8(a) contracting under the partnership agreements. See GAO, *Small Business Administration: Agency Should Assess Resources Devoted to Contracting and Improve Several Processes in the 8(a) Program*, [GAO-09-16](#), (Washington, D.C.: Nov. 21, 2008).

³³ SBA regulations provide that, through special contract clauses in the 8(a) contract documents or by separate agreement, SBA may delegate to procuring activities responsibility for certain contract administration matters. 13 C.F.R. § 124.512.

³⁴ SBA regulations require 8(a) firms to certify in their offers that they will meet the applicable percentage of work requirement for each contract when subcontracting. However, for agencies with partnership agreements, monitoring compliance with the limitations on subcontracting clause after contract award is the procuring agency's responsibility. As noted above, for all of the agencies in our review, SBA has delegated responsibility for contract administration to the contracting officers through partnership agreements.

subcontractor's president had part-ownership in the tribal 8(a) firm. For another contract, to build an airplane hangar at an Air Force base—in which the percentage of work subcontracted was not monitored—the tribal 8(a) firm had subcontracted with a large business that had extensive experience in hangar building. During the negotiation process, after much discussion about the project, a government representative asked the tribal 8(a) firm what work it would be doing; up to that point the subcontractor had been answering all the questions. In another example, for construction of an aircraft facility at another Air Force base, the prime contractor stated in its proposal that it could not meet the 15 percent of work requirement, and thus a legal review initially found the pending award to be legally insufficient and unacceptable. The contracting specialist wrote a note on the legal memo stating that the prime contractor would meet the required work percentages, with no additional explanation. Notwithstanding the concerns raised, the contract was awarded. The contracting officer told us that she does not monitor the percentage of work that is subcontracted on this contract.

Although contracting officers should consider all applicable regulations when awarding and administering 8(a) contracts, several contracting officers we spoke with told us they depend primarily on the requirements outlined in the FAR for guidance. The FAR only directs contracting officers to include the “limitations on subcontracting” clause—under which the prime contractor agrees to perform a certain percentage of the contract work itself in its 8(a) contract. The FAR does not state who is accountable for monitoring compliance with the required percentages. While the partnership agreements between SBA and the agencies clearly state that the procuring agencies are responsible for the monitoring, these agreements are signed by high level SBA and agency procurement officials; contracting officials may not be aware of the content of the agreements.

Adding to the confusion over which agency is responsible for monitoring subcontracting, in reviewing 8(a) files in the SBA Alaska district office, we found examples where prime contractors had reported to SBA that they were complying with the limitations on subcontracting. However, SBA officials told us that they do not consistently collect this information from 8(a) firms and that it is ultimately the responsibility of the procuring agency to monitor compliance.

Contracting Officers Unclear about How to Monitor Subcontracting Limitations

Many contracting officials told us they do not know how to monitor the percentage of work that is subcontracted. Based on our review of agency contract files, data were not readily available, making it difficult to determine how much work was being performed by the prime contractor versus the subcontractor. For example, contractor invoices in some of the files we reviewed did not reflect the subcontracting activity. And for those invoices that did include subcontractor information, the separation between labor and materials costs was unclear. This information would be needed for contracting officers to properly monitor compliance with the limits on subcontracting, which excludes the costs of materials. Some contracting officials noted that the prime contractor itself would have ready access to the subcontracting percentages (such as in its financial systems). One contracting official noted that contractor invoices for time-and-materials services under a contract in our sample identified the subcontracted work, but the invoices for fixed-price services, billed under the same contract, did not. She estimated that it would take her several weeks to calculate the percentage of work that was subcontracted.

A further complication pertains to monitoring subcontracting under indefinite quantity contracts, the government's use of which is now outpacing stand-alone contracts. Of the 41 indefinite quantity contracts in our sample that had subcontractors, we found no evidence that the subcontracting limits were being routinely monitored. SBA regulations state that the 8(a) participant must demonstrate semi-annually whether it has incurred 50 percent of personnel costs with its own employees for the combined total of all task or delivery orders at the end of each 6-month period.³⁵ However, the FAR does not cross-reference to this provision or otherwise describe how to monitor subcontract limitations in indefinite quantity contracts.

Contracting officials told us they would appreciate additional guidance regarding methods they should employ to track compliance with the limits on subcontracting. The FAR is silent on this subject, and the SBA 8(a) regulation does not provide detailed instructions on how to do so. In the absence of specific guidance, some of the contracting officers we spoke with pointed to techniques that they have used to try to gauge the amount

³⁵ For supply or service contracts, this 50 percent minimum requirement does not apply to work performed under each individual task order, nor does it oblige a contractor to meet the required percentages cumulatively for work performed under all task orders at any given point in time during the contract's life. 13 CFR § 124.510 (c).

of work that is subcontracted. For example, one official said that he monitored subcontractors by “walking the ground,” so he can easily sight-check contractor badges to determine who is a prime contractor and who is a subcontractor. In another scenario, officials stated that they visit the worksite to check the company names on the trucks parked there. Others relied on their personal knowledge of the contractors, stating that because they were very familiar with the prime contractor, they would know if the firm was not performing its required percentage of the work. And still others tallied the number of workers employed by the prime versus subcontractor to get a general picture of the amount subcontracted, but did not calculate the percentage of labor costs associated with the subcontractors. While these actions are ways to get a general sense of subcontracting activity, they are not adequate to determine the extent of personnel costs that are incurred by the contractor.

Many contracting officials also told us they reviewed contractor proposals to verify that the prime contractor planned to perform the required percentage of the work. However, this level of review alone does not ensure compliance with the limitations on subcontracting clause because subcontractors, and the amount of work they do, can change once the contract is awarded. In addition, contracting officers may not even be aware that work is being subcontracted. The tribal 8(a) contractor’s proposal for one contract we reviewed, for example, noted as a benefit to the government that the contractor’s own employees would be indistinguishable from those of its subcontractor. We also found cases in our review where contracting officials inadvertently learned that their prime contractors were using subcontractors. One Department of Agriculture official told us that he did not realize certain positions were going to be subcontracted until he questioned a particular wage rate during the negotiation process, and the firm stated that it needed to seek additional information from the subcontractor. In another instance, a contracting official at the Department of Justice was unaware that the prime contractor had subcontracted work until we brought it to her attention based on our review of the contract file. She added that often “the contracting officer is the last to know” about the prime contractor’s hiring subcontractors, because of a lack of communication among the contractor, program office, and contracting office. In yet another example, a DOD contracting officer said that he only learned that work was being subcontracted when a subcontractor employee was caught speeding on the base.

During our review of contract files, we found a few instances where the file included a recently performed analysis of subcontracting percentages that appeared to have been prepared in anticipation of our visit. In one case, at the Centers for Medicare and Medicaid Services, an analysis, which the contracting officer said was prepared for our visit, showed that the prime contractor had subcontracted almost 72 percent of the total costs for the 3-month base period of a 5-year, almost \$205 million contract, but a few years into the contract the overall subcontracting level had dropped to about 40 percent. The contracting officer explained that he knew that the 8(a) firm would have to initially subcontract out a substantial portion of the work, but the expectation was that the contractor would meet the required work percentage over the course of the period of performance. In another case, a recent analysis of the subcontracting percentages for several 6-month periods on an Army indefinite quantity contract showed that the prime contractor was performing the required percentage of the work, but when we asked the contracting officer about the analysis, he was not sure who had completed it or the basis for the figures. In another example, a document in a Food and Drug Administration contract file showed the prime contractor was performing the required percentage of the work. The contracting officer said that, in preparation for our visit, she had requested the analysis from the contractor, as she did not have the information to do it herself. She told us that she requests this information periodically from the vendor; however, there was no record of these periodic analyses in the contract file. We also talked to contracting officials who told us that they requested regular reports from the contractor on the amount of work subcontracted, but when we asked for examples of the reports, none could be provided, and there were no examples of these reports in the contract files.

SBA's New Regulations Will Be Difficult to Implement, and Other Problems and Practices Have Not Been Addressed

SBA made the first significant revision to 8(a) program regulations, effective March 14, 2011, in over 10 years, aimed at clarifying program rules, correcting misinterpretations, and addressing program issues. The revised rules include new requirements that will affect tribal firm participation in the 8(a) program, such as rules related to sole-source follow-on contracts and work performed by joint ventures. However, SBA will have difficulty enforcing some of these new regulations given the information currently available. Further, SBA, in its regulations or elsewhere, has still not addressed some issues we raised in our 2006 report. Finally, in this review we discuss practices that highlight how some tribal 8(a) firms operate, in effect, like large businesses due to their parent corporation's backing and relationships with their sister subsidiaries. SBA

has not reviewed these practices to determine whether they are acceptable given the business development purpose of the 8(a) program.

SBA Lacks Data to Implement and Enforce Some of the New Regulations

Although the recent SBA rule changes are intended, in part, to address tribally owned firms' participation in the 8(a) program, SBA does not have critical data it needs to implement or enforce compliance with some of the new requirements. These include new restrictions on agencies' ability to award sole-source follow-on contracts to firms under the same tribal entity and restrictions on work performed by the non-8(a) partner in a joint venture. SBA headquarters officials told us they are currently in the initial stages of developing the requirements for a new system intended to provide necessary data on 8(a) firms, and estimate that it will be operational between September 2012 and January 2013. They are also in the process of re-writing their Standard Operating Procedures for district officials to implement the new regulations; however, they could not estimate at this time when the final version will be completed.

SBA Will Have Difficulty Tracking Sole-Source Follow-on Contracts with Sister Subsidiaries

In 2006, we reported that ANC 8(a) firms were taking advantage of their ability to create new subsidiaries to win follow-on work from subsidiaries that had left the 8(a) program. One of the new SBA rules prohibits the award of successive follow-on sole-source 8(a) contracts to multiple firms owned by the same tribal entity. Specifically, agencies are now prohibited from awarding a follow-on 8(a) sole-source contract to another subsidiary firm owned by the same entity—also called a sister subsidiary.³⁶ In its explanation of this new provision, SBA stated that having one subsidiary take over work previously performed by a sister subsidiary does not advance the business development of two distinct firms. SBA expects that, when it accepts multiple firms under the same tribal entity into the 8(a) program, each firm will operate and grow independently in line with the business development purposes of the program. SBA's intention was to address a negative perception that businesses could operate in the 8(a) program in perpetuity by changing their structure or form to continue to perform work as they had under previous contracts. As an example of this perception, we found that one tribal 8(a) firm stated in its marketing materials that it would "never graduate" from the 8(a) program. Agency officials told us that it is their general impression that by awarding follow-

³⁶ NHOs are also subject to the new prohibition; however, it applies only 2 years from the date on which the firms have been admitted to the 8(a) program.

on contracts to the incumbent firm's sister subsidiary, they are, for all intents and purposes, working with the same company.

In our current review, we found multiple examples of follow-on sole-source 8(a) contracts being awarded to a sister subsidiary. While these contracts had all been awarded prior to the effective date of the new rule, these examples suggest that it is not unusual for agencies to turn to sister subsidiaries for follow-on sole-source 8(a) contracts. For example:

- When we spoke to one contracting officer's representative with the Army in May 2011, we found that he was unaware of the new regulation. He explained that when a tribal firm graduates from the 8(a) program, his office would typically award a sole-source follow-on contract to one of the firm's sister subsidiaries based upon the past performance of the incumbent. Noting that a current sole-source tribal 8(a) contract to provide research and development support was set to expire in 2012 and that the incumbent was graduating from the 8(a) program, he stated that it made sense to award the follow-on to one of the firm's sister subsidiaries, especially since the incumbent had performed well. After we told him this was no longer permissible under SBA regulations, he said that the new rule put a "kink" in his plans and that he would need to start planning right away to ensure there was adequate time to successfully award the requirement competitively.

In another example from our review, a procuring agency had awarded a follow-on contract to a sister subsidiary without realizing the relationship between the firms. In September 2007, the Social Security Administration awarded a \$48 million 8(a) sole-source follow-on contract for information technology support services. The incumbent 8(a) ANC firm recommended that the agency make the award to its protégé, as the incumbent was no longer in the 8(a) program. When we spoke to agency officials in July 2011, the agency was not aware that the protégé firm, which received the follow-on award, was also a sister subsidiary of the incumbent. According to the officials, they will rely on SBA to know if a firm targeted for a follow-on procurement is eligible for an 8(a) award based on the new rules.

Although prohibiting this practice of awarding sole-source follow-on contracts to sister subsidiaries of 8(a) firms is a positive step toward curbing some perceived abuses of the 8(a) program, the required information is not always available to enforce this new rule. For example, SBA's data system for tracking 8(a) participants does not provide district offices with the full information needed to track compliance. District officials have access only to information on the firms that they service. Yet a number of tribal entities have firms in multiple locations throughout

the country, and those firms are serviced by different SBA district offices. To illustrate, one ANC parent company has eight subsidiaries serviced in six different district offices. Because SBA's Alaska district office services the majority of ANC 8(a) firms, its insight into the activities of those parent corporations' subsidiaries may be greater than that of other SBA districts, which may service only one of several subsidiaries under the same parent corporation. When we visited the Alaska district office 7 weeks after the new rule had taken effect, we found evidence that SBA had turned down a follow-on contract offer from a procuring agency because the contract violated the new regulation; district officials informed us that they had declined four to five other contract offers for the same reason. However, the officials explained that they maintain paper files and that they would have limited procurement history information—including information about the prior, incumbent firm—unless the requirement had always been serviced by that district. Conversely, officials at an SBA district office that services relatively few tribal 8(a) firms told us that they have not turned down any offer letters that violate this new regulation, but that they also would not necessarily know if the incumbent was a sister firm given the information they can access in the 8(a) tracking system.

SBA headquarters officials are aware of the limitations of the data system and told us that they are currently developing a new system that is intended to provide a more global view of tribal entities to the officials at all district offices. They are also considering ways to access more information on a contract's procurement history, including linking their new system to FPDS-NG to obtain more information on 8(a) contract awards. Officials reported that, as of September 2011, they were in the process of awarding a contract to develop the system; they estimated it would be operational between September 2012 and January 2013.

Further, SBA regulations require procuring agencies to discuss the requirement's acquisition history, if any, in their 8(a) offer letter and information on any small business contractors which had performed the requirement in the past 2 years.³⁷ In some cases, however, we found that contracting officers did not include the complete procurement history in their offer letters to SBA even when the requirement had been performed by a prior 8(a) contractor. For one contract we reviewed, the contracting

³⁷ These regulations were in place prior to the revisions in SBA's 2011 final rule and were used to determine if other small businesses would be adversely impacted by accepting the requirement into the 8(a) program. 13 CFR § 124.502(c)(9) and 13 CFR § 124.502(c)(10).

SBA Cannot Implement New Rules Intended to Strengthen 8(a) Role in Joint Ventures with Current Information

officer had provided no acquisition history in its offer letter to SBA even though he told us that the requirement had previously been performed by the same contractor under another contract awarded by a different agency. He explained that he did not provide the procurement history to SBA because his office had no acquisition history with the requirement. In another example, the contracting officer told SBA there was no acquisition history for the procurement; however, documents in the contract file showed that the agency clearly considered it a follow-on requirement. The contracting officer could not recall why no acquisition history was included in the SBA offer letter, but noted that the scope of work had significantly expanded. SBA district officials also told us that they do not always receive complete procurement history information. In some cases, this is because agency contracting officials are unaware of the full procurement history, which can be a result of contracting officer turnover. Without access to a complete and accurate procurement history, SBA district offices will have difficulty enforcing this new regulation.

Non-8(a) businesses can create a mentor-protégé joint venture with an 8(a) firm to win 8(a) prime contracts. In 2006, we reported that there was a risk that large businesses could take advantage of the 8(a) status of firms for their own benefit and that SBA may not obtain the information necessary to determine if the partnership is working as intended.³⁸ SBA officials told us that they had seen cases where the non-8(a) partner in a joint venture was performing the vast majority—80 to 90 percent—of work on a contract. SBA's new rules require that the 8(a) partner in certain kinds of joint ventures perform a specific portion of the work. Application of this new rule depends on whether the joint venture is *populated* (i.e., it is a separate legal entity that has its own employees) or *unpopulated* (i.e., it merely exists through a written agreement and would use the employees of the 8(a) and non-8(a) partners). The new regulation specifies that the 8(a) partner in (1) an unpopulated joint venture or (2) a populated joint venture with one or more administrative personnel, must perform at least 40 percent of the work performed by the joint venture.

³⁸ [GAO-06-399](#). In another report, also issued in 2006, we found that SBA had not carried out its responsibilities to monitor an 8(a) joint venture, mentor/protégé partnership that had won a \$354 million sole source contract where the protégé firm did not appear to be getting the beneficial experience expected. See GAO, *State Department Contract Awarded for Security Installation at Embassies Awarded to 8(a) Joint Venture*, [GAO-07-33R](#) (Washington, D.C.: Nov. 8, 2006).

The previous regulations simply stated that the 8(a) partner must perform a “significant portion” of the contract.³⁹ SBA officials believe that this is an improvement because it gives an exact measure of how much work should be done by the 8(a) partner, to better ensure that the firm receives significant benefit from the venture. However, the agency does not have the information necessary to implement this new requirement.

SBA relies on information from 8(a) firms on their joint venture agreements, but SBA officials told us that they do not always get the information they need to determine how the work would be performed. For example, one joint venture mentor-protégé agreement we reviewed—approved by SBA but formed prior to the new rule—stated that the 8(a) firm would have full responsibility in overseeing performance of any contract awarded to the venture. It further stated that the 8(a) partner would perform at least 51 percent of the work for the contract, but did not provide any details on how the work would be divided. Questions were subsequently raised about this joint venture. In 2008, DCAA—at the request of Army officials who had concerns about the amount of work the tribal 8(a) firm in this joint venture would perform—found that there was not enough financial information available to perform an assessment of either the joint venture or tribal 8(a) firm. DCAA noted, however, that the 8(a) firm had only one employee and that a majority of its work had been subcontracted.⁴⁰ An SBA official from the district office overseeing the firm said the agency generally receives an annual statement that a firm is complying with joint venture requirements, but does not receive further information on how the work is split between the 8(a) and non-8(a) partner. SBA officials acknowledge having little insight into how joint

³⁹While the new rule specifies that the 8(a) partner in a populated joint venture with administrative personnel must perform at least 40 percent of the work, the new rule does not address the amount of work the 8(a) partner must perform in a joint venture populated with employees intended to actually perform the contract work. For these joint ventures, the 8(a) participant must demonstrate what it will gain from performance of the contract and how this will assist in its business development. The new rule also states that the 8(a) participant must demonstrate that it controls the joint venture. 13 CFR § 124.513 (d)(1).

⁴⁰ SBA records we reviewed showed that the 8(a) firm had grown to almost 100 employees in 2010.

venture partners share the work, making it difficult to enforce new regulations.⁴¹

The new rule also requires that, for populated joint ventures, the non-8(a) firm and its affiliates cannot receive subcontracts at any level—first tier or below—under a joint venture 8(a) contract.⁴² For example, the new rule would be violated if a joint venture subcontractor further subcontracted work to a firm that was an affiliate of the non-8(a) partner. Thus, enforcing this rule requires knowledge of all subcontractors at all levels, as well as the ability to identify whether any of the subcontractors are affiliated with the non-8(a) partner. Given SBA's limited insight into subcontracting on 8(a) contracts, this new regulation will be hard to enforce. SBA officials state that they do not see information on planned subcontractors, noting that this information may be included in the contract proposal, which they currently do not review. They also acknowledged that a significant amount of research would be required to uncover any relationship between the non-8(a) firm and all levels of its subcontractors and affiliates. According to SBA headquarters officials, district officials could request contract proposals that would include more information on the planned subcontractors. However, SBA officials do not receive information on changes to the planned subcontractors after contract award.

SBA Has Not Addressed Previously Identified Issues

While the new regulations address certain issues pertaining to the primary and secondary lines of business under which 8(a) firms can operate, the rules' impact on tribal firms, given their special advantages in the program, are not clear. Specifically, SBA has not addressed, in regulation or otherwise, issues we raised in our 2006 report regarding (1) the need for SBA to track the various industries under which multiple 8(a) subsidiaries of one tribal organization are generating revenue and (2)

⁴¹ The new SBA rules require the 8(a) participant in a joint venture to annually, and at contract completion, describe how it is meeting or has met the performance of work requirements for 8(a) contracts performed as a joint venture. However, SBA officials did not explain whether or how they will use this reporting requirement to ensure compliance with the new regulations.

⁴² The final rule provides an exception to this rule if SBA determines that other potential subcontractors are not available, or the joint venture is populated only with administrative personnel.

SBA Still Has Not Addressed
Need to Track Revenue
Generators

SBA's statutory requirement to determine if firms in a tribal organization will obtain a substantial unfair competitive advantage in an industry.

In 2006, we reported that SBA was not tracking the business industries in which ANC subsidiaries won 8(a) contracts under secondary NAICS codes. Thus, SBA was not ensuring that a firm's secondary NAICS codes did not, in effect, become the primary business line under which the firm generated the majority of its revenue. Prior to the recent regulatory changes, if an 8(a) firm outgrew its primary NAICS code, it could still operate in the program and be awarded contracts under one or more of its secondary NAICS codes, as long as it qualified as small for these secondary codes.⁴³ The new regulations now state that, when an 8(a) participant outgrows the size standard for its primary NAICS code, SBA considers that firm to have met its goals in the program, and SBA may graduate the firm prior to the expiration of its program term. Although this change may shorten the length of time that a tribal 8(a) firm is in the program, its impact is not clear because tribal entities can simply create a new subsidiary with a different stated primary industry, and the subsidiary can continue to work in any industry under secondary NAICS codes.⁴⁴ Conversely, non-tribal 8(a) firms can only own one 8(a) firm in a lifetime.

A second regulatory change allows 8(a) participants to change their primary NAICS code if they can show that they have been performing work in a different industry.⁴⁵ Previously, the primary NAICS code identified at the time of application was in effect through the firm's tenure in the 8(a) program. For tribal 8(a) firms, this new requirement means that, if they are outgrowing the size standards for their initial primary NAICS code, they can change to a secondary code with larger size standards to stay in the program (as long as it is not the same primary code as a sister subsidiary). However, SBA officials have said that firms will have to show that they are moving into a new industry through a thoughtful process and that outgrowing the size standard cannot be the

⁴³ A firm outgrows its primary NAICS code when it exceeds the size standard for that NAICS code for three successive program years.

⁴⁴ New tribal 8(a) firms cannot operate under the same primary NAICS code as a sister firm that has already been admitted to the program or that graduated within the last 2 years.

⁴⁵ This is demonstrated when a majority of a firm's revenues during a 2-year period has evolved from its former primary code to another code in a different industry.

only reason for changing their industry as this would not be in the spirit of the 8(a) program. At the same time, 8(a) firms are allowed to pursue multiple, diverse lines of business in an unlimited number of secondary NAICS codes. We found that one tribal firm in the 8(a) program had 49 declared NAICS codes, including industrial building construction, investigation services, and religious organizations. Another firm reported 25 different NAICS codes under which it may pursue work, including computer and software stores, advertising agencies, and educational support services.

While the regulatory changes are a step in the right direction in enforcing and enhancing the business development aspects of the program, SBA has not taken steps to address a key finding and recommendation from our 2006 report pertaining to tracking secondary lines of business of 8(a) firms under the same ANC. We reported that SBA was not tracking revenue generated under these firms' secondary lines of business. Thus, SBA was not ensuring that a firm's secondary NAICS codes did not, in effect, become the primary business line by generating the majority of revenue. This situation could allow for a tribal organization to have more than one 8(a) subsidiary perform most of its work under the same primary NAICS code, which SBA regulation does not allow. We recommended that SBA collect data on primary revenue generators for 8(a) ANC firms to ensure that multiple subsidiaries under one parent company were not generating their revenue in the same industry.

SBA systems that track 8(a) participant data do not collect information on the industries in which firms generate their income. In fact, in reviewing annual reports that tribal 8(a) firms had submitted to SBA, we found cases where multiple 8(a) firms under the same tribal entity reported generating most of their revenue in the same industry. For example, SBA records showed that six 8(a) firms under one ANC parent entity generated most of their 2009 revenue in the same lines of business, although each firm has declared a unique primary industry. Table 4 shows the declared primary revenue and actual main revenue generators for 2009 for each subsidiary.

SBA Has Not Articulated a Process for Addressing the Statutory Requirement to Determine Unfair Competitive Advantage

Table 4: Example of the Declared Primary Industries and Actual Revenue Generators of 8(a) Subsidiaries under One ANC Parent Entity

	Declared primary industry	Primary revenue-generating industry, 2009
Subsidiary A	Site preparation contractors	Commercial and institutional building construction
Subsidiary B	Industrial-building construction	Commercial and institutional building construction
Subsidiary C	Facilities support services	Commercial and institutional building Construction
Subsidiary D	Highway, street, and bridge construction	Commercial and institutional building construction
Subsidiary E	Engineering services	Facilities support services
Subsidiary F	Commercial and institutional building construction	Facilities support services

Source: GAO analysis of SBA files.

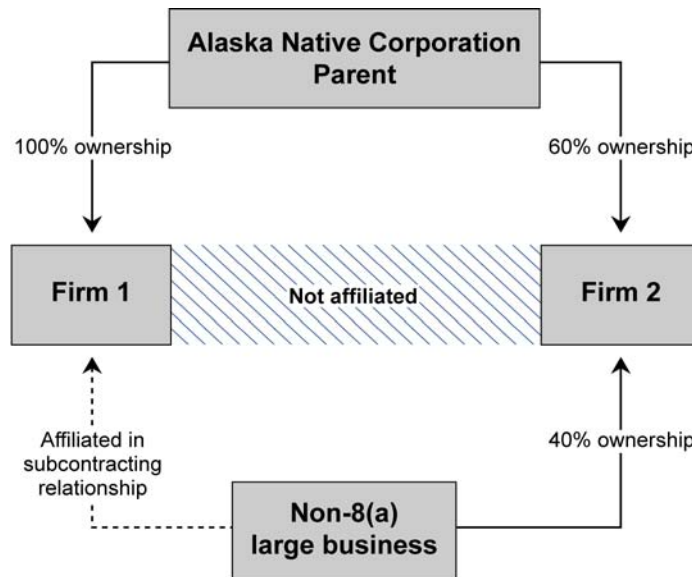
SBA has not addressed another recommendation we made in 2006 as to how it will comply with an existing law requiring the Administrator to determine whether and when one or more ANC firms are obtaining, or are likely to obtain, a substantial unfair competitive advantage in an industry. “Substantial unfair competitive advantage” is not clearly defined in statute or regulation.⁴⁶ We found that the SBA Administrator has never made this determination, nor is there a process in place to do so. Making such a determination would result in all the subsidiaries under a tribal entity being considered affiliated and thus no longer considered independent for size purposes. A finding of affiliation with the parent organization or a sister 8(a) firm could result in a tribal 8(a) firm exceeding small business size standards and not being eligible for 8(a) contracts.

In our current review, we found a few cases where the SBA district office had made such an affiliation determination between tribal 8(a) firms and related non-8(a) firms. In one case, SBA’s Alaska district office found affiliation between a tribal 8(a) firm and its part-owner, a business that had previously graduated from the 8(a) program. In another complex situation, a tribal 8(a) firm was 40 percent owned by a large business that was also a subcontractor to one of the 8(a) firm’s sister subsidiaries. SBA eventually determined that there was affiliation between the large

⁴⁶ 15 U.S.C. § 636(j)(1)(J)(ii)(II) and 13 C.F.R. § 124.109(c)(2)(iii).

business and the sister subsidiary, resulting in the two firms' revenues being considered together for the sister firm's size standard determination. As a result, SBA rejected a contract offer for the sister subsidiary where the large business would be a subcontractor, because the firm could not meet the size standards when its revenues were jointly considered with those of the large business. Figure 6 illustrates the relationships between the parent entity, the 8(a) firm and its sister subsidiary, and the large business.

Figure 6: Example of Relationship between Large Business and Tribal 8(a) Firm That Were Found Affiliated



Source: GAO analysis of SBA documentation.

Because SBA has not taken steps to more rigorously determine how to ascertain substantial unfair competitive advantage, there is a risk that tribal 8(a) firms are being considered independent for size determinations when they should be considered affiliated. SBA officials told us that they are in the early stages of drafting a policy that will outline the process for making determinations of unfair competitive advantage.

SBA Has Not Considered Whether Tribal 8(a) Firms' Large Business-Like Practices Are Consistent with the Business Development Purpose of the 8(a) Program

In 2006, SBA officials told us that the charter of ANCs under ANCSA—economic development for Alaska natives from a community standpoint—can be in conflict with the business development intent of the 8(a) program. We pointed out ways that ANCs use the 8(a) program differently than individually owned 8(a) businesses do. Congress has stated that the 8(a) program purpose is exclusively for business development purposes to help small businesses owned and controlled by the socially and economically disadvantaged to compete on an equal basis in the mainstream of the American economy. SBA, in changing its rules to disallow the award of follow-on contracts to tribal 8(a) sister subsidiaries, stated that it expects that two or more firms under the same tribal organization are to operate and grow independently, in line with the business development purposes of the 8(a) program. However, we found other practices, not addressed under the regulations, that highlight the particular nature of tribal 8(a) firms' interconnectedness. These practices result in some firms essentially operating like large businesses and not developing as independent 8(a) firms. For example, the tribal firms often have common management and subcontract with each other or otherwise draw resources from one another or from the parent corporation. Access to these additional resources can help promote their significant business growth over a short period of time, sometimes resulting in firms leaving the 8(a) program early after outgrowing their size standards. By not participating in the transition phase of the program, these firms are missing out on some of the business development aspects of the program, such as competing for non-8(a) contracts to demonstrate their progress in developing into viable businesses that are not solely reliant on the 8(a) program.

SBA headquarters officials recognize that tribal 8(a) firms have some advantages over other 8(a) firms because of the resources they can draw from their parent organization and sister firms. But SBA has not determined whether these other practices we identified are congruent with the business development purpose of the 8(a) program. SBA officials look at individual firms during annual reviews, but do not consider the consequences of their interconnectedness with sister subsidiaries and the parent company in the areas discussed below.

Common Management of Sister Subsidiaries

One way firms under tribal organizations are generally interconnected is through common management. Common management was evident in many of the tribal 8(a) firms' applications we reviewed. For example, the manager of one 8(a) firm also served as Chief Executive Officer to three sister subsidiaries under the same parent, including a sister subsidiary that provides administrative support services to the "family of

companies.”⁴⁷ This practice of common management is a key factor in tribal 8(a) firms’ ability to show potential for success in the 8(a) program. SBA requires applicants to show potential for success by having at least 2 years of experience in their primary industry or by showing that their managers have technical and management experience in that industry, among other things. Of the 62 tribal 8(a) firms we reviewed, 44 entered the 8(a) program with less than 2 years of experience in their primary industry. Most of the firms demonstrated potential for success by showing corporate managers’ significant experience in the stated primary industry through work with a sister subsidiary. For example, in considering an applicant that was applying to the 8(a) program just 6 months after it was organized, SBA pointed to the extensive managerial and technical experience of the firm’s president, including his previous position as vice president to a sister subsidiary. Further, the interconnectivity of some tribal 8(a) firms is also evident where the same board members oversee multiple firms under their parent entity. For example, we found that a member of the board of directors had served on the board of three different 8(a) subsidiaries, while also serving as a member of the board of directors for the parent entity.

Using Sister Subsidiaries for Subcontracting and Past Performance

Another way tribal 8(a) firms become interconnected is through subcontracts with their own sister subsidiaries. During negotiations with the Army for an 8(a) contract, one tribal firm noted its ability to quickly subcontract with its sister firms as a benefit. We found that some tribal firms demonstrated their potential for success when they did not have 2 years in business, using these subcontracts as a record of successful performance in their primary industry. Of the 44 firms we reviewed that entered the program with less than 2 years of experience in their industry, we identified 20 that had obtained some initial experience through subcontracts with a sister subsidiary. For example, we reviewed seven firms owned by one Indian tribe, and five of those seven firms used subcontracts from sister firms to demonstrate their ability to successfully perform work in their primary industry.

⁴⁷ Federal laws provide that a tribal 8(a) firm may own more than one firm eligible for assistance from the 8(a) program if, among other things, the individuals responsible for the management and daily operations of the concern do not manage more than two program participants. We did not assess whether these individuals met the requirements for management and control of the daily operations of the tribal 8(a) firm.

Capitalizing on Corporate
Resources and “Brand” to
Promote Business

As another example of firms’ interconnectedness, we found that tribal 8(a) firms can leverage subcontracts from sister subsidiaries to generate required percentages of non-8(a) revenue as the firm progresses in the 8(a) program. During the last 5 years in the program, known as the transition period, firms are required to obtain a certain percentage of non-8(a) revenue to demonstrate their progress in developing a viable business that is not solely reliant on the 8(a) program. In one example, a firm did not meet its non-8(a) revenue requirements in its seventh year in the program. Consequently, the SBA district office placed the firm under remedial action, wherein it was ineligible to receive sole-source 8(a) contracts. However, SBA reinstated the firm after a sister subsidiary awarded it a \$20 million subcontract that boosted its non-8(a) revenue to the required annual level. The firm then regained its eligibility to receive sole-source 8(a) contracts.

Tribal 8(a) firms may also cite the past performance of sister firms to demonstrate their own capability to perform under an 8(a) contract. In our review of contract files, we found a number of examples where firms pointed to the past performance of sister subsidiaries in their proposals to demonstrate their capability. One firm, in its business plan presented to SBA, pointed out that leveraging the past performance of a sister company was extremely important as a basis for demonstrating capability to perform. The firm noted that during its first 2 months of operation, it was often asked to provide past performance documentation and that “this is a requirement that is obviously difficult to meet given that we are a brand new company that has only been just recently certified and approved to begin accepting contracts.” Another firm pointed out that it had an advantage over competitors because of the history of successful contract performance by sister subsidiaries.

Some tribal 8(a) firms promote the fact that they are part of a larger corporate brand and can access resources from their parent organization and sister firms. Even though tribal 8(a) firms must be “small” under the SBA size standard for their primary industry, their ability to leverage these additional resources can vastly increase the breadth and depth of their capabilities. As the following examples show, the firms can operate, in effect, more like large businesses.

- One ANC 8(a) firm reported to SBA that it is without “geographical limitations as the ANC presence has been established in 49 states. [The firm] will continue to work with its existing customer base as well as network with agencies familiar with the ANC name.”

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- One ANC firm reported the intention to transfer staff and management from other subsidiaries as workloads dictate, “with reach back capabilities to access 6,700 employees nationwide and the means of accessing many in-house subject matter experts when necessary.” In another contract, the same firm advertised to a procuring agency that its resources included over 7,000 employees at over 90 locations in 31 states to support construction projects. For a different ANC 8(a) firm, procuring agency officials noted that the firm had 4,000 employees it could draw from to perform the contract.
 - One firm owned by an Indian tribe, in describing its prior experience, advertised in its proposal to the Army the overall success of firms under the parent entity in providing services to the federal government and managing contract employees. The firm also stated in the proposal that its performance on the contract would be at the same high level as its successful sister firm that had graduated from the 8(a) program, as the firms share the same senior management.
 - One ANC has a marketing and proposal services center that is dedicated to supporting all of its subsidiaries in developing cost and technical proposals for government contracts. This ANC also designated an employee to act as the sole point of contact to the SBA for all correspondence and filings for seven of its 8(a) subsidiaries.
 - An ANC firm stated in its business plan that a benefit of its organizational structure is the ability to operate as a small company while having access to corporate backing “that typically only a large, seasoned company can provide.” Another firm—in its capabilities briefing to a procuring agency—advertised that while the firm is an 8(a) small business, it operates within a resource environment of a large business.
 - In its business plan to SBA, an ANC 8(a) firm listed some large businesses as primary competitors in its market, including Lockheed Martin, Northrop Grumman, CACI and General Dynamics.

Tribal 8(a) Firms Can Quickly Outgrow the 8(a) Program

Access to these additional resources, plus the special advantages afforded tribal 8(a) firms, can help promote their significant business growth in the 8(a) program over a short period of time. For example, one tribal 8(a) firm reported average revenues of \$31,000 from landscaping contracts when entering the program in 2009. Subsequently, the firm received a \$500 million contract for construction. In 2011, the firm reported sales of \$21.3 million, an increase of 764 percent from the previous year. In another example, a firm had one employee when it applied to the 8(a) program, but had grown to 124 employees by its first annual review by SBA.

Many tribal 8(a) firms have left the program prior to completing the full 9 year term. Table 5 shows that of the 165 tribal 8(a) firms that have left the program, 70 left prior to completing the full 9 year term. Furthermore, more ANC firms withdrew or graduated from the program early than completed the 9 year term.

Table 5: Summary of Tribal 8(a) Firms That Have Left the Program

	ANC	Indian tribe	NHO	Total
Firms completing full 9 years of program	60	22	3	85
Firms that withdrew or graduated early	64	6	0	70
Firms that were terminated ^a	5	5	0	10
Total firms	129	33	3	165

Source: GAO analysis of SBA data.

^aSBA may terminate a firm's participation in the 8(a) program for a number of reasons, including submitting false information in its 8(a) application and failing to maintain eligibility for program participation.

For some tribal 8(a) firms, their rapid growth prevents them from reaching the transition phase of the 8(a) program because they have outgrown the small business size standards. The small business regulation states that to ensure participants do not develop an unreasonable reliance on 8(a) awards and to ease their transition into the competitive marketplace after graduating from the 8(a) program, participants must make maximum efforts to obtain business outside the 8(a) program. As a result of withdrawing from the program early, these firms never have to compete for contract awards and thus do not experience some of the intended business development aspects of the 8(a) program. For example:

- In its review of an ANC firm's third year in the 8(a) program, SBA found that the firm had average annual revenue of \$78.4 million, which exceeded its small business size standards. Furthermore, SBA pointed out that the firm likely would not meet its targets for non-8(a) revenue once it reached the transition phase and recommended early graduation from the program as a result of these factors. During the firm's time in the program, 99 percent of its revenue came from 8(a) contracts.
- SBA stated in its analysis of another ANC firm's 8(a) application that rapid growth could be a weakness, as subsidiaries under the firm's parent entity tended to grow too large to continue in the 8(a) program after just 4 to 5 years. This firm had reported \$318 million in revenue from 8(a) contracts in its third year in the program, and SBA recommended that the firm be graduated early from the program as it

was no longer a small business. However, the firm remained in the program for one more year.

- In another example, an ANC firm voluntarily withdrew from the 8(a) program after almost 4 years. In commenting to SBA about its experience, the firm suggested that SBA should increase size standards for industries because of the size of large government contracts that tribal firms win.

For tribal 8(a) firms that do continue to the transition phase, some have difficulty meeting non-8(a) revenue requirements because they were awarded large 8(a) sole-source contracts in their early years in the program. In one example, a tribal firm reported to SBA that large 8(a) sole-source contracts were taking up a lot of its existing labor pool, not allowing it to seek non-8(a) contract opportunities. Another firm did not meet its non-8(a) revenue requirements in the transition years, and SBA district officials eventually recommended that this firm voluntarily withdraw as officials believed the firm had not complied with the spirit of the 8(a) program. When a firm does not meet its non-8(a) revenue requirements, it is generally prohibited from receiving further sole-source contracts. However, we found that in 2009, SBA accepted an offer from the Army for a \$45 million sole-source award on behalf of a firm that had not met its non-8(a) revenue requirements. SBA district officials thought they may have accepted the offer on behalf of the firm because of severe financial hardship, but they could not locate the file to determine the exact reason.

Conclusions

It has been more than 20 years since Congress began granting tribal firms special advantages under the 8(a) program. The steady growth in government obligations to these firms, largely through sole-source contracts, draws attention to policies that are designed to promote small businesses and the need to spend taxpayer dollars wisely. SBA has taken some steps, based on our earlier recommendations, to clarify program rules, including the need for monitoring the limitations on subcontracting. However, contracting officers generally are not performing the monitoring—often because of confusion about how to go about doing so and a lack of clarity in existing regulations, particularly with respect to indefinite quantity contracts. Not monitoring the limitations on subcontracting can pose a major risk that an improper amount of work is being done by large business subcontractors under large-dollar value, sole-source contracts to tribal 8(a) firms.

Tribal firms, because of their special advantages in the 8(a) program, can operate under more complex contracts and business relationships than

typical 8(a) firms, making oversight difficult. SBA's recent revisions to the 8(a) regulations are intended to address several issues we had raised in the past regarding improved oversight of ANC 8(a) contracting that also apply to all tribal 8(a) firms. However, SBA does not have a way to track the information it needs and lacks clear procedures to deter certain prohibitions addressed in the regulations—for example, sister subsidiaries winning follow-on sole-source contracts and joint-venture partners unduly benefiting from their 8(a) partners' contracts by performing most of the work or improperly subcontracting to an affiliate. The new 8(a) tracking database, which is in the initial stages of development, could, if structured to capture key information, better position SBA to implement these new regulations and to address issues we identified, such as tracking revenues from tribal 8(a) firms' primary and secondary industries. Further, when agencies do not provide the full acquisition history in offer letters, SBA may not have the necessary information to enforce the new regulations. Finally, while SBA officials recently told us they are in the early stages of drafting a policy that will outline a process for determining unfair competitive advantage, SBA still has not addressed in its regulations the process for implementing the statutory requirement to determine whether substantial unfair competitive advantage exists for one or more tribal 8(a) firms.

Finally, some tribal 8(a) firms effectively operate as large firms in a small business program. The practices we have identified, such as capitalizing on corporate resources to promote business and using sister subsidiaries for subcontracting and past performance, are currently allowed, even under SBA's revised regulations. However, it is within SBA's purview as the agency statutorily authorized for the 8(a) program to determine if these practices are congruent with the purpose of the 8(a) program—which is to develop sustainable, small, disadvantaged businesses in the U.S. economy.

Recommendations for Executive Action

To improve oversight of the limitations on subcontracting clause and to clarify who has responsibility for monitoring compliance with the clause, we recommend the Administrator of the Office of Federal Procurement Policy, in consultation with the Administrator of SBA, take the following two actions:

1. Provide specific guidance (including data collection options) to agency officials, including to contracting officers, about how to monitor the extent of subcontracting under 8(a) contracts, including for orders under indefinite quantity contracts.

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2. Take actions to amend the FAR to (1) direct contracting officers at agencies that have been delegated responsibility for ensuring compliance with the limitations on subcontracting clause to document in the contract file the steps they have taken to ensure compliance and (2) clarify the percentage of work required by an 8(a) participant under indefinite quantity contracts.

To improve oversight of tribal firms' participation in the 8(a) program, we recommend that the Administrator of SBA take the following five actions:

1. As the new 8(a) tracking database is being developed, take steps to ensure that it has the capability to
 - provide visibility to district offices into all tribal 8(a) firms' activity by tribal entity to ensure compliance with new prohibition to award sole-source 8(a) follow-on contracts to sister subsidiaries;
 - track revenue from tribal 8(a) firms' primary and secondary industry codes to ensure that subsidiaries under the same parent company are not generating the majority of their revenue from the same primary industry; and
 - track information on 8(a) contracts and task or delivery orders, including orders awarded under basic ordering agreements, to help ensure that district officials have information necessary to enforce the 8(a) program regulations.
2. In light of the new prohibition on awarding 8(a) sole-source follow-on contracts to sister subsidiaries, reinforce to procuring agencies the requirement to provide the full acquisition history of the procurement in the offer letter, when available, and direct district office business development specialists to focus on this issue when they review offer letters for tribal 8(a) firms.
3. Establish procedures to enforce new joint venture rules, including how SBA district officials will ascertain that the 8(a) partner performs the required percentage of the joint venture's work and, for populated joint ventures, that the non-8(a) partner and its affiliates do not receive subcontracts under the 8(a) contract.
4. Examine relationships between subsidiaries under tribal entities to determine whether practices such as subcontracting to a sister subsidiary or using the past performance of a sister subsidiary to show capability to perform on an 8(a) contract are in line with the business development purposes of the 8(a) program and should be allowed under program rules. If SBA determines that these practices are not in line with the 8(a) program purposes—and to the extent that

Congress has not authorized a practice in law—SBA should address them in its regulations.

5. Establish and communicate to Congress the time frame for developing and implementing SBA's new, planned policy regarding determination of substantial unfair competitive advantage in an industry, and when the policy will be incorporated into the regulations.

Agency Comments and Our Evaluation

We provided a draft of this report to SBA; OFPP; the departments of Agriculture, Defense, Energy, Health and Human Services, Homeland Security, Justice, Labor, and State; and the Social Security Administration. We received written comments from SBA, which are reproduced in appendix II. SBA did not address our recommendations. OFPP provided comments on our recommendations via email. The Social Security Administration provided technical comments, which we incorporated as appropriate. The other agencies responded with no comment.

In written comments, SBA provided background information pertaining to the history of Indian tribes' and ANCs' special preferences and their purpose in the 8(a) program. We believe this information is adequately reflected in our report. Although the SBA did not specifically comment on our recommendations, it stated that it will work with us to further strengthen its administration of the 8(a) program. SBA also stated that it will make changes as necessary to continue its efforts to eliminate waste, fraud, and abuse and to ensure that the 8(a) program is operating according to its statutory intent, but did not specify what these actions would entail. In addition, SBA stated that it is fully committed to implementing all of the provisions of its March 2011 regulations, but did not specifically address the issues we raised that may impede such implementation or our related recommendations.

SBA also acknowledged the challenges in administering the 8(a) program with respect to tribal entities because the purpose of including tribally owned entities in the 8(a) program can be contradictory to the program's business development purpose. We recognize in the report that 8(a) businesses owned by tribal entities have special preferences in the program. However, we also note that these entity-owned businesses are subject to the business development purpose of the 8(a) program. This requirement led to our recommendations that SBA determine whether certain practices we found that are currently allowed under the 8(a) regulations—such as firms subcontracting to a sister subsidiary—are consistent with the business development purpose of the 8(a) program.

SBA also commented that its foremost concern with our report was our use of a nonprobability sample, with the suggestion that this sampling technique can be biased based on the judgment of the sampler and that we used this technique to generalize results for tribal 8(a) firms. We strongly disagree. Our use of a nonprobability sample was a sound methodological approach to address our reporting objectives. Nonprobability samples are appropriate to provide illustrative examples or to provide information on a specific group within a population. We used this sampling technique to balance a sample that was large enough to provide a sufficiently comprehensive understanding of the issues with one that was small enough to study within our time and resource constraints. Further, we took a number of steps to ensure the factual accuracy of our findings, including traveling to locations where contract files were located so that we had access to the complete available records and the ability to ask follow-up questions as appropriate to ensure that we did not misinterpret or misrepresent any information in the files. Appendix I of the report sets forth the many steps we took to ensure that our contract file and tribal 8(a) file samples were selected in a non-biased, transparent, and objective manner. In accordance with generally accepted government auditing standards, we appropriately state the results of our work in the report, including the clear statement that our results are not generalizable to the population of tribal 8(a) firms. We did not attempt to generalize our results because that approach was not necessary to meet our objectives.

In an email response, OFPP generally agreed with our recommendations and with our conclusion that steps need to be taken to provide clarity to the acquisition community regarding limitations on subcontracting. OFPP also noted that steps need to be taken to strengthen the application of these requirements to all small business set-aside programs in FAR Part 19. Regarding our recommendation that OFPP provide guidance on how to monitor the extent of subcontracting, OFPP noted that agency officials other than contracting officers—such as agency offices that perform acquisition management reviews and SBA officials—would also be interested parties. We agreed and modified our recommendation to include “agency officials” and not only contracting officers. OFPP stated that it intends to work with the FAR Council and the Chief Acquisition Officers Council to review the roles of various agency officials and evaluate strategies for monitoring and receiving data about the percentage of work performed by a small business prime contractor. It also stated that, with respect to data collection, it anticipates seeking input from the public on strategies to receive and monitor data regarding the percentage of work performed by small business prime contractors.

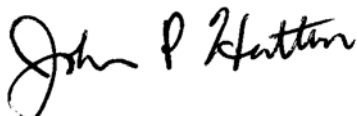
OFPP added that, in taking this action, it intends to minimize the burden on both small businesses and agencies.

OFPP also commented on our recommendation that it take actions to amend the FAR to direct contracting officers to document steps taken to ensure compliance with the limits on subcontracting and to address monitoring requirements for indefinite quantity contracts. OFPP stated that it intends to ask that the FAR Council open a case so that appropriate regulatory refinements may be made to support improvements in the implementation of the limitation on subcontracting. OFPP stated that this action will include reviewing existing clauses that implement the limitation, considering alternatives for collecting information, and documenting steps taken. OFPP also plans to obtain comments from the public, including small businesses, as it develops amendments and evaluates alternatives that can accomplish goals in the least burdensome manner for industry and agencies. Consistent with our recommendation, OFPP plans to clarify in the FAR the percentage of work required by an 8(a) participant under an indefinite quantity contract, but OFPP asked that the recommendation be amended to allow the FAR Council and SBA to work together to determine the best way to clarify this point. We agreed that this would be appropriate and modified the recommendation to reflect this approach.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 7 days from the report date. At that time, we will send copies of this report to interested congressional committees; the Secretaries of Agriculture, Defense, Energy, Health and Human Services, Homeland Security, Labor, and State; the Administrator of SBA; the Attorney General; the Commissioner of the Social Security Administration; and the Acting Director of the Office of Management and Budget. This report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report or need additional information, please contact me at (202) 512-4841 or huttonj@gao.gov.

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Staff acknowledgments are provided in appendix III.

A handwritten signature in black ink, reading "John P. Hutton". The signature is written in a cursive style with a large, stylized "J" and "H".

John P. Hutton
Director
Acquisition and Sourcing Management

List of Congressional Requesters

The Honorable Claire McCaskill
Chairman
Subcommittee on Contracting Oversight
Committee on Homeland Security and Governmental Affairs
U.S. Senate

The Honorable Mark Begich
U.S. Senate

The Honorable John McCain
U.S. Senate

The Honorable Darrell E. Issa
Chairman
The Honorable Elijah Cummings
Ranking Member
Committee on Oversight and Government Reform
House of Representatives

The Honorable Edward J. Markey
Ranking Member
Committee on Natural Resources
House of Representatives

The Honorable Edolphus Towns
House of Representatives

The Honorable Don Young
House of Representatives

Appendix I: Scope and Methodology

The objectives of this review were to (1) identify trends in government 8(a) contracting with firms owned by Alaska Native Corporations (ANC), Native Hawaiian Organizations (NHO), and Indian tribes; (2) determine the reasons federal agencies awarded sole-source contracts to tribal 8(a) firms and the methods used to make price determinations; (3) assess the procuring agencies' oversight of tribal 8(a) contracts for compliance with subcontracting requirements; and (4) examine the Small Business Administration's (SBA) new 8(a) regulation, effective March 14, 2011, to determine how the changes could affect oversight of tribal firms and the extent to which previously identified problems are addressed. In this report, "tribal entities" refers to ANCs, NHOs, and Indian tribes. We use the term "tribal 8(a) firm" to refer to a firm that is majority-owned by an ANC, NHO, or Indian tribe. During the course of our work, we also discussed with procuring agency officials the potential impact of the recent Federal Acquisition Regulation (FAR) requirement for written justifications for sole-source 8(a) awards over \$20 million. This requirement was not applicable to the contracts we reviewed. We evaluated the administration of the tribal 8(a) program; the scope of our work did not include an evaluation of the program's merits.

To identify the trends in government tribal 8(a) contracting, we analyzed data from the government's procurement database—the Federal Procurement Data System-Next Generation (FPDS-NG) for fiscal years 2005 through 2010. To assess the reliability of the FPDS-NG we (1) reviewed related documentation, and (2) performed electronic testing on required data fields. We found the FPDS-NG data fields that identify firms owned by ANC, NHO, and Indian tribes to be unreliable because these data were not available during the entire time period. Subsequently, we requested that SBA provide Data Universal Numbering System (DUNS) numbers for 8(a) firms owned by ANC, NHO, and Indian tribes, in addition to mentor-protégé joint ventures that participated in the 8(a) program, for fiscal years 2005 through 2010.¹ We tested the reliability of these DUNS numbers by using them to search for the tribal 8(a) firms and joint ventures in the Central Contractor Registry and SBA's Dynamic Small Business Search database. We used these systems to verify the data SBA had provided, including to identify additional DUNS numbers that were not included among the data SBA had provided. We also requested

¹ A DUNS number is a 9-digit identification number assigned by Dun & Bradstreet, Inc., to identify unique business entities.

additional DUNS numbers from SBA on joint ventures with tribal 8(a) firms; however, the information provided was on all joint ventures in the 8(a) program. To select contracts for our sample that were awarded to joint ventures with at least one tribal 8(a) partner, we identified those that had obligations in fiscal year 2009 and then used the Central Contractor Registry to determine whether the joint venture was listed as owned by an ANC, Indian Tribe, or NHO. Once we substituted the compiled final list of DUNS numbers for the tribal 8(a) data fields, we determined that the FPDS-NG was sufficiently reliable to identify trends in tribal 8(a) contracting for fiscal years 2005 through 2010. We adjusted the obligation data for inflation using a gross domestic product price index with a base year of 2010.

To identify the reasons agencies have awarded 8(a) sole-source contracts to firms owned by ANCs, NHOs, and Indian tribes and the methods contracting officials use to determine fair and reasonable price, we selected and reviewed a stratified nonprobability sample of 87 contracts, 7 of which had been competitively awarded. This nonprobability sample was based upon contracts (1) with fiscal year 2009 obligations over the competitive threshold,² especially if those obligations exceeded \$100 million (fiscal year 2009 data were the most recent at the time) and (2) in locations where multiple tribal 8(a) contracts had been awarded. The majority of the contracts we reviewed (75) were with ANC firms; 10 were with Indian tribes, and 2 were with NHOs. The majority of contracts in our sample (62) were awarded at the Department of Defense (DOD). Our findings from the contract reviews are not generalizable to the population of all tribal 8(a) contracts.

We originally selected 90 contracts for review, 10 of which were coded as competitively awarded. In reviewing the source documentation, we found that two of the contracts had been incorrectly coded: one was not owned by a tribal entity and the other was not awarded through the 8(a) program. We eliminated these contracts from our sample. We also found that obligations under one indefinite quantity contract were listed as two separate contracts in our initial sample; therefore, this was counted as only one contract. Another three contracts had been incorrectly coded in

² The competitive 8(a) threshold is \$6.5 million for manufacturing or \$4 million for all other acquisitions.

FPDS-NG as competitively awarded or as sole-source. These three contracts remained in our sample.

The specific locations of the contracts in our review were as follows:

DOD:

- Air Force Metrology and Calibration, Heath, OH
- National Guard Bureau, Arlington, VA
- Defense Advanced Research Projects Agency, Arlington, VA
- Defense Supply Center, Philadelphia, PA
- Fleet and Industrial Supply Center, Pearl Harbor, HI
- Fort Sam Houston Army Base, TX
- Fort Wainwright Army Base, AK
- Joint Base Elmendorf-Richardson, AK
- Kirtland Air Force Base, NM
- MacDill Air Force Base, FL
- Marine Corps Systems Command, Quantico, VA
- Naval Facilities Engineering Command, Pearl Harbor, HI
- Redstone Arsenal Army Base, AL
- U.S. Army Corp of Engineers locations in Anchorage, AK; Alexandria, VA; Baltimore, MD; Fort Worth, TX; Philadelphia, PA; and Vicksburg, MS
- U.S. Army Research Development and Engineering Command, Natick, MA
- Washington Navy Yard, District of Columbia
- Wright-Patterson Air Force Base, OH

Civilian:

- Department of Agriculture's Forest Service, New Mexico
- Department of Energy's National Nuclear Security Administration-Service Center, New Mexico
- Department of Health and Human Service's Centers for Disease Control and Prevention Atlanta, GA; Centers for Medicare and Medicaid Services, Baltimore, MD; and Food and Drug Administration, Rockville, MD
- Department of Homeland Security's Bureau of Customs and Border Protection, Federal Emergency Management Agency, and Office of Procurement Operations, Washington, D.C.
- Department of Justice's Drug Enforcement Administration, Washington, D.C., and Federal Bureau of Investigation, Chantilly, VA
- Department of Labor's Office of Procurement Services, Washington, D.C.
- Department of State's Office of Acquisition Management, Arlington, VA

-
- Social Security Administration's Office of Acquisition and Grants, Baltimore, MD.

For the contracts in our sample, we examined contract file documentation, including acquisition plans, market research reports, and price negotiation memorandums. However, for three of the contracts we reviewed, one each at the Army Corps, Department of Homeland Security, and the State Department, pre-award information was completely missing from the files. For one of these, we were unable to determine whether or not it had been competitively awarded, as coded in FPDS-NG, because of the missing information. We also interviewed contracting officials, small business advocates, and program officials.

To determine the extent to which procuring agencies are overseeing tribal 8(a) contracts for compliance with the 8(a) program's subcontracting requirements, we reviewed and analyzed documentation for the contracts in our review, including acquisition plans, price negotiation memorandums, contractor proposals, and SBA offer and acceptance letters, in addition to any additional information pertaining to subcontractor monitoring. We also interviewed contracting and program officials, as well as agency small business advocates, about the methods they employ to monitor compliance. Additionally, we reviewed agency-specific guidance or operating instructions, various statutory provisions, the Federal Acquisition Regulation, and Title 13 of the Code of Federal Regulations. We also drew from the findings in our 2006 report on 8(a) contracting with ANC firms.³

To determine the extent to which SBA's new regulations could affect oversight of tribal firms' participation in the 8(a) program and to which previously identified problems have been addressed, we reviewed SBA documents, such as annual reviews and 8(a) program applications, for selected tribal firms. These firms were strategically chosen based upon their parent entity's (i.e., ANC, NHO, or Indian tribe) representation in our overall contract sample. We selected those firms whose parent entities had higher representation in our sample and those with less representation. Consequently, we examined the files for 49 ANC, 3 NHO, and 10 Indian tribe firms. For the ANC firms, the 49 firms fell under 11 parent entities. The results of our review are not generalizable to the

³ GAO, *Contract Management: Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight*, [GAO-06-399](#) (Washington, D.C.: Apr. 27, 2006).

population of tribal 8(a) firms. Moreover, we reviewed SBA regulations, operating procedures and business systems (such as the system used to process 8(a) applications), and interviewed officials at SBA headquarters and the Alaska, Hawaii, Oklahoma, New Mexico, and Washington, D.C., district offices. We also met or spoke with ANC, NHO, and Indian tribe representatives in three “town hall” meetings to explain the scope and methodology for this review. We did not assess the extent to which benefits from tribal 8(a) contracts flow to the parent entity.

We conducted this performance audit from October 2010 to January 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Small Business Administration

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

January 9, 2012

Mr. John Hutton
Director
Acquisition and Sourcing Management
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Hutton:

Thank you for the opportunity to comment on the draft Government Accountability Office (GAO) report entitled, "Federal Contracting: Monitoring and Oversight of Tribal 8(a) Firms Need Attention" (GAO-12-84).

While this report in large part mirrored the report issued by GAO in 2006¹, it also attempted to evaluate the 8(a) participation of tribally-owned and Native Hawaiian Organization (NHO)-owned companies, and address the Small Business Administration's (SBA's) recent regulatory changes to the 8(a) program.

The SBA has acknowledged on numerous occasions – including the 2006 GAO report² and subsequent testimonies – that tribally-owned companies have a different purpose in the 8(a) program than companies owned by individuals. This history and context of the participation of tribally-owned entities in the 8(a) Business Development program begins with the unique government-Indian tribe relationship. This relationship exists due to three fundamental legal bases: (i) "Article I, sec. 8, clause 3 [of the United States Constitution] provides Congress with the power to 'regulate Commerce ... with the Indian Tribes.'"³; (ii) the federal government has a "permanent trust relationship" with and to Native Americans⁴; and (iii) the willful and abhorrent treatment of Indians over the centuries that have placed Native Americans in a state of coerced dependency and this relationship was forced upon them.⁵

¹ GAO, *Contract Management: Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight*, GAO-06-399

² *Ibid.*

³ *Morton v. Mancari*, 417 U.S. 535, 552 (1974)

⁴ See *Report of the Task Force on Indian Economic Development of the U.S. Dept. of the Interior* (July 1986) at page 240

⁵ See *Cobell v. Babbitt*, 91 F. Supp. 2d 1, 7 (D.D.C. 7999), *aff'd*, 240 F.3d 1081

For these reasons, the United States has a long history of special treatment of Alaska Natives and other Native Americans. For more than 200 years, Congress has enacted laws pertaining only to Indians and to persons dealing with Indians and has justified these laws as necessary to fulfill the country's special obligation to its Native people and their descendants.⁶

In 1971, Congress passed the Alaska Native Claims Settlement Act (ANCSA). ANCSA established Alaska Native Corporations (ANCs) in part to resolve historical land disputes and facilitate entrance into the Western economic system. ANCSA's goals and the means used to effect its intent and deliver its benefits differ from most government programs. ANCSA's main goal is Native American self-determination through building a capital base in order to fully participate in our capitalist society.⁷ Recognizing that something was still required to achieve its goals, in 1988 Congress began to address some of the shortcomings of ANCSA and, in amending ANCSA, Congress stated that for all purposes ANCs and subsidiaries controlled by ANCs would be considered owned and controlled by Natives as a minority business enterprise. In 1992, Congress further amended ANCSA clarifying that ANCs and the businesses controlled by them would be "economically and socially disadvantaged," which eliminated the need for ANCs or their subsidiaries to prove they have this status.⁸

The mission of the SBA 8(a) Business Development Program is to assist eligible small disadvantaged business concerns compete in the American economy through the provision of business development assistance. Small businesses can benefit from a wide range of services the SBA offers, some of which include support for government contractors, access to capital, management and technical assistance, and export assistance. ANC participation in the SBA 8(a) Program is more challenging to put into context because of special provisions granted to ANCs by Congress.

The ownership structures of tribally-owned enterprises were created in response to a much broader mandate to address a wider range of interests than other minority-owned 8(a) firms. Tribal and ANC firms must operate and provide benefits that go far beyond the bottom-line of profitability. The special provisions which apply to tribal and ANC 8(a) contracting were tailored to take into account these differences and to take into account the federal Indian policy of promoting self-determination and economic self-sufficiency. The special provisions include different criteria which govern the admission of tribally-owned and ANC-owned small businesses into the 8(a) program, and they exempt such firms from the competitive threshold provisions that apply to individually-

⁶ See *AFGE v. United States*, 195 F. Supp. 2d 4, 78-20 (D.C. 2002), *aff'd* 330 F.3d 513 (D.C. Cir.), *cert. denied*, 540 U.S. 1088 (2003).

⁷ See H.R. Conf. Rep. 92-746, 92nd Congress, 1st Session, 37, reprinted in 1971 U.S. Code Cong. and Administrative News at 2247, 2259.

⁸ H.R. Rep. No. 102-673, 138 Cong. Rec. 1450, 1456 (1992). Also see 43 U.S.C. § 1626(e) (1) and (2).

owned firms and also establish different affiliation rules, which permit tribes and ANC's to own multiple 8(a) companies.⁹ Because of the ANC's automatic qualification as "economically disadvantaged," they are treated as part of governmental efforts to encourage Native American participation in federal contracting. Tribes and ANC's are exempt from the dollar limitations placed on sole source contracts that apply to other 8(a) BD program participants. This key distinction was created by Congress because tribes and ANC's serve large communities and groups of shareholders, while other minority small businesses generally provide benefits to sole proprietors or small groups of owners.

ANC-owned 8(a) companies do not have to be run or controlled by tribal members. The Alaska Native Claims Settlement Act provides that a concern which is majority owned by an ANC shall be deemed to be both owned and controlled by Alaska Natives and an economically disadvantaged business. Therefore, an individual responsible for control and management of an ANC-owned applicant or Participant need not establish personal social and economic disadvantage. Similarly, management of a company or applicant owned by an Indian Tribe may be provided by non-Tribal members if the concern can demonstrate that the Tribe can hire and fire those individuals, that it will retain control of all management decisions common to boards of directors, including strategic planning, budget approval, and the employment and compensation of officers, and that a written management development plan exists which shows how Tribal members will develop managerial skills sufficient to manage the concern or similar tribally-owned concerns in the future. Congress also encourages ANC's and tribally-owned 8(a) firms to enter into joint ventures so that the tribally- and ANC-owned businesses can take on larger contracts, generate greater revenue, develop greater expertise and thus build their own capital base.¹⁰

Another distinguishing factor regarding the participation of tribal entities in the 8(a) Program is the regulatory treatment of businesses or separate corporations they own. Pursuant to statute¹¹ and SBA's implementing regulations, tribal entities are allowed to have more than one company (subsidiary) in the 8(a) program at the same time and to be able to create new 8(a) companies as others graduate from the program. However, a Tribe cannot own 51% or more of another firm which, either at the time of application or within the previous two years, has been operating in the 8(a) program under the same primary North American Industry Classification System (NAICS) code as the applicant. A Tribe may, however, own a Participant or an applicant that conducts or will conduct secondary business in the 8(a) BD program under the same NAICS code that a current Participant owned by the tribe operates in the 8(a) BD program as its primary SIC code. In addition, once an applicant is admitted to the 8(a) BD program, it may not receive an

⁹ Section 602 of the Business Opportunity Development Reform Act of 1988, P.L. 100-656, 102 Stat. 3853, November 15, 1988

¹⁰ See H. Rep. No. 1070, 100th Cong., 2d Sess. 38 (1988); reprinted in 1988 U.S.C.C.A.N. 5485

¹¹ Section 602(d) of the Business Opportunity Development Reform Act of 1988, P.L. 100-656, November 15, 1988.

8(a) sole source contract that is a follow-on contract to an 8(a) contract that was performed immediately previously by another Participant (or former Participant) owned by the same Tribe.

These tribally-owned 8(a) companies must remain independent of each other and must remain classified as small for size purposes.¹² Business concerns owned and controlled by tribal entities will not be found to be affiliated because of common management or ownership.¹³ In addition, affiliation will not be found based on performance of common administrative services, such as bookkeeping and payroll, so long as adequate payment is provided for those services.¹⁴

Equally important, The Justice Department has determined that tribal and ANC-owned 8(a) firms are not subject to the U. S. Supreme Court's ruling in the *Adarand* case¹⁵. As set out in the Justice Department's proposed policy, issued in the May 23, 1996 Federal Register, any limitations that may end up being imposed on the Small Disadvantaged Business and 8(a) programs as a result of *Adarand*¹⁶ will not be applicable to tribal and ANC-owned 8(a) firms. This is because the tribes and ANC are included in the 8(a) and the SDB programs as a result of their unique government-to-government relationship with the United States, not because of race or national origin factors. This in turn goes back to the U. S. Supreme Court's 1975 ruling in *Morton v. Mancari*¹⁷, in which the Court ruled that Indian preference is not a racial classification but a political one based on the government-to-government relationship discussed above.

Based on the above, it is clear that the purpose of the inclusion of tribally-owned entities in the 8(a) Program can be contradictory to the Program's business development purpose. Given this dual purpose, the SBA has historically faced challenges in administering the 8(a) program with respect to tribally-owned, ANC-owned and Native Hawaiian Organization-owned entities.. given that, because of the statutory waiver of affiliation, these are the only businesses that without such a waiver may be considered other than small that are eligible to participate in various legislated SBA programs.

At the same time, the SBA has diligently focused on ways to enhance 8(a) program oversight for all companies with the aim of eliminating waste, fraud and abuse. The SBA's regulations that became effective March 14, 2011, are a big step in this continuing effort, as is the SBA's on-going effort at establishing a new data collection/management system.

¹² 13 CFR §121.103(a)(2)

¹³ See § 7(j)(10)(J)(ii) of the Small Business Act, 15 U.S.C. § 636(j)(10)(J)(ii).

¹⁴ 13 C.F.R. §121.103(b)(2)(ii)

¹⁵ *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200 (1995)

¹⁶ *Ibid.*

¹⁷ *Morton v. Mancari*, 417 U.S. 535, 552 (1974)

Given these challenges, we are concerned with a number of claims made in this report. Foremost, the GAO relied on nonprobability sampling in order to address its objectives.

With probability sampling, all elements in the population from which the sample was taken have some opportunity of being included in the sample, and the mathematical probability that any one of them will be selected can be calculated. Further, the conclusions drawn can be calculated with a degree of mathematical confidence. With nonprobability sampling, in contrast, the population elements from which the sample was taken are selected on the basis of their availability or because of the researcher's personal judgment that they are representative of the population. The consequence is that an unknown portion of the population is excluded. With nonprobability sampling, because some members of the population have no chance of being sampled, the extent to which a convenience sample – regardless of its size – actually represents the entire population cannot be known, and the confidence level cannot be calculated.

It is well known in the field of statistics, that nonprobability sampling cannot be projectable to the entire population because the sample is not representative of the population, it is not random, and the sampling error rate is unknown – e.g., part of the population can be missed, the population can be over-represented with certain characteristics, and the sampling can be biased based on the judgment of the sampler. Unfortunately, this report relies on nonprobability sampling and uses this sampling to generalize results of tribally-owned 8(a) participants as a group, including ANC- and NHO-owned companies, despite the statement on page 3 of the draft report which states, “(t)he results of our contract file analysis are not generalizable to the population of tribal 8(a) contracts.” The fact that this type of sampling was used to respond to several of the objectives of the report raises concern.

Based on the above, while the Small Business Act created the 8(a) program as a business development program, the enactment of ANCSA provisions has put the SBA in the position of administering the 8(a) program in a way that acknowledges the clear distinctions between tribally-, ANC- and NHO-owned companies and other 8(a) program participants.

Following are other issues that the SBA is concerned about which are included in the draft report:

- Page 5 of the report states that employee-based size standards are calculated over a three-year period. Size standards using employee numbers are not averaged over three years, but are based on the number of employees for each of the pay periods for the preceding 12 months.
- Pages 5 and 48 of the draft report state that a firm that does not meet its applicable business activity or mix target is not eligible for 8(a) sole-source contracts. This is not true. Pursuant to SBA's regulations, if an 8(a) firm does not achieve its

See comment 1.

See comment 1.

See comment 2.

See comment 3.

See comment 2.

See comment 4.

See comment 5.

See comment 6.

competitive business mix target, the prohibition on the award of further 8(a) sole source contracts can be waived, and the waiver mechanism is frequently used during challenging economic times.

- Numerous locations in the report rely on anecdotal information and hypothetical scenarios, without analyzing the issue from other perspectives, including those of the tribal and ANC participants. Relying on the anecdotal information and hypothetical scenarios gives a negative view of the participation of tribally- and ANC-owned entities in the program and may potentially deter agencies' use of the 8(a) program.
- In referring to joint ventures with other-than-small businesses, pages 8 and 36 of the draft report reflect an overly simplistic explanation of the mentor-protégé initiative within the 8(a) program and do not explain the benefits of the mentor-protégé relationship with respect to business development.
- In its hypothetical scenario on page 9, the report places a misleading emphasis on the use and prevalence of un-populated joint ventures, without analyzing whether evidence shows the scenario occurs or could occur in reality.
- On pages 33 through 48 of the draft report, it appears that the SBA's ability to implement the new regulations has been pre-judged without affording the SBA an opportunity to in fact see the results of the regulatory changes. Also, there is little to no mention of Agency initiatives such as the agency's recognition of these shortcomings and its response including on-going efforts to re-vamp its automated data collection and monitoring to address the noted shortcomings and or obstacles.
- The portion of the report on pages 42 and 43 fails to take into account that entity-owned 8(a) program participants have been provided with a variety of statutory benefits.
- On pages 35 through 38 of the draft report, the report uses examples of statements made by certain SBA offices with little experience in administering entity-owned 8(a) companies. The GAO noted that "officials at an SBA district office that services relatively few tribal 8(a) firms" told the GAO about a circumstance in which they would have implemented the new regulations improperly. This implies that the agency as a whole lacks knowledge, which is not the case.

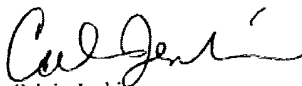
See comment 7.

- The statements on pages 21 through 27 of the draft report by agency procurement officials concerning contract pricing and cost savings are both negative and positive. We are concerned that while you did not draw conclusions regarding cost savings related to 8(a) contracts, as written, there appears to be a strong indication in the draft report that cost savings could be realized by using procedures other than 8(a). We do not believe there is sufficient data to assume an appropriate comparison.

To the extent that they are consistent with the provisions of the Small Business Act and subsequent modifications to the Alaska Native Claims Settlements Act, be assured that the SBA will make changes as necessary to continue its efforts to eliminate waste, fraud and abuse and to ensure that the 8(a) program is operating according to its statutory intent. We are fully committed to implementing all of the provisions of the regulations published in the Federal Register in February of 2011 which became effective in March of 2011, and are in the process of providing additional guidance and tools. The SBA is also continuing its focus on ensuring a well-trained staff.

We will continue working with the GAO to both further strengthen our administration of the 8(a) program, and to discuss our concerns regarding this report. Thank you for taking our views into consideration.

Sincerely,



Calvin Jenkins
Deputy Associate Administrator
Government Contracting and Business Development

GAO's Comments

1. SBA said that we had incorrectly reported that employee-based size standards are calculated over a 3-year period. We disagree; the statement in the report accurately states that the size standards are based on the number of employees *or* on the average revenues from the previous 3 years. Therefore, no change is needed.

SBA also characterized as “not true” our statements that a firm that does not meet its applicable business activity or mix target is not eligible for 8(a) sole-source contracts. SBA noted that if the competitive business mix target is not met, the prohibition on the award of further 8(a) sole-source contracts can be waived. We agree and, to be consistent in how we addressed this issue later in the report, we added the word “generally” the first time it was mentioned to reflect the potential for a waiver.

2. SBA stated that the report relied on anecdotal information and hypothetical scenarios, without analyzing the issue from other perspectives, including those of the tribal and ANC participants, and that this reliance gives a negative view of the participation of tribally owned 8(a) firms. We disagree with this comment. As stated in our report, we did not generalize our findings. Our findings are not anecdotal and did not rely on hypothetical scenarios. Nonetheless, our objectives for this review were to examine SBA's and procuring agencies' administration of various aspects of the 8(a) program and not to capture the views of program participants. We provided one illustrative example to give the reader insight into how 8(a) firms—both tribal and nontribal—are able to form relationships with non-8(a) businesses and non-disadvantaged individuals under current SBA regulations. This illustrative example is factually correct in terms of what the current regulations allow. All of our findings are based on criteria for the program as set forth in statute and regulation.
3. SBA stated that, in discussing joint ventures with other-than-small businesses, we provide an overly simplistic explanation and do not explain the benefits of the mentor-protégé initiative within the 8(a) program. Our purpose was simply to discuss this program in the context of one way that 8(a) businesses can grow and develop. We believe this discussion is adequate for the purposes of this report.
4. Regarding the section of our report that discusses challenges SBA will face in implementing parts of its new regulations, SBA stated that its ability to implement the regulations has been “pre-judged” without affording SBA an opportunity to see the results of the regulatory changes, and that there is little mention of the agency's current

initiatives. We disagree. As we stated in our report, SBA has recognized some of the challenges it faces in implementing the new regulations. The report also includes information on SBA's initial steps to develop a new data collection system and notes that the agency is in the process of re-writing its standard operating procedures. SBA did not provide us with any evidence that it will address the data limitations we identified in our report, which was the basis for several of our recommendations. Because SBA did not comment on our recommendations, the agency's planned actions remain uncertain.

5. SBA stated that we did not take into account tribal 8(a) entities' special statutory benefits. We disagree. The background section of our report clearly presents information on these preferences. The existence of the preferences is what allows some firms to, as we state, operate in effect as large businesses in a small business program.
6. SBA stated that we implied that the agency as a whole lacked knowledge in administering entity-owned 8(a) companies, based on our findings at a specific SBA district office. Our point was not what was known at the policy level, but at the implementation level. Our findings were based on interviews with agency officials and file reviews at several SBA district offices, as discussed in appendix I of the report. As our report states, the data system gaps we identified do, in fact, create knowledge gaps across SBA, which led to our recommendation on this issue. SBA did not address our recommendations intended to improve oversight of tribal firms' participation in the 8(a) program. For example, we recommended several actions SBA could take as it develops its new 8(a) tracking database that may help provide more visibility across district offices.
7. SBA commented that we implied that cost savings could be realized by using procedures other than 8(a). We disagree with this characterization. Our focus in this section of the report was on competitive versus noncompetitive awards, not on 8(a) versus non-8(a). As we have reported in the past, competition is a cornerstone of the acquisition system and a critical tool for achieving the best possible return on investment for taxpayers. Further, as we explain in the background of this report, once a requirement is awarded as an 8(a) contract, it must remain in the 8(a) program unless the procuring agency decides it would like to fulfill the follow-on requirement outside of the program and requests approval from SBA to do so.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

John P. Hutton, (202) 512-4841 or huttonj@gao.gov

Staff Acknowledgments

In addition to the person named above, Michele Mackin, Assistant Director; Tatiana Winger; Virginia Chanley; Celina Davidson; Julia Kennon; Jeff Malcolm; Kenneth Patton; Sylvia Schatz; Erin Stockdale; Roxanna Sun; and Holly Williams made key contributions to this report.

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