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BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

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## The 8(a) Pilot Program For Disadvantaged Small Businesses Has Not Been Effective

The Small Business Administration's use of a special pilot program which gives SBA the authority to demand contracts for the 8(a) program has not been successful.

SBA (1) did not have enough information to properly assess and match 8(a) firms' capabilities with pilot procurements and (2) approved 8(a) firms to perform pilot contracts without knowing their capabilities. GAO believes SBA made a poor choice of those firms that were awarded the three initial pilot contracts.

There is a difference between Army, which was selected as the pilot agency, and SBA over the way the pilot program can be used most effectively. GAO is recommending that the Congress allow further testing of the pilot program in an additional agency that, unlike the Army, has not demonstrated its complete support for the 8(a) program.



GED-81-22  
JANUARY 23, 1981

14795



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

B-197880

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

This report, which was prepared pursuant to Public Law 95-507, (discusses the Small Business Administration's implementation of the 8(a) pilot contracting program. The Department of the Army was selected as the pilot agency on January 30, 1979. The report discusses the need for (better management and recommends that the Small Business Administration make a number of improvements)

The report also discusses (the difference of opinion between Army, the pilot agency, and the Small Business Administration over the way the pilot program can be used most effectively.) We are recommending that the Congress allow further testing of the pilot program in an additional Federal agency that, unlike the Army, has not demonstrated its complete support for the 8(a) program. This will require a change in the legislation which presently allows for designating a single pilot agency.

Just prior to issuance of this report, we learned that on December 19, 1980, the President designated, under the provisions of Public Law 96-481, three additional Federal agencies to participate in the Small Business Administration's pilot program--the Departments of Energy and Transportation and the National Aeronautics and Space Administration. While we have no further information about the President's action, we see (no basis in the law for designating more than one agency to participate in the pilot program)

This report is one in a series under Public Law 95-507. We are sending copies of this report to the Director, Office of Management and Budget; the Administrator of the Small Business Administration; and the Secretary of Defense.

A handwritten signature in cursive script, reading "Elmer B. Staats".

Comptroller General  
of the United States

COMPTROLLER GENERAL'S  
REPORT TO THE CONGRESS

THE 8(a) PILOT PROGRAM  
FOR DISADVANTAGED  
SMALL BUSINESSES HAS  
NOT BEEN EFFECTIVE

D I G E S T

GAO's review of a 2-year pilot program showed that the Small Business Administration (SBA) has not improved its ability to secure procurements for the 8(a) program. SBA awards procurement contracts under this program to socially and economically disadvantaged small businesses for the purpose of helping them become competitive. When SBA uses the pilot program, it has the exclusive authority to designate procurement requirements.

The Department of the Army was selected as the pilot agency in January 1979. SBA and the Army took 4 months to formalize an interagency agreement. Four months later, in September 1979, SBA issued guidelines to field officials. It was not until February 1980 that SBA's central office officials met with SBA regional officials and procurement center representatives to discuss implementation of the pilot program.

GAO's review--which was performed after SBA selected and awarded the three initial pilot contracts--disclosed that SBA approved the 8(a) firms that received these three contracts without adequately assessing their capability to perform. In GAO's opinion, SBA made a poor choice of firms. (See p. 11.)

In the administration of the pilot program, SBA made little use of its field offices to select and award contracts.

GAO also believes that opportunities exist to more fully test the pilot program in an additional agency that has not yet demonstrated its complete support for the 8(a) program. (See p. 22.)

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SBA did not consider whether the firms successfully delivered on prior 8(a) contracts. Also, SBA's capability assessment did not use all sources of information on the firms, such as regional and district officials, who are closer to the firms and monitor their progress through the 8(a) program.

For example, the central office awarded one of the three contracts even though the firm had not started work on its previous \$70,000 8(a) contract until a year after it was awarded. SBA district officials objected to the pilot award of \$4 million because they believed the firm was not capable of performing. Despite this objection, the award was made, but only after SBA negotiated a joint venture arrangement which in effect placed most of the work performance in the hands of several nondisadvantaged companies. (See pp. 12 to 14.)

Procurement center representatives do not have information on the capabilities of 8(a) firms. They need this information to match qualified firms to pilot procurements they identify. (See pp. 14 to 16.)

The results of GAO's review were discussed with SBA program officials. They had no comments regarding these deficiencies; however, one official said that SBA would closely monitor the work progress of the firm that received the \$4 million contract. (See p. 14.)

#### ADDITIONAL PROGRAM TESTING NEEDED

SBA and Army hold differing opinions on the pilot program's purpose and the most appropriate agency in which to test the program. SBA's interpretation of the purpose is the opportunity to improve the quality of 8(a) procurements through criteria calling for sophisticated, high technology, large-dollar, multiyear procurements. Army's interpretation is "more procurements" from an agency that has not yet supported the 8(a) program. Army has had a history of supporting the program.

them under the regular 8(a) program. Also, these officials should use the pilot program only when a qualified firm is available.

- Direct program officials to make sure that 8(a) firms selected for the pilot program have the capabilities to do the job successfully. SBA should use information on the firm's past performance in delivering on 8(a) contracts.
- Direct program officials to make sure that procurement center representatives have enough information on 8(a) firms' capabilities so that this data can be used to match qualified firms to procurements.
- Ask that the Office of the Inspector General conduct reviews of the three initial pilot contracts to find out how effectively contractors performed.

#### RECOMMENDATION TO THE CONGRESS

The Congress should amend the authorizing legislation to allow for further testing of the pilot program in an additional Federal agency that has yet to demonstrate its complete support for the 8(a) program.

#### SBA, ARMY, AND 8(a) FIRMS' COMMENTS AND GAO'S EVALUATION

Although SBA said the report unduly criticizes the pilot program, it did not offer any additional data to cause GAO to revise or modify the report. SBA also said it is seeking methods, which it did not identify, to improve the program and provided comments on GAO's recommendations.

In GAO's opinion, SBA's comments did not adequately respond to all the recommendations in the report. For example, although SBA apparently disagreed with GAO's recommendation that the pilot program should be used only when the Army is reluctant to offer a contract under the regular 8(a) program, it did not clearly state how the pilot program should be used with the regular 8(a) program. In addition, the comments did not address SBA's need to know

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## CHAPTER 1

### INTRODUCTION

Section 8(a) of the Small Business Act, as amended, gives the Small Business Administration (SBA) the authority to enter into procurement contracts with Federal agencies for the purpose of subcontracting to small business. The authority is intended to help socially and economically disadvantaged small businesses achieve a competitive position in the financial marketplace.

Public Law 95-507, dated October 24, 1978, amended section 8(a) to provide, among other things, for creating a special 2-year pilot contracting program between SBA and a Federal agency that was to be designated by the President. The Department of the Army was selected as the pilot agency on January 30, 1979. The 8(a) program is administered by SBA's Associate Administrator for Minority Small Business and Capital Ownership Development.

### THE DIFFERENCES BETWEEN THE PILOT AND REGULAR 8(a) PROGRAMS

SBA uses section 8(a) authority to obtain contracts from Federal agencies and subcontract them on a noncompetitive basis to 8(a) firms. In the regular 8(a) program, agencies strictly volunteer these contracts. However, in the pilot program, SBA has the exclusive authority under the act to demand procurement requirements for firms.

In the event that SEA and Army disagree over the terms and conditions of a pilot contract, the Secretary of the Army may establish the terms and conditions. SEA must then decide whether to accept them or withdraw its pilot contract request.

It was not until May 16, 1979, that SBA and Army entered into an interagency agreement which formally established the terms and arrangements for implementing the pilot program. Each agency appointed pilot program managers who act as the focal points for planning, coordination, operation, implementation, and resolution of problems within the agencies. These managers are located centrally in the Army's Office of Small and Disadvantaged Business Utilization and in SEA's Office of the Associate Administrator for Minority Small Business and Capital Ownership Development.

Operating procedures for the pilot program were issued to all SBA regional administrators on September 4, 1979. SBA

were awarded under the program. Since the pilot program is administered centrally by SBA, a part of our work was performed at the SBA and Army headquarters offices by reviewing files and records and interviewing all personnel involved in the pilot program. We also reviewed how SBA and Army established the pilot program within their organizations as well as all policy and procedures issued by the agencies.

Our work consisted of a detailed review of the circumstances behind the selection and negotiation of the initial three contracts awarded under the program. We gathered and analyzed all file data from SBA and Army on these contracts. Since contract records were maintained at field locations, we reviewed the contract files at the Army procurement centers and at SBA field locations involved in the negotiations. The firms' 8(a) program files were also reviewed at SBA. To accomplish our objectives, we also interviewed those SBA field officials who were involved with the negotiations and/or the firms' prior participation in the 8(a) program, as well as those Army officials at the installations responsible for the contracts. It was also necessary for us to conduct interviews with the consultants hired by SBA to provide services to the pilot program.

We also visited the 8(a) firms receiving the initial three contracts. While at these firms we interviewed officials about their involvement in the pilot program. We did not review the records of these firms, since our objectives only covered SBA's administration of and Army's participation in the program.

Our work was performed at the SBA central office and the Office of the Secretary of the Army; SBA field offices in San Francisco and Los Angeles, California, and Washington, D.C.; and Army installations at Fort Belvoir, Virginia, and Omaha, Nebraska, which were responsible for negotiating the three contracts.

While our review of the three initial contracts was in process, SBA was locating and in some cases selecting other procurements for the pilot program. We analyzed whatever data was available at the SBA central office and interviewed program officials at SBA and Army headquarters.

Our review also required us to conduct interviews with 10 SBA procurement center representatives (PCRs) designated specifically for the pilot program.



purification units termed "reverse osmosis water purification units" (ROWPUs). Separate contracts were awarded to two 8(a) firms. One contract of about \$5 million was awarded to a firm to assemble and test the water purification units and install them on trailers. The other contract of about \$1.9 million was awarded to a firm to build the trailers and frames for the units.

#### Regular 8(a) procurement

The Army contracting officer (in charge of the ROWPU procurement) at the Mobility Equipment Research and Development Command (MERADCOM), Fort Belvoir, Virginia, told us that when the ROWPU procurement was being planned, his office decided to place it in the regular 8(a) program. Both the contracting officer and the chief of the Engineering Division, MERADCOM Energy and Water Resources Laboratory, told us that it is not particularly difficult to manufacture. They said that the Army had submitted other procurements to the regular 8(a) program that were more difficult to manufacture. In addition, they told us that the main reason that the ROWPU procurement ended up in the pilot program was that SBA needed to select and award a contract in the pilot program rather quickly.

#### Limited development potential for the firms manufacturing the ROWPU units and trailers

The development potential of the ROWPU contracts is mixed. The firm manufacturing the ROWPUs has the opportunity to enter a new and growing industry. Manufacturing ROWPUs, however, is an entirely different field from the firm's traditional line of work, which is manufacturing electronic components. In addition, the firm has been in the 8(a) program for 9 years and has received \$4.8 million in 8(a) contracts, yet has failed to make satisfactory progress--mostly due to questionable operating practices. If the firm has failed to progress before, it is questionable whether it will progress now even after receiving the ROWPU contract.

The pilot contract to the firm to manufacture the trailers and frames for the ROWPU units is not consistent with the firm's normal line of business, which is engineering, repairing, installing, and checking out electronic and ordnance systems, principally aboard U.S. Navy vessels. The firm has been very successful in its line of work. In fact, in April 1979 SBA's Los Angeles district office conducted a review of the firm's progress in the 8(a) program and concluded that it had achieved the developmental objective of its business plan and had become as competitive in the marketplace as could reasonably be expected. The firm

## SBA's NEW PILOT PROGRAM CRITERIA

### Special requirements for pilot 8(a) firms

On April 3, 1980, SEA's Deputy Associate Administrator for Business Development promulgated criteria that 8(a) firms must meet before they can be selected for pilot program participation. In addition, a selection panel was formed in the central office to evaluate 8(a) firms for possible selection for the pilot program. The entrance requirements are much more stringent than those of the regular 8(a) program. For example, the new pilot criteria require that an 8(a) firm have minimum annual revenues of at least \$500,000; 20 or more employees (preferably skilled); a plant; and a previous successful history of performance. Although these criteria were not implemented at the time of our review, we doubt that two of the first three firms receiving pilot program awards would qualify under the new criteria.

In August 1980 we followed up to determine if the new selection panel had acted on any applications. We were told by the SBA pilot program manager that SEA has terminated the panel and now is seeking to have the regional administrators assume the responsibility of the panel.

### Special criteria for contracts selected for the pilot program

On April 15, 1980, SBA's Associate Administrator for Minority Small Business and Capital Ownership Development issued a memorandum to all SBA regional administrators listing the characteristics of projects most desired for pilot program procurements. He emphasized that Army projects that have a history of activity under the regular 8(a) program should not be selected for the pilot program. He added that projects traditionally excluded from the 8(a) program but having the following characteristics, should be identified for the pilot program:

- Sophistication/high technology.
- Large dollars.
- Multiyear/follow-on potential.
- Commercial applications.

The Army officials also said that although SBA's request was denied, Army will use minority firms as participating subcontractors in this major procurement. They view this approach as the most constructive way of meeting Army's needs while offering opportunities for minority firms to enter a new line of manufacturing on a developmental basis.

#### CONCLUSIONS

SBA's implementation of the pilot program has not improved its ability to obtain procurements which were not currently offered by the Army under the regular program. In addition, our review of the initial three contracts selected and awarded under the pilot program raises doubts that these contracts will contribute to the development of the 8(a) firms that received them.

SBA has developed criteria for pilot procurements and 8(a) firms participating in the pilot program in an effort to upgrade the quality of pilot program contracts. Unfortunately, many procurements identified for the pilot program do not fit these criteria. It appears to us that SBA is trying to make the pilot program look more successful than it really is.

#### RECOMMENDATION TO THE ADMINISTRATOR

We believe that SBA's intent to use the pilot program to upgrade the quality of procurements available to participants in the 8(a) program is laudable. We recommend that the Administrator, SBA, direct program officials to diligently enforce the objective of the pilot program by demanding contracts only when Army is reluctant to offer them under the regular 8(a) program. Also, these officials should use the program only when a qualified firm is available.

#### SBA AND ARMY COMMENTS AND OUR EVALUATION

While SBA stated that it did not take issue with our recommendation, its comments did not clearly state how the pilot program should be used with the regular 8(a) program; nor did the comments address SEA's need to use the program only when a qualified firm is available. SBA said it believes that the congressional intent behind the pilot program neither envisions nor requires that it use the program only when it must force action by another agency (the Army). However, this statement appears to conflict with the Associate Administrator for Minority Small Business and Capital Ownership Development's September 4, 1979, operating procedures, which state that SBA's overall

### CHAPTER 3

#### SEA HAS POORLY ADMINISTERED THE PILOT PROGRAM

Our review of SBA's implementation of the pilot program has shown that:

- SEA did not have enough information at the central office level to properly assess and match 8(a) firms' capabilities with procurement requirements.
- SEA approved the 8(a) firms that received the initial three pilot contracts without adequately assessing their capability to perform. In our opinion, SEA made a poor choice of firms.
- Procurement center representatives have not been effective in identifying pilot projects.

#### IMPLEMENTATION OF THE PILOT PROGRAM

Implementation of the pilot program has proceeded slowly since the act authorizing it was passed in October 1978. After the Army was designated the pilot agency in January 1979, SPA and the Army took 4 months to formalize an interagency agreement implementing the program. Four months later, in September 1979, or about 1 year after passage of the act, SBA issued guidelines to field officials. It was not until February 1980 that SBA's central office officials met with SBA regional officials and PCRs to discuss program implementation.

While SBA was still developing its guidelines, its central office was already considering three 8(a) contractors for pilot project procurements. The first procurement involved two contracts totaling about \$5 million to produce 30 reverse osmosis water purification units, and the second procurement involved a contract valued at about \$4 million to install storm windows and insulation for the Army at Fort Leonard Wood, Missouri. As of June 1980, these three contracts were the only projects selected and awarded under the pilot program.

#### SEA IS SEEKING LARGE-DOLLAR, SOPHISTICATED PROCUPEMENTS

When a suitable procurement is identified to its central office, SEA requests that the Army reserve it for the pilot

8(a) firms perform on their contracts, which is an important indication of their capability to perform on future projects. For example, one of the initial pilot contracts was a \$4 million project awarded to a one-man firm that had not started work on its first 8(a) project, for \$70,000, which had been awarded a year earlier. (See p. 34.)

In another example we found that the central office designated an 8(a) firm to perform an estimated \$30 million contract despite the fact that the firm did not have any facilities. We asked the pilot program manager why the firm should receive the contract, but he could not provide justification. He also told us that as yet, no final decision on the award had been made.

Several Army officials questioned SBA's ability to adequately assess 8(a) firms' capabilities. The Small Business and Economic Utilization Advisor at Fort Belvoir said that the Army should have required SBA to certify its responsibility for ensuring that the 8(a) firms have the ability to perform at the time the procurement was initially requested. An Army contract officer at Fort Belvoir said that the Army bears the primary responsibility for assuring itself of 8(a) firms' capability to perform through its preaward surveys. But he said that SBA should develop certain minimum information on each of its 8(a) firms, including the firm's performance on past 8(a) contracts, its prior experience, and the adequacy of its facilities.

SBA's central office recognizes the importance of knowing about the 8(a) firms' capabilities and thus is attempting to acquire the information necessary to assess those capabilities. A February 4, 1980, central office directive instructed the regional offices to nominate the top three 8(a) manufacturing firms in their regions for participation in the pilot program. In addition, the central office requested documents from the regions justifying why each 8(a) firm should participate in the pilot.

In April 1980 the central office also formed a five-member selection panel to approve or disapprove the 8(a) firms nominated for the pilot by the regions. Subsequently, in August 1980 the SBA project manager told us that SBA had discontinued the selection panel and was seeking to have regional administrators assume the responsibility of the panel.

stationed at major procurement activities, they are closely attuned to the day-to-day activities of Army procurement centers, and SBA considers them to be in the best position to review and identify procurements for the program. They also serve as liaison officials to ensure that small business interests are being met.

Contrary to the policy guidelines of the interagency agreement, however, PCRs have not been effectively used in identifying pilot projects. While SBA and the Army envisioned that the PCRs would play a significant role in identifying Army projects, they have had limited success in identifying pilot projects. Of the 47 pilot projects listed by the SBA central office as of June 20, 1980, only 17 projects had been identified by PCRs.

The following table summarizes how the 47 contracts for the pilot project as of June 1980 were identified.

<u>PCRs</u>	<u>SBA regional offices</u>	<u>SBA central office</u>	<u>8(a) firm</u>	<u>Army</u>	<u>Total</u>
17	a/20	1	8	1	47

a/The 20 projects identified by the regional offices were Army Corps of Engineers construction projects which, in many cases, were offered to SBA's regional offices by the Army.

Our analysis revealed that 12 of the 17 projects identified by PCRs were identified at Fort Monmouth, New Jersey. A PCR at Fort Monmouth told us that most of the projects were identified by a newly hired PCR. He said that all but one of the projects that the new PCR identified were procurements that could have been reserved under the regular 8(a) program. When we brought this to the SBA pilot program manager's attention, he agreed and said that he was recommending to the Army that eight of the pilot projects identified by the PCR be transferred to the regular 8(a) program.

Other than those procurements identified by the Fort Monmouth PCRs, PCRs in other locations have had limited success in identifying pilot procurement opportunities.

## CONCLUSIONS

SBA has not demonstrated that it has the ability to effectively implement the pilot program. In guiding the program toward seeking large-dollar, sophisticated procurements for its 8(a) firms, SBA has experienced difficulties in identifying pilot projects, assessing 8(a) firms' capabilities, and matching 8(a) firms' capabilities with procurement requirements. More specifically,

- SBA lacks sufficient information on 8(a) firms' capabilities as well as procurement requirements to properly match firms to procurement requirements,
- SBA has awarded multimillion-dollar contracts to its 8(a) firms without internally assessing the firms' capabilities to perform, and
- PCRs have not been effective in identifying pilot projects.

The selection and award of the three initial contracts are associated with several conditions which could adversely affect the 8(a) firms' ability to discharge their responsibilities. Therefore, an independent evaluation would be useful in determining the effectiveness of the firms' performance.

## RECOMMENDATIONS TO THE ADMINISTRATOR

Before any further contracts are selected and awarded under the pilot program, the Administrator, SBA, should:

- Direct program officials to make sure that 8(a) firms selected for the pilot program have the capability to successfully do the job. SEA should use information on the firm's past performance in delivering on 8(a) contracts.
- Direct program officials to make sure that procurement center representatives have enough information on 8(a) firms' capabilities so that this data can be used to match qualified firms to procurements.
- Ask the Office of the Inspector General to conduct reviews of the three initial pilot contracts to find out how effectively the contractors performed.

## CHAPTER 4

### THE PILOT PROGRAM CAN BE MORE

#### FULLY TESTED IN AN ADDITIONAL AGENCY

SBA and Army hold differing opinions on the pilot program's purpose and the most appropriate Federal agency in which to test the program. The legislative history suggests only that the program's purpose is to increase SBA's ability to develop disadvantaged firms. SBA has interpreted this as the opportunity to improve the quality of 8(a) procurements, while Army interprets it as the opportunity to increase the quantity of procurements.

#### LEGISLATIVE HISTORY

Public Law 95-507 and its legislative history suggest that the pilot program is meant to help SBA increase its ability to develop disadvantaged firms by providing a way to demand 8(a) procurements. The pertinent report of the House of Representatives (H. Rept. 95-949, 1978) stated that reports prepared by us <sup>1</sup>/<sub>and others</sub> found that one of the reasons that the regular 8(a) program was not as successful as it could be was SBA's inability to control the supply of contracts from Federal agencies. The House attempted to solve this problem by incorporating a provision in the bill that would have allowed SBA to negotiate for any contract requirements it deemed appropriate for program use.

The Senate substitute bill did not contain this provision. The conference version of the joint bill substituted a 2-year trial for the mandatory contracting provision to be applied between SBA and one Federal agency to be chosen by the President.

The conference report stated only that the purpose of the pilot program was to "\* \* \* increase SBA's ability to develop disadvantaged firms \* \* \*."

#### INTERPRETATIONS OF THE PILOT PROGRAM'S PURPOSE

SBA's interpretation of the purpose of the pilot program is "better procurements." Accordingly, as discussed in

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<sup>1</sup>/"Questionable Effectiveness of the 8(a) Procurement Program" (GGD-75-57, Apr. 16, 1975) and "Ways To Increase the Number, Type, and Timeliness of 8(a) Procurement Contracts" (CED-78-48, Feb. 1, 1978).



2. DOD's wide variety of procurements, which allows a wide variety of 8(a) firms to participate.
3. DOD's decentralized procurements, which allows 8(a) firms all over the Nation to participate.

The SBA Administrator approved the recommendation and forwarded it to the President's Assistant for Domestic Affairs and Policy. The Office of Domestic Affairs and Policy acted as coordinator between SBA and DOD. After several discussions, all three organizations mutually decided that having all of DOD in the pilot program was too unwieldy. They decided that Army, which has the largest volume of 8(a) procurements of any single Federal agency, was the most logical choice. In addition, Army itself has a wide variety of procurements which are decentralized.

It should be noted that in selecting Army as the pilot agency, the present SBA and Army interpretations of the pilot program's purpose--better or more procurements, respectively--were not considered. Instead, the major reason for selecting Army seemed to be its history of cooperation with the 8(a) program.

#### Other Federal agencies considered for the pilot program

The SBA committee did not seriously consider any alternatives to DOD. However, several other officials did express their opinions.

SBA's Acting Associate Administrator for Procurement Assistance submitted his choices for the best agencies to participate in the pilot program to the Administrator of SBA in December 1978. He recommended three agencies, ranked in this order: Veterans Administration, Department of the Interior, and the General Services Administration. He gave the following reasons:

1. Each of the three agencies has a wide variety of procurements which would allow a wide variety of 8(a) firms to participate.
2. The centralized location of the agencies' procurement functions would allow SBA to maintain control over the pilot program.
3. The relatively low dollar amounts and technology of the procurements would make it easy for 8(a) firms to participate.

SBA AND ARMY COMMENTS  
AND OUR EVALUATION

With regard to our recommendation to the Congress, SBA commented that while other agencies' participation in the pilot program would be welcomed, it believes that it is important for the Army to continue in the program. SBA stated that the Army needs to emphasize manufacturing-type procurements instead of the nonprofessional service requirements it offered to the 8(a) program in the past. However, as we noted in chapter 2, the Army has previously submitted other procurements to the regular 8(a) program more difficult to manufacture than the ROWPU procurement.

The Army stated that it fully supports our position that the pilot program should be further tested in an agency that has not yet demonstrated its complete support for the 8(a) program. However, Army stated further that it should be dropped from the pilot program. It commented on the excessively high administrative costs Army has sustained in dealing with the pilot program. For example, during the past year, 75 percent of all professional staff time in the Office of Small and Disadvantaged Business Utilization has been devoted to the pilot program. Yet, this has resulted in only \$19.3 million in pilot program contracts in fiscal year 1980 versus \$273.4 million in regular 8(a) program contracts for the same period. It should be noted that Public Law 96-481, passed on October 21, 1980, extends the Army's participation in the pilot program until September 30, 1981.

SBA certifies capability without  
an internal assessment

At the time SBA selected the ROWPU procurement for the pilot project, it assured the Army that the two firms had the capability to do the job. As required by Army procurement regulations, SBA also submitted a letter to the Army certifying that SBA was competent to perform the ROWPU procurement.

However, we found that while SBA gave assurances that both firms had the capability to perform the procurement, it did not actually assess the two firms' capabilities or the amount of help the firms would need to meet the terms of the procurement. Instead, SBA relied upon the Army's assessment of the firms' capabilities.

An Army inspection team conducted preaward surveys at the two firms' facilities. We found, however, that these surveys were intended only to determine whether the two firms possessed needed management and technical expertise. The surveys did not assess the adequacy of the two firms' facilities, since it was the Army's understanding that SBA would provide funds to help both 8(a) firms acquire needed facilities and equipment.

The Army's inspection team concluded that both firms had the management and technical expertise to produce the ROWPUs. Since the second firm had some metal fabrication capabilities, the team recommended that this firm be awarded a contract to make the trailers and ROWPU frames. Since the first firm did not have a metal fabrication capability, the team recommended that it be awarded a contract to assemble the ROWPUs and install them on the trailers.

Several Army officials questioned the ability of SBA to adequately assess 8(a) firms' capabilities. The Small Business and Economic Utilization Advisor at Fort Belvoir said that the Army should have required SBA to certify its responsibility for ensuring that the 8(a) firms have the ability to perform at the time the procurement was initially requested. Another Army official said that SBA subcontracts procurements to 8(a) firms but does not have the responsibility of ensuring that the procurement requirements are satisfied. Thus, the official said, if 8(a) firms default or fail to perform adequately, the Army loses--not SBA.

An Army contract officer at Fort Belvoir said that the Army bears the primary responsibility for assuring

- While annual sales increased substantially from 1973 to 1978, the firm has consistently sustained large operating losses.
- The partners paid themselves large salaries and supplemented their salaries through rental fees charged to the firm for fixed assets they owned.
- Since 1973 the firm recorded a small profit only once.
- When the disadvantaged owner acquired the firm from the nondisadvantaged co-owner in 1978, an agreement allowed the latter to retain ownership of the building and to receive \$30,000 a year in rental fees. The agreement also gave him a minimum of \$36,000 a year in consulting fees for 3 years plus certain other employee benefits, including health and life insurance and a new car with insurance, repairs, maintenance, and fuel costs paid by the firm.
- The disadvantaged owner acquired equipment previously held in joint ownership with the nondisadvantaged co-owner. Rental fees for equipment used by the firm were then charged to the firm at \$40,152 per year even though both the equipment and building were previously rented for this total fee. The firm also agreed to pay the taxes on the property.
- Besides receiving bonuses in 1977, both partners were granted direct loans. In 1978 a bonus compensation was granted that canceled the direct loans to the partners.

Because of the firm's unsatisfactory progress in its 9 years in the 8(a) program and its questionable operating practices, the Los Angeles district office recommended the firm's termination from the program. In April 1980 the region IX Administrator, however, rejected this recommendation and instead accepted the firm's response to SBA's termination inquiry and sent a letter to the SBA central office defending the firm's viability. But the Regional Administrator did not respond to the questionable financial practices cited in the district office's assessment. No further investigation was conducted by the regional office or by the SBA central office.

At the conclusion of negotiations, the SEA contract negotiator recorded the firm president's closing statement that "the two positions left the issue up to SBA to make up any difference, as was stated at the commencement of negotiations."

SBA's contract negotiator declined to recommend approval of the award

SBA's contract negotiator declined to recommend approval of the award to the first firm for the following reasons:

- The SEA central office accepted the firm's proposed 12-percent fixed fee (profit) above the base cost of the contract instead of the 9 percent that the SBA contract negotiator recommended.
- The \$323,000 in BDE funds for capital equipment and leasehold improvements was approved by the SBA central office without the proper justification and documentation.
- The SBA central office granted the firm a \$2 million advance payment to support its performance even though the contract negotiator advised against doing so.

Twelve-percent fee not recommended

The 12-percent fixed fee that the SBA central office approved for the firm was not recommended by the section 7(j)(10) technical consultant, the contract negotiator, or the district office. Instead, they supported the technical consultant's analysis that a fixed-fee incentive contract offered the best possible alternative. The technical consultant's proposal provided for the firm to receive a 9-percent fixed fee above the base cost of the contract, plus 30 to 40 percent of all additional cost savings. The consultant's support for this fee proposal was based on:

- His estimates that about \$580,000 in potential cost savings could be realized by the firm with SBA sharing in these savings and thus reducing BDE costs.
- The incentive fee provision that would allow SBA to gain full auditing capability and maximum price advantage for follow-on orders.

Advance payment of funds not recommended

The SBA contract negotiator also disagreed with the SBA central office's approval of the \$2 million advance payment requested by the firm to support initial financial requirements. He recommended against an advance payment to the firm because of the SBA district finance division's assessment of the firm's financial status, which concluded that the firm's use of advance payments would not be in the best interest of the Government since it was unlikely that the firm could repay it. The basis for this assessment was the firm's insolvency, represented by a debt-to-net-worth ratio of 49.4 to 1, and pending litigation that could adversely affect the firm's viability.

Questions about SBA's selection of the second firm to build the ROWPU trailers

The \$1.9 million pilot award to the second firm to build 30 flatbed trailers and frames for the ROWPUs does not appear to be consistent with the firm's traditional line of business. While the long-term plan was eventually to allow the firm the opportunity to build the whole ROWPU, it is our opinion that the building of the trailers themselves is not considered to be the most important aspect of the production effort and does not seem to be in the best interests of the second firm. In addition, other 8(a) firms which already possessed the capability to build these trailers could have been considered for the contract instead of the second firm.

Background

The second firm's traditional line of business is engineering, repairing, installing, and checking out electronic and ordinance systems, principally aboard U.S. Navy vessels. The firm has contracted almost exclusively with the Navy. Since the firm's inception, it has grown rapidly until its annual sales approached several million dollars in fiscal year 1979. The company employs approximately 200 employees at work facilities in San Diego, California, and Norfolk, Virginia. The firm's administrative staff is located in Los Angeles, California, and in Arlington, Virginia.

The selection of the second firm

SBA's selection of the firm to build the 30 trailers was based upon the Army's preaward survey. The Army's assessment found that the first firm was not capable of building the trailers, but it was capable of assembling the ROWPUs on

supported his position and requested that the region be authorized to negotiate the requirement to allow both firms to provide complete systems. However, this proposal was not accepted by the SBA central office.

Other 8(a) firms capable of fabricating the trailers were not considered

The SBA central office did not consider other 8(a) firms for the procurement before it awarded the second firm the contract and approved \$273,000 in BDE funding for capital equipment. SBA's records show, however, that there were 14 other 8(a) firms whose regular business is supplying fabricated metal products. One procurement center representative commented that he knew several 8(a) firms that were capable of building the trailers for which BDE funding would not have been required, or at least not to the extent that was required for the second firm. We question whether the firm should have been awarded a contract to build trailers when other 8(a) firms already had this capability.

The second firm's program completion proposed by SBA

In April 1979 the Los Angeles district office conducted a review of the second firm's progress in the 8(a) program. The district office concluded that the firm "\* \* \*" has substantially achieved the developmental objectives of the approved business plan, and [that] it has effectively achieved as competitive a position in the market place as can reasonably be expected."

On July 16, 1979, the district office notified the firm of its plan to gradually reduce its 8(a) contractual support through September 30, 1982. At that date, the district office indicated, the firm will be considered to have reached program completion. SBA took this action because of its determination that the firm has substantially achieved its approved business development objectives and attained the ability to compete in the marketplace without 8(a) program assistance.

XYZ's introduction to  
the pilot program

SBA's region III sent a request to the other regions for any requirements for storm window installation. The chief of the Requirements Division, Office of Business Development, SBA central office, told us that the request was sent in an effort to quiet XYZ's president down and to forestall him from sending more letters to the Congress. He said that "in this business, noisy, vociferous people always get the attention."

Region VII sent a reply dated March 27, 1979, that described a \$5.8 million Army project for upgrading insulation and storm window installation at Fort Leonard Wood, Missouri. However, this reply was sent to SBA's central office--not region III. Unfortunately, region VII also told the Army Corps of Engineers' Omaha district office, which was in charge of the project, that SBA was not interested in reserving the project for the 8(a) program because there were no 8(a) firms in its district portfolio capable of handling the project. In addition, SBA's subsequent request to Army to reserve the project for XYZ was sent to Fort Leonard Wood, which was unfamiliar with the project, instead of the Corps' Omaha district office.

Because of the general lack of communication between SBA's central office, SBA region III, and the Army, the Army Corps of Engineers proceeded with processing the Fort Leonard Wood procurement in its normal manner. First the Army advertised the project as a small business set-aside. Three bids were received on May 31, 1979. Two bids were too high and the third was not responsive to the invitation.

The Corps of Engineers readvertised the project for general bidding with bid opening scheduled for August 8, 1979. On July 25, 1979, the Army finally received SBA's formal request to reserve the project for the 8(a) program. Because the Army, having already advertised for bids, was unlikely to comply with such a request under the regular 8(a) program, SBA cited the mandatory provisions of the pilot program.

XYZ's negotiations for the  
Fort Leonard Wood contract

The Army withdrew the Fort Leonard Wood project from competitive bidding and issued project plans and specifications to SBA's central office on August 20, 1979. It also



Questions raised about  
XYZ's capability

During the last weeks in November, several important things occurred. The management consultant filed a report with SBA stating that XYZ was not capable of performing the work called for on the project. In addition, the chief of the Contracts Division of SEA's Washington district office, wrote the pilot program manager notifying him that, although XYZ had collected \$39,863.09 in advance payments on its \$70,000 contract at Fort Howard, Maryland, it had not done any work at all. (XYZ finally started work on this project in May 1980.) She questioned the responsibility of XYZ's president as a contractor, citing his lack of performance on the Fort Howard contract and the fact that XYZ is a one-man shop with no equipment or trucks. She wondered if the Fort Howard advance payment could even be repaid. These concerns were expressed in spite of the fact that on August 6, 1979, SEA's Director of the Office of Business Development certified that XYZ was capable of performing the work called for on the Fort Leonard Wood project.

Also during the end of November 1979, XYZ dropped ABC and selected a firm we will refer to as DEF, Inc., for the joint venture. DEF--like ABC, a nondisadvantaged firm--had previously been preparing to bid on the project when it was advertised for general bidding and was already working on a similar project at Fort Leonard Wood.

In addition, the Army Corps of Engineers sent two letters to SEA in the latter part of November pleading for SEA to give support to XYZ and to get ready to resume negotiations. One of the letters threatened to withdraw the project.

Second negotiation session

Negotiations were resumed on December 4, 1979, and an agreement was reached. On December 20, 1979, Army awarded the prime contract.

In addition, the project manager designated by XYZ's president was previously an employee of DEF, Inc.

We discussed the above with SEA's Chief of the Requirements Division, Office of Business Development. We also discussed the November 30, 1979, SEA Washington district office memo to the pilot program manager describing XYZ as a one-man operation and questioning the firm's responsibility as a contractor since no work had been performed on its other 8(a) contract. The central office official expressed shock and surprise at these revelations and said that XYZ should not have received the Fort Leonard Wood contract. This official could not provide the actual percentage of work that the 8(a) firm would be responsible for performing, but he said SBA would be closely monitoring the progress of this work. He said that the XYZ contract is an example of the consequences of SEA quickly approving a firm for the pilot program because of the political pressure on SEA to get more minority contracts.

FUTURE JOINT VENTURES BETWEEN  
8(a) FIRMS AND NONDISADVANTAGED  
FIRMS DECLARED ILLEGAL

On May 14, 1980, SEA's General Counsel notified the Office of Business Development that joint ventures between 8(a) firms and nondisadvantaged firms, such as the XYZ-DEF joint venture, are illegal under Public Law 95-507. Accordingly, the Director of the Office of Business Development told us that while joint ventures such as XYZ-DEF will be allowed to complete their contracts, no new joint ventures will be allowed between 8(a) firms and nondisadvantaged firms. SBA is changing its SOPs to forbid these types of joint ventures.

COMMENTS BY THE 8(a) FIRMS

The three firms discussed in these case studies were given the opportunity to review and comment on the factual material that bears directly on their firms. Two of the three firms responded.

In summary, one firm offered additional information which it thought GAO did not have. The other firm also offered additional information it thought GAO did not have; offered information which contradicted information contained in this report which is from official SBA and Army records; and provided reasons and justifications for its actions and

CONTRACTS SELECTED BY SBA FOR THE  
PILOT PROGRAM AS OF NOVEMBER 4, 1980

<u>Pilot project</u>	<u>Estimated value (000 omitted)</u>	<u>Army procurement activity</u>	<u>Procurement identified by</u>	<u>Date reserved (note a)</u>	<u>Status as of 11/4/80</u>
Water purification unit, reverse osmosis (ROWPU) (30 ea)	\$3,825 (note b)	Mobility Equipment Research and Development Command (MERADCOM)	8(a) firm	3/15/79 3/19/79	Contract awarded by Army to SBA on 1/31/80; SBA awarded contract to 8(a) firm on 2/22/80
Trailer, flatbeds (for ROWPU) (30 ea)	1,600 (note c)	MERADCOM	SBA	3/15/79 3/19/79	Contract awarded to SBA 9/28/79; SBA awarded contract to 8(a) firm on 9/28/79
Insulation & installation of storm windows at Ft. Leonard Wood, MO	4,100	Omaha District Corps of Engineers (COE)	(note d)	7/20/79 7/24/79	Contract awarded to SBA 12/20/79; awarded by SBA to 8(a) firm on 3/3/80
High frequency radio network up-grade	3,750	Communications and Electronics Material Readiness Command (CERCOM)	SBA	5/09/80 5/12/80	Contract awarded to SBA 7/22/80

<u>Pilot project</u>	<u>Estimated value (000 omitted)</u>	<u>Army procurement activity</u>	<u>Procurement identified by</u>	<u>Date reserved (note a)</u>	<u>Status as of 11/4/80</u>
Addition and alterations on library, USAF Academy, CO	4,000	Omaha District COE	8(a) firm	10/02/79 1/28/80 1/29/80	Project deferred because of lack of FY80 funds
High mobility multi-purpose wheeled vehicle	Undetermined	Tank Automotive Research and Development Command (TARADCOM)	8(a) firm	2/08/80 2/25/80	Request denied by Army-- SBA withdrew the reservation on 9/17/80 (See p. 8.)
43 Division level data entry device (DLDED)	110,000 (multiyear)	Communication Research and Development Command (CORADCOM)	8(a) firm	12/19/79 1/10/80	Being negotiated
Modular tactical communication center of the Tri-Tac family of modular record traffic	Undetermined	CORADCOM	8(a) firm	12/19/79 1/10/80	On 2/6/80 SBA withdrew its request
Construction of flight line laboratory at Wright-Paterson AFB, OH	8,000	Baltimore District COE	SEA, Chicago regional office	2/20/80 2/26/80	Project deferred until FY81 because of lack of FY80 funds

APPENDIX II

APPENDIX II

<u>Pilot project</u>	<u>Estimated value (000 omitted)</u>	<u>Army procurement activity</u>	<u>Procurement identified by</u>	<u>Date reserved (note a)</u>	<u>Status as of 11/4/80</u>
Construction of utility fill alongside U.S. hwy. and Interstate 85, Granville County, NC	1,500	Wilmington, NC, district COE	SBA	7/02/80 7/07/80	Award expected FY 1981
Construction of Chatham County I recreation area, Beverett Jordan Dam	5,000 to 10,000	Wilmington, NC, district COE	SBA	7/02/80 7/07/80	Referred to COE-- project will not start sooner than FY 1982
45 Construction of composite medical facility at Ellsworth AFB, SD	11,800	Denver district COE	SBA	7/17/80 7/17/80	Referred to COE-- Air Force deferred project until FY 1981
Crane for 5-ton tractor/wrecker	3,000	TARCOM	SBA-PCR	7/17/80 7/17/80	Solicitation issued 8/14/80
Building of Missouri River levee system, stage 2, unit L	3,400	Denver district COE	SBA	7/17/80 7/17/80	Scheduled for award in FY 1981
Antenna assembly	Undetermined	CORADCOM	SBA-PCR	7/30/80 7/31/80	Scope of procurement not yet determined



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

OFFICE OF THE ADMINISTRATOR

DEC - 2 1980

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

Dear Mr. Eschwege:

This is in response to your letter of October 16, 1980, which requested this Agency's comments on your draft report entitled, "Implementation of the 8(a) Pilot Program for Disadvantaged Small Businesses Has Not Been Effective."

Before we comment on each of the recommendations in the report, we would like to generally state that we are of the opinion that the report is unduly critical. We believe the Pilot Program has revealed very positive features which further enables SBA to assist minority-owned companies to systematically plan their growth and development and to improve SBA's management of firms in the 8(a) portfolio. This program has also enhanced SBA's ability to assist and develop viable minority-owned businesses in penetrating the non-traditional types of federal procurement contracts which have historically eluded minority-owned business firms in this country. We agree that improvements can be made and we are seeking methods to improve this program. The following are our comments on each recommendation made in the report.

Recommendation: "Direct program officials to diligently enforce the objective of the pilot program by demanding contracts only when Army (sic) is reluctant to offer them under the regular 8(a) program. Also these officials should only use the pilot program when a qualified firm is known."

Comments: This recommendation, in part, relates to GAO's observations that only contracts which would not traditionally be offered to SBA by the Army under the regular 8(a) program should be considered as procurements under the Pilot Program in a manner consistent with the objectives of that program. While we do not take issue with this observation, we are concerned that the language of the recommendation does not adequately or accurately describe the role of SBA under the Pilot Program.

As noted earlier, the primary goal of the Pilot Program is to actively involve SBA in efforts to identify high technology, multi-year, monetarily significant contracts which traditionally have not been awarded to firms owned and controlled by socially

Mr. Henry Eschwege

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therefore, not aware of the capabilities of individual 8(a) contractors. In short, when the PCR knows company capability, he/she has usually been able to get agreement from the Army to use 8(a) procurement procedures. By definition this procedure is the "regular" 8(a) program - not the Pilot Program. Paragraph II B (3) of the "DA/SBA Interagency Procedures Implementing the Pilot Program Under Public Law 95-507, Amending Section 8(a)(1)(B) of the Small Business Act" states that "The SBA Procurement Center Representative (PCR) will be the primary individual responsible for a) identifying requirements on the local level, b) coordinating actions with the procuring activity or placement of requirements identified on the national level and c) recommending requirements or categories of requirements to be identified on the national level." (Emphasis added.) Under any circumstances the PCR recommends, identifies or coordinates, but cannot and should not decide. Specifically, the decision to "accept" or "take" a requirement or "match" a requirement with an 8(a) company is not in the hands of the PCR.

In support of the "Pilot Program" and the 8(a) program in general, Bulletin #2 to the Prime Contracting SOP was issued October 15, 1979. Copies of this bulletin and copies of the MSB-COD lists of commodities and services required to support the FY '80 requirements for the 8(a) program portfolio companies were distributed at our national training sessions in October and November 1979. These were specifically discussed with all PCRs in attendance.

The cumulative three quarters reports for FY '80 indicate that 1,865 items have been referred by PCRs for the 8(a) program. These have an estimated value of \$1,233,733,000. With specific reference to those items referred which might have been used for the Pilot Program, the following examples are cited:

Tractor/trailor with crane \$2.7 million - under negotiation.

M-332 Cargo Trailor - awarded in September - \$10.5 million.

Operation of National Training Center estimated at \$25 million.

Tactics Trainer (Patriot System) estimated at \$16 million.

Stinger System - 7 items estimated at \$3 million.

Roland containers - estimated at \$1.8 million.

Software Services - estimated 1st year \$800,000  
2nd year \$1,000,000.

In summary, it is evident that the PCRs have supported the 8(a) program and the "pilot" with referrals and recommendations.

Mr. Henry Eschwege

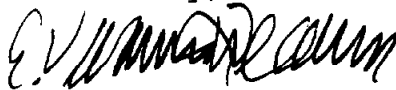
Page 5

GAO questions SBA's use of BDE fund in support of a second firm, implying that the action was improper since the contract in question was outside the firm's current line of business. However, the particular contract required capabilities existing within the firm's management structure and the firm's performance to date justifies the SBA decision.

GAO states that a third firm was awarded a \$4 million contract in a joint venture with a non-8(a) firm even though the firm was a one-man operation. The joint venture was required since the 8(a) firm could not have obtained the necessary bonding without this type of arrangement. Over the years, joint ventures have been used in construction procurements principally to enable the 8(a) firm to obtain bonding. The excellent contract performance to date supports the decision in this case.

Finally, we would like to express our appreciation for the opportunity to comment on the report and if you need any additional information, please advise.

Sincerely,



A. Vernon Weaver  
Administrator

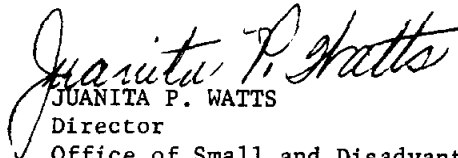


The Army recommends that some comment be made as to the excessively high administrative costs incurred by the Army in dealing with the Pilot Program. During the past year, 75% of all professional time in the Office of the Director, SADBUD was devoted to some aspect of the Pilot Program. The result was only \$19.3 million in pilot program contracts in Fiscal Year 1980 while the expenditure of only about 15% of the professional time related to \$273.4 million of regular 8(a) Program contracts. Added to the Pilot Program costs should be the increased demands on other DA headquarters offices, major commands and purchasing activities in administrative functions, technical evaluations, negotiations and extensive conferences, briefings and communications.

The Army fully supports the GAO position (p. iii) that the pilot program should be more fully tested in an agency that has not yet demonstrated its support for the 8(a) program. The Army experience can now be analyzed without continuing the Pilot Program with the Army. The program has been tested with the Army. At this time a different agency should be designated as the Pilot Program agency; one which has not demonstrated its support of the regular 8(a) Program. With the experience gained through the Army test, the SBA should be able to proceed expeditiously with a new agency. At the end of the test period, a valid comparison can be made as to the benefits that accrue to 8(a) firms from two very different approaches to the Pilot Program concept.

Other comments are included at Inclosure 1.

Sincerely,



JUANITA P. WATTS  
Director  
Office of Small and Disadvantaged  
Business Utilization

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as





DEPARTMENT OF THE ARMY  
OFFICE OF THE SECRETARY OF THE ARMY  
WASHINGTON, D.C. 20310

SADBU

2 DEC 1980

Mr. W.H. Sheley, Jr.  
Acting Director  
Procurement and Systems Acquisition  
Division  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Sheley:

This is in reply to your letter of October 16, 1980 to the Secretary of Defense regarding your draft report on "Implementation of the 8(a) Pilot Program for Disadvantaged Small Business Has Not Been Effective", OSD Case #5553, GAO Code 077940.

The report reflects a keen understanding of the way in which the Pilot Program has been administered by the SBA. The GAO team has done an excellent job of uncovering the facts, analyzing them and then setting them forth in the proper perspective. While the Army was aware of some of the situations covered in the report, many additional elements were revealed in the report. The team members should be complimented for their development of this report.

The central theme of the report realistically presents the inability of the Small Business Administration (SBA) to properly assess and match an 8(a) firm's capabilities with procurement opportunities. In light of this observation a comment might be included in your report that reflects the repeated attempts that have been made by the Army during this period of the Pilot Program to assist the SBA in this area. Formal and informal communications have been made to the SBA to submit the names of those firms which the SBA intends to support under the Pilot Program. The Army would, utilizing the expertise available to it, analyze each firm and identify procurement opportunities that could be made available to them with the objective of establishing an orderly development effort for those firms. This approach was iterated during hearings on March 6, 1980 before the Task Force on Minority Enterprise of the Subcommittee on General Oversight and Minority Enterprise of the Committee on Small Business of the House of Representatives. It should be noted that such an approach can be carried out under the purview of the regular 8(a) program.

Mr. Henry Eschwege

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Recommendation: "Direct that the Office of the Inspector General conduct reviews of the three initial pilot contracts to determine the effectiveness of contractors' performance."

Comments: SBA will initiate two actions regarding this recommendation. First, you are aware that the Office of the Inspector General over the last three years has used substantial staff resources for various reviews in the 8(a) program. In fact, a followup review of prior findings dealing with 8(a) business development expense funds and advance payments is now in process. This work was requested by the Chairman, Subcommittee on Federal Spending Practices and Open Government during oversight hearings. Accordingly, the Inspector General advised me that he will, as part of his 8(a) followup, review the use of all SBA funds disbursed to the 8(a) firms under the reverse osmosis water purification unit contracts. Second, I will direct the Associate Administrator for Minority Small Business and Capital Ownership Development to also have his Office of Program Surveillance and Assistance initiate reviews to determine if the three initial pilot contracts were effectively performed by the 8(a) firms.

Recommendation: "The Congress should amend the authorizing legislation to allow for the further testing of the pilot program in an additional agency that has yet to demonstrate its complete support for the 8(a) program."

Comments: While we would welcome other agencies' participation in the Pilot Program, we believe that it is important for the Army to continue in the program. While the Army's 8(a) program has been more successful as compared to other agencies, they have relied very heavily upon non-professional service requirements to meet their goals. In this respect, there is a need to have the Army place far more emphasis in the area of manufacturing.

In addition to the above, we would like to make several comments not directly concerning the report recommendations.

The report indicates that an 8(a) contract was awarded by SBA's Central Office at the same time a firm was being recommended and terminated by the District Office. It goes on to say that the particular firm had continually experienced financial difficulty due to questionable financial practices, and that SBA agreed to provide \$1.2 million in BDE to support the firm's performance. We believe that the selection of this firm was proper and that its performance to date on the contract support SBA's confidence in its ability to deliver. We also feel that the use of BDE was appropriate and consistent with the guidelines of SOP policy.

Mr. Henry Eschwege

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and economically disadvantaged businesspersons. Because Congress recognized the historical reluctance of Government agencies to award such contracts to these firms, it provided SBA with a vehicle by which it could require that an identified contract opportunity be reserved for a qualified 8(a) firm under the Pilot Program. This provision neither envisions nor requires that SBA should become actively involved only when it must force action by another agency. Rather, it is more an expression of the Congressional sense of purpose that the Army shall take all steps to ensure compliance with the spirit and intent of the will of Congress.

The success of the Pilot Program, therefore, depends on the ability of SBA and the Army to work closely together in a good faith effort to identify and reserve contracts in a manner consistent with the intent of the program. As these relationships are developed, it is believed that an adequate number of contracting opportunities will become available absent any resort to the mandatory reservation provisions of the program. Since this is a new and creative contracting process, we recognize our responsibility to evaluate, select and closely monitor those firms operating under the Pilot Program to ensure to the maximum extent possible, that the business development goals of those firms as well as the objectives of the Pilot Program will be realized.

Recommendation: "Direct program officials to make sure that 8(a) firms selected for the pilot program have the capability to successfully perform the procurement. SBA should use information on the firm's past performance in delivering on 8(a) contracts."

Comments: We believe that SBA's record is satisfactory in this regard; however, we will continue to endeavor to improve in this area. Notwithstanding procedural questions concerning requirements identification and source selection on the first three projects, it should be noted that performance of all three contractors have been satisfactory. This indicates that SBA selected capable management teams in each case.

Recommendation: "Direct program officials to make sure that procurement center representatives are provided sufficient information on 8(a) firms' capabilities so that this data can be used to match qualified firms to procurements."

Comments: We believe that the conclusion which caused this recommendation to be made, i.e., "PCR's have not been effective in identifying pilot projects," may be misleading without clarification of the operational division of responsibility within SBA.

Operational control of the Pilot Program has been centralized in the Washington Office. While it was agreed that Procurement Center Representatives (PCRs) would continue to identify Army requirements which appeared to be susceptible to performance by 8(a) contractors, it was understood that PCRs by the nature of their work are at posts of duty away from regional offices and,

<u>Pilot project</u>	<u>Estimated value (000 omitted)</u>	<u>Army procurement activity</u>	<u>Procurement identified by</u>	<u>Date reserved (note a)</u>	<u>Status as of 11/4/80</u>
Training management control system	2,300	Computer System Selection and Acquisition Agency	SBA	8/12/80 8/15/80	Technical proposal under evaluation

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- a/The first date is the date of the SBA letter requesting reservation. The second date is the date the Army received the SBA letter. Where three dates are shown, SBA made an initial request but did not provide information on the contractor as required by the SBA/Army agreement. In this case the third date is the date sufficient information was received by Army to proceed with the procurement process.
- b/The SBA-Army contract was for \$3,825,000. In addition the 8(a) firm received \$1.2 million in business development expense funds from SBA.
- c/The SBA-Army contract was for about \$1.6 million. In addition the 8(a) firm received \$273,000 in business development expense funds from SBA.
- d/The procurement was originally offered to SBA by the Army for the regular 8(a) program; however, SBA's central office demanded it for the pilot program (see appendix I for further information on this contract).
- e/This is a follow-on to the ROWPU contract discussed in appendix I. On 1/16/80, SBA requested Army to reserve this requirement for the second firm discussed in appendix I. Accordingly Army issued a request for proposal to the second firm on 4/18/80. On 4/29/80 SBA requested Army to issue the request for proposal to the first firm (in appendix I) instead. The new request for proposal was issued to the first firm on 7/2/80.

<u>Pilot project</u>	<u>Estimated value (000 omitted)</u>	<u>Army procurement activity</u>	<u>Procurement identified by</u>	<u>Date reserved (note a)</u>	<u>Status as of 11/4/80</u>
Standard military gasoline engines	31,400	Troop Support and Aviation Material Readiness Command	Army	4/30/80 5/06/80	Army offered requirement under regular 8(a) program in 10/78. SBA placed it in pilot 4/30/80 (See p. 16.)
Transportable shelter system, Army Calibration Lab	750	MICOM	SBA-PCR	5/06/80 5/09/80	Proposal received from 8(a) firm on 9/5/80
Battery chargers	9,400 (multiyear)	ERADCOM	SBA-PCR	5/09/80 5/13/80	Solicitation issued 9/12/80
HF air/ground support equipment	200,000 (multiyear)	CORADCOM	SBA-PCR	5/21/80 5/21/80	Solicitation issued 8/8/80
Acquisition, installation, and management of a wide range of computer controlled range instrumentation equipment	30,000 (multiyear)	MICOM	SBA-PCR	6/04/80 6/04/80	Being negotiated

<u>Pilot project</u>	<u>Estimated value (000 omitted)</u>	<u>Army procurement activity</u>	<u>Procurement identified by</u>	<u>Date reserved (note a)</u>	<u>Status as of 11/4/80</u>
AN/PPS-15 doppler radar set	1,600	Electronics Research and Development Command (ERADCOM)	8(a) firm	7/16/79 7/19/79	Contract awarded to SBA 9/29/80
Water purification unit (ROWPU--11 units complete)	950	MERADCOM	8(a) firm	1/16/80 1/16/80	Contract awarded to SBA 9/30/80 (note e)
Operation and maintenance of ground-air coordination equipment for maneuvering troops, tanks, and helicopters	8,854 (1st year-- multiyear)	Experimental Development Command (EDEC) Ft. Ord, CA	8(a) firm	1/28/80 1/29/80	Contract awarded to SBA 10/14/80
42 Cargo Trailers (1-1/2 ton)	8,800	Tank Automotive Material Readiness Command (TARCOM)	SBA-PCR	5/21/80 5/21/80	Contract awarded to SBA 9/29/80
Validation and verification for general support rocket system	818	Missile Command (MICOM)	8(a) firm	5/21/80 5/21/80	Contract awarded to SBA 10/15/80
Liquid waste disposal, Rocky Mountain Arsenal	6,500	Omaha District COE	8(a) firm	10/02/79 1/28/80 1/29/80	Being negotiated
Construct commissary store, Ft. Ben. Harrison	5,000	Omaha District COE	SBA	10/02/79 1/28/80 1/29/80	Project deferred to FY81 because of lack of FY80 funds



gave opinions. GAO scrutinized these comments and reevaluated all evidence obtained from SBA and Army; as a result, GAO did not have to make any substantive changes in developing the final report.

Joint venture agreement  
and contract signing

During the period November 29, 1979, to February 29, 1980, XYZ and DEF endeavored to develop a joint venture agreement that would satisfy SBA. The first draft was completed November 29, 1979; however, it was not until February 29, 1980, that SBA approved the final joint venture agreement. Meanwhile, on February 6, 1980, after receiving no response to inquiries on the status of the contract, Army again threatened to withdraw the project.

On March 3, 1980, SBA awarded the subcontract between XYZ-DEF and SBA. The Notice to Proceed was issued March 18, 1980.

Who's doing what

SBA's standard operating procedures (SOPs) for joint venture agreements between 8(a) firms and other concerns performing on 8(a) subcontracts state that "The 8(a) concern shall perform at a minimum the following percentage of the total dollar amount of any subcontract with its own labor force:

(a) Manufacturing	50 percent
(b) Construction	15 percent
(1) General Contractor	15 percent
(2) Specialty crafts, such as Electrical, Plumbing, Mechanical, etc.	25 percent
(c) Professional Services	55 percent
(d) Non-Professional Services	95 percent."

In addition, the SOP states that "The 8(a) concern shall appoint one of its employees as project manager responsible for contract performance."

The Fort Leonard Wood project has several parts. The following is a list of these parts and the firm responsible for performing the work on each part.

- Manufacture windows--DEF Products (a subsidiary of DEF, Inc.).
- Install windows--XYZ-DEF joint venture.
- Install insulation--subcontracted to a non-disadvantaged insulation firm.
- Manufacture siding--purchased from a supplier.
- Install siding--DEF, Inc.

gave SBA a timetable calling for a proposal from XYZ to be delivered to the Army by September 25, 1979. Formal negotiations were to start November 5, 1979.

The Army, as expected, received several complaints from firms that had planned to bid on the project and had spent considerable funds drawing up their bid proposals. The Army cited the provisions of Public Law 95-507, section 8(a)(1)(B)--the pilot program--and apologized. The Comptroller General of the United States also denied a formal bid protest.

#### XYZ's joint venture

Because XYZ itself did not have the capability to complete the substantial work required on the Fort Leonard Wood project, it proposed a joint venture with a non-disadvantaged firm, hereinafter referred to as ABC, Inc. On September 19, 1979, the presidents of both firms visited the Corps' Omaha district office to discuss the project. It soon became apparent to Army officials that XYZ had not received some of the proposal package from SBA nor any assistance on how to prepare a proposal of this magnitude. The Army attempted to help XYZ, but by then it was too late to prepare an adequate proposal by the September 25 deadline.

During October 1979 the Army contacted SBA on three separate occasions urging SBA to support XYZ and to ask about preparations for contract negotiations. It is apparent that SBA was doing almost nothing to help XYZ and actually did not intend even to send a representative to the negotiations (until Army requested it to do so).

#### First contract negotiation session

The first negotiation session was held November 7, 1979--it was inconclusive. During the session it became apparent that ABC, Inc., was not the proper choice for a joint venture--it had no experience in the type of work called for by the project. In addition, the price demanded by the XYZ-ABC joint venture was far in excess of the Army's estimate. A second session was scheduled for November 14 and 15.

On November 13, 1979, SEA's pilot program manager notified Army that SBA had hired a management consultant to analyze XYZ's proposal and the Army's estimate and attempt to resolve the differences. He requested an extension of the negotiation date.

CASE SUMMARY ON CONTRACT 3--STORM  
WINDOWS AND INSULATION PROCUREMENT

An 8(a) firm (hereinafter referred to as the XYZ Company), specializing primarily in window installation, received the third contract awarded through the pilot program. SBA's central office approved and qualified XYZ to perform on a complicated \$4 million project without assessing the firm's capability.

Background

The XYZ Company, located in Washington, D.C., applied for eligibility in the SEA 8(a) program in 1978. The application was approved on July 5, 1978, with a projected assistance--if contracts were available--of \$2,000,000 for the first and second years, \$1,500,000 for the third year, and \$500,000 for the final year. SBA advised the firm to pursue commercial and competitive business contracts on its own in accordance with the firm's business plan.

XYZ's initial experience  
in the 8(a) program

The president of XYZ has self-marketed his firm from the beginning of its certification into the 8(a) program. On July 13, 1978, he bypassed SBA by submitting a direct request to the Department of Commerce to set aside a procurement for the installation of windows at the Merchant Marine Academy in New York under the 8(a) program. In addition, he wrote the Chairman of the House Subcommittee on Minority Enterprise and General Oversight, Committee on Small Business, requesting the chairman to contact the Secretary of Commerce and the SEA Administrator on his behalf. The Commerce Department refused his request to be treated as a separate prime contractor only for the installation of windows on the project. It would have allowed him as a subcontractor--he refused.

In the fall of 1978, XYZ's president unsuccessfully sought to obtain a contract to replace windows at the Veterans Administration Center in Wilmington, Delaware. He again wrote the Chairman of the House Subcommittee on Minority Enterprise and General Oversight complaining of unfair treatment. In the spring of 1979, XYZ finally received a \$70,000 contract to install windows at the Veterans Administration Medical Center, Fort Howard, Maryland.

the trailers. The Army found that the second firm was capable of building the trailers and assembling the ROWPUs. In an effort to "please everybody," the Army suggested a compromise wherein the second firm was to build the trailers and ship them to the first firm which would then assemble the ROWPUs on them.

The president of the second firm, however, expressed his dissatisfaction with splitting the ROWPU procurement in such a manner. He felt it would be more appropriate to split the fabrication of the complete units between the firms rather than have his firm build the trailers and the first firm assemble the components into a final product. According to SBA's technical consultant, the second firm believed the division of effort with the first firm was ill conceived because:

- The second firm would be confined to assembling trailers, a job that requires metalworking capabilities not within its current line of business.
- SBA would have to provide BDE funding (\$273,000) for capital assets that are not particularly relevant to the firm's current field service contracts with the Navy. 1/
- The second firm's ability to gain this contract requires that the first firm's bid be acceptable.
- Any follow-on awards are dependent on the first firm's successful performance, making the second firm doubly dependent on the first.

The second firm's president further stated that by fabricating the trailers alone, his firm would not gain the necessary experience and expertise in manufacturing processes needed to produce the complete ROWPU system. The Assistant Regional Administrator for Procurement Assistance in San Francisco

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1/Officials in Army's Office of Small and Disadvantaged Business Utilization told us on October 31, 1980, that SEA recently selected the first firm to produce 11 additional ROWPUs and trailers. They pointed out that SEA is apparently willing to spend additional BDE funds to equip the first firm to build trailers and that SBA wasted the BDE funds it used to equip the second firm to build trailers.

- Incomplete and inconclusive supporting data from the firm's proposal attributed to the large differences in labor hours and rates between the Army's estimates and the firm's proposal.
- The lack of historical data on prior ROWPU purchases, which precludes price analyses that could provide a realistic pricing standard.

The fixed-price incentive contract, however, was not accepted by the SBA central office. Instead, the central office allowed the firm its 12-percent profit.

The first firm's request for BDE not adequately supported

The SBA central office approved \$323,000 in BDE funds requested in the firm's proposal for purchasing capital equipment and for leasing facilities. The SBA contract negotiator and the technical consultant, however, criticized the approval of these funds because they felt such a large amount lacked adequate justification. The technical consultant felt that the need for such a large amount of BDE funding reflected poorly on the firm's capability to properly plan and procure facilities and equipment to support its ROWPU business objectives.

The technical consultant's cost estimate for acquiring needed facilities and equipment came to \$191,000. The consultant suggested a BDE grant of \$220,000. He suggested that the firm could reduce the amount of BDE funds needed by purchasing used equipment, avoiding excessive investments in hand tools, deferring lease deposits, and obtaining quantity discounts on furniture and other equipment.

The Assistant Regional Administrator for Minority Small Business for region IX told us that the \$323,000 in BDE funding finally appropriated at the SBA central office had been promised to the firm by the Director, Office of Business Development. The contract negotiator expressed dissatisfaction with the contract and with the amount of BDE funds SBA agreed to provide. He indicated that he did not believe that either the procurement or the BDE funding allowance would contribute to the firm's ultimate viability.

SBA's use of BDE was not an  
incentive to negotiate earnestly

As part of the contract between SBA and the first firm, SEA is providing it with about \$1.2 million in business development expense funds to meet the price difference between the Army's estimated fair market price (about \$3.8 million) and the firm's final negotiated price (about \$5 million). Included in this amount of BDE funding is about \$323,000 calculated by the firm as the cost to obtain the equipment and facilities it needed to go into production. This approval was granted by the Director, Office of Business Development, since it substantially exceeded SBA's \$350,000 ceiling, which regional administrators can approve. The Assistant Regional Administrator for Minority Small Business for region IX said that providing BDE funds to the firm was prearranged at the SBA central office in order to ensure the consummation of this initial pilot program award.

Our assessment of the negotiation process, however, indicated that SBA's agreement to provide BDE funds was not an incentive for the negotiators to come to terms. Instead, our review indicates that the prospect of SEA providing BDE funds probably encouraged the firm and the Army to avoid reaching a mutually agreed-upon price. Also, SBA did not determine what BDE savings would have resulted had the second firm been selected to produce the ROWPUS.

At the start of the negotiation process, the first firm's initial proposal was almost twice the amount proposed by Army. The firm's proposal was for \$6.5 million; Army's was for \$3.8 million. The \$2.7 million difference was attributed to the firm's expectation of a production effort far in excess of Army's scope of work. Even after SBA advised the firm to negotiate the contract price in accordance with the scope of work defined by the Army, the firm's and the Army's revised proposals still reflected a difference of about \$2.3 million.

In the final negotiation session, the Army and the firm could not agree upon a compromise figure for indirect costs. The negotiations proceeded to a bottom-line price proposal when the Army concluded that the firm was not concerned about the reasonableness of individual cost elements. At the close of negotiations with the Army, the firm's offered price was \$5,193,988.50.

itself of 8(a) firms' capability to perform through its preaward surveys. But he said that SEA should develop certain minimum information on each of its 8(a) firms, including the firm's performance on past 8(a) contracts, its prior experience, and the adequacy of its facilities.

SBA central office does not  
have sufficient information  
on its 8(a) contractors

Although the SBA central office assured the Army that the two firms had the capability of meeting the terms of the procurement, several SBA field office officials questioned the first firm's capability because of their knowledge of the firm's poor performance in the past.

The Los Angeles district office was not involved in the selection of the firms for the ROWPU pilot project. However, a contract negotiator in that office expressed reservations to SBA central office officials about the firm's capability to perform the tasks called for in the procurement. His reservations were based on his knowledge of the firm's poor performance on past contracts, its poor financial condition due to questionable financial practices, and its lack of adequate facilities and resources to support the new operation.

The Assistant Regional Administrator for Minority Small Business and Capital Ownership Development in region IX agreed with this criticism of the firm. He said the firm was selected for the ROWPU procurement more as a result of its marketing effort than on its prior 8(a) performance. He also said that if the decision had been up to him, he would not have recommended the firm for the procurement based on his knowledge of the company and its past performance on 8(a) contracts.

District office proposes  
termination of the first  
firm for unsatisfactory progress

At about the same time that SBA was processing the contract, the Assistant Regional Administrator in region IX who oversees the firm's progress was endorsing the district office's recommendation that the firm be terminated from the 8(a) program. The firm's unsatisfactory performance, its history of nonprofitability, and its negative retained earnings and diminished net worth due to questionable financial transactions were factors in the district office's recommendation. Further SBA district office analysis revealed that:



CASE SUMMARIES ON THE  
THREE INITIAL PILOT CONTRACTS

The following cases demonstrate SBA's problems in selecting and awarding the three initial contracts selected in the pilot program. They also demonstrate other problems and issues relating to the regular 8(a) program. We found that SBA awarded the first three 8(a) pilot project contracts to firms without adequately assessing their capability to do the job.

CASE SUMMARY ON CONTRACTS 1 and 2--  
THE ROWPU PROCUREMENT

The first procurement awarded under the pilot program was for the production of 30 trailer-mounted reverse osmosis water purification units. Separate contracts were awarded to two 8(a) firms. One contract of about \$5 million was awarded to a firm (hereinafter referred to as the first firm) to assemble and test the water purification units and install them on trailers. The firm, initially owned by two partners--one disadvantaged and one nondisadvantaged--was accepted into the 8(a) program in November 1970. Later, the two partners incorporated the business, and in 1978 the disadvantaged owner subsequently acquired complete ownership.

The other contract of about \$1.9 million was awarded to a firm (hereinafter referred to as the second firm) to build trailers and frames upon which the unit would be installed. This firm entered the 8(a) program in December 1973 and was incorporated in 1974.

The first firm identifies the ROWPU procurement

The president of the first firm took the initiative in seeking this procurement after learning from a 1977 Army document that Army intended to procure ROWPUs. The firm's normal business was manufacturing and assembling electrical and electronic products, but the firm's president realized that this procurement offered an opportunity to enter a new, growing industry. Through his own marketing efforts, and with the support of the National Association of Black Manufacturers, he was able to convince the SBA central office to reserve the procurement from Army as the initial contract selected under the pilot program.

The Deputy Associate Administrator of the Office of Federal Procurement Policy, Office of Management and Budget, made an unsolicited recommendation to the President's Assistant for Domestic Affairs and Policy. He recommended the National Aeronautics and Space Administration because it has been an enthusiastic supporter of the 8(a) program.

#### WAS THE ARMY THE BEST AGENCY FOR THE PILOT PROGRAM?

We have noted the differences of opinion between SBA and Army over Army's selection as the pilot agency. In addition, we noted that the major reason for Army's selection seemed to be its history of cooperation in offering procurements to the regular 8(a) program. The question remains--was the Army the best agency?

It appears that Army can offer enough procurements of a sophisticated, high-technology, large-dollar, multiyear nature to test this aspect of the pilot program's purpose. In addition, the Army's Office of Small and Disadvantaged Business Utilization has expressed its interest in helping SBA to identify procurements that offer development opportunities to 8(a) firms.

However, we believe that another aspect of the pilot program needs to be tested further. This is its ability to help SBA secure more procurements from an agency that has been reluctant to volunteer procurements to the regular 8(a) program. This would require that the authorizing legislation be amended to allow an additional pilot agency to be selected.

#### CONCLUSION

Because the Army--a cooperative agency--was selected to participate in the pilot program, we believe that the legislative objective to use the pilot to help SBA secure more 8(a) procurements has not been fully tested. The selection of another agency with a history of not being conscientious in volunteering 8(a) procurements would fully test this legislative objective.

#### RECOMMENDATION TO THE CONGRESS

The Congress should amend the authorizing legislation to allow for the further testing of the pilot program in an additional Federal agency that has yet to demonstrate its complete support for the 8(a) program.

chapter 2, it is attempting to use the pilot program to upgrade the quality of 8(a) procurements. This is reflected in the special criteria issued on April 15, 1980, listing the most desired project characteristics for pilot program procurements. These criteria call for sophisticated, high-technology, large-dollar, multiyear procurements.

In addition, SBA issued special requirements for 8(a) firms nominated to perform these procurements. This action recognized the probability that only relatively strong firms are capable of successfully performing such challenging projects.

#### Army's interpretation of the pilot program's purpose

On the other hand, Army's interpretation of the pilot program's purpose is "more procurements." Officials of the Office of Small and Disadvantaged Business Utilization, Office of the Secretary of the Army, told us that they believe that the pilot's purpose is to augment the regular 8(a) program by giving SBA the right to demand procurements not previously offered to it. They said that the Army has had a history of cooperating with the regular 8(a) program--Army has had the largest dollar amount of 8(a) contracts of any Federal agency every year since fiscal year 1975. In addition, from fiscal years 1977 through 1979, Army volunteered \$640.5 million to the regular 8(a) program that was rejected by SBA. They told us that an agency that has not yet supported the 8(a) program should have been chosen as the pilot agency.

#### HOW ARMY WAS SELECTED

In November 1978 a small committee consisting of SBA's Associate Administrator for Minority Small Business and Capital Ownership Development and two members of his staff was formed to recommend which Federal agency should participate in the pilot program. This committee assembled information on the various agencies' performances in supplying contracts for the regular 8(a) program. Based on this study, the committee recommended to the Administrator, SBA, on December 15, 1978, that all of the Department of Defense (DOD) be included as pilot participants. The committee's reasons for selecting DOD were:

1. DOD's large volume of 8(a) procurements--56.4 percent of the total of all Federal agencies in fiscal year 1978. (The largest civilian agency--General Services Administration--had 7.9 percent.)

## SBA COMMENTS AND OUR EVALUATION

SBA did not adequately respond to two of the three recommendations.

In commenting on our first recommendation, SBA believes its record in the pilot program is satisfactory; however, it will continue to try to improve its efforts. Although we criticized SBA's selection of the first three contracts in the report, SBA said only that it stands behind its decisions on these contracts and that the contractors' performances have been satisfactory. SBA offered no specific comments on the need for program officials to know the capabilities of 8(a) firms selected for the pilot program, especially information on the firms' past performance in delivering on 8(a) contracts. We continue to believe that SBA made a poor choice in awarding the three initial contracts. Program officials need to make sure that 8(a) firms selected for the pilot program have the capability to successfully perform the procurement. A firm's past performance in delivering on 8(a) contracts must also be considered.

With regard to the second recommendation, SBA appears to be saying that it wants to keep a functional role for PCRs in the pilot program, but it does not say whether they should have information on 8(a) firms' capabilities. Moreover, SBA said that the decision to accept a requirement or match a requirement with an 8(a) firm should not be in the hands of the PCR. We continue to believe that in order for the PCR to have an effective role in the pilot program, he or she needs information on 8(a) firms' capabilities in order to know what procurements to seek for the pilot program. As discussed on page 16, PCRs feel that this is a problem in the pilot program and must be corrected.

With regard to the third recommendation, SBA commented that its Office of the Inspector General will review the use of all SBA funds disbursed to the two 8(a) firms involved in the ROWPU contracts. In addition, the Associate Administrator for Minority Small Business and Capital Ownership Development, Office of Program Surveillance and Assistance, will initiate reviews to determine if the three initial pilot contracts were effectively performed by the 8(a) firms involved.

To review this problem further, we interviewed 10 PCRs stationed at various major Army procurement centers to determine why they have not identified more procurements. One PCR said that he did not identify any projects for the pilot program because the Army is now more willing to voluntarily offer projects under the regular 8(a) program rather than have SBA request them for the pilot program.

Other reasons PCRs gave for not identifying more pilot projects ranged from the opinion that they do not possess enough knowledge of 8(a) firms and their capabilities to allow them to refer procurements to SBA to the argument that they are too busy with other PCR activities. A number of PCRs said that they were not aware of 8(a) firms that had the capabilities needed to perform procurements. Another PCR said that complying with subcontracting requirements for the regular 8(a) program leaves little time for pilot activities.

SBA's ATTEMPT TO MAKE THE PILOT PROGRAM  
LOOK MORE SUCCESSFUL THAN IT IS

Our review disclosed that SBA has placed many projects in the pilot that actually belong in the regular 8(a) program. In our opinion, this was done to make the pilot program look more successful than it actually is.

The authorizing legislation and SBA guidelines distinguish a pilot procurement from a regular 8(a) procurement on the basis of whether a procurement is volunteered to or demanded by SBA. SBA guidelines state that when the Army offers a procurement to SBA, it should not be placed in the pilot. According to the guidelines, a procurement should be placed in the pilot only when SBA is compelled to demand it from Army.

For example, in the November 1980 list of 28 pilot program contracts and project reservations (see app. II), 9 are Army Corps of Engineers projects. We were told by the Director of Army's Office of Small and Disadvantaged Business Utilization that, because the Corps of Engineers has a policy of offering their projects to SBA, most of these projects could be in the regular 8(a) program. This policy was also mentioned by the Chief, Procurement and Supply, Corps of Engineers, Omaha, Nebraska.

Another example is the "standard military gasoline engine" procurement. (See app. II, p. 44.) SBA identified it as a pilot project on April 30, 1980, even though the Army identified it for the regular 8(a) program in October 1978.

To gain technical expertise to assess project requirements, the central office is hiring consultants under the section 7(j)(10) program to help SEA and the 8(a) firms acquire pilot contracts.

The following are the types of problems that were noted in our review of SEA's selection and negotiation of the three initial pilot contracts.

- An 8(a) firm was awarded a \$5 million contract by SEA's central office at the same time it was being recommended for termination by the district office for poor management and unsatisfactory progress in the 8(a) program. Despite the fact that this firm had continuously experienced financial difficulties due to questionable financial practices, SEA agreed to provide \$1.2 million in business development funds to support the firm's performance.
- A second firm was awarded a \$1.9 million contract, including \$273,000 in capital equipment funds, to support a capability that was outside its current line of business.
- The third firm was awarded a \$4 million contract (in a joint venture with a non-8(a) firm) even though the district office described the firm as a "one-man firm" that had not started work on its initial 8(a) procurement, awarded a year earlier. The non-8(a) firm and a non-8(a) subcontractor will do most of the work on this contract.

The results of our review were discussed with the Associate Administrator for Minority Small Business and Capital Ownership Development and his staff on June 12, 1980. They had no comments regarding these deficiencies. However, on another occasion, SEA's chief of the Requirements Division, Office of Business Development, said that SEA would closely monitor the progress of the work of the firm that received the \$4 million contract. Further details of the three contracts are discussed in appendix I.

PCRs HAVE NOT BEEN EFFECTIVE  
IN IDENTIFYING PILOT PROJECTS

The interagency agreement provides that PCRs are to be SEA's primary means of identifying and recommending procurements for the pilot program. Since the PCRs are

program and proceeds to screen 8(a) firms to perform it. But questions have arisen about what constitutes a suitable procurement for the pilot program.

The interagency agreement did not specify objectives to be achieved by the pilot program. However, SBA guidelines issued in September 1979 indicated that the program's objective was to seek 8(a) opportunities that had not otherwise been offered or identified by the Army under the existing 8(a) program. The guidelines also indicated that the pilot program was not intended to eliminate the existing 8(a) program. Instead, it was expected that the Army would continue to actively identify and recommend procurements for the existing 8(a) program.

In April 1980 SBA issued further guidelines on the types of procurements that field office officials were supposed to seek for the pilot program. The revised guidelines stated for the first time that large-dollar, sophisticated procurements were most desirable for the pilot program. By stating that SBA was most interested in seeking these types of procurements, these new criteria represented a narrower scope than the program's original scope of seeking all suitable procurements for the 8(a) program that had not otherwise been offered by the Army.

Our review of the first three contracts awarded under the pilot program demonstrated that SBA does not have the capability to assess whether or not 8(a) firms can perform procurements of this type. (See app. I.) After these contracts were awarded, SBA decided to seek large-dollar, sophisticated procurements. However, this approach has subsequently caused problems for SBA in identifying projects for the pilot program.

SBA'S CENTRAL OFFICE CANNOT ASSESS  
8(a) FIRMS' CAPABILITIES

When the pilot program is used, matching 8(a) firms with procurement requirements is the responsibility of SBA's central office. However, the central office does not have enough information to assess 8(a) firms' capabilities to perform pilot procurements. Therefore, SBA cannot properly match pilot projects with those firms capable of doing the job. Specifically, we found that the central office often lacked information on the procurement's specifications and on the 8(a) firms' capabilities and past performance. We found that SBA does not even maintain records on how well

objective for the pilot program is to seek procurement opportunities that are not currently offered by the Army under the regular 8(a) program. SBA believes its record in selecting firms for the pilot program is satisfactory.

Army does not believe that SBA can properly assess and match an 8(a) firm's capabilities with procurement requirements in the pilot program. Army said that it has made repeated attempts to help SEA with this function by seeking lists of firms that SBA intends to support under the pilot program. Even though Army said it would be willing to use its experts to do the analysis and identify procurements so that an orderly development effort can be established for 8(a) firms, it believes this approach can be performed under the purview of the regular 8(a) program.

We continue to believe that the 8(a) pilot program should be used to identify contracts for the 8(a) program only when Army is reluctant to offer them under the regular 8(a) program. Also, the pilot program should be used only when a qualified firm is available.



MANY NEW PROCUREMENTS IDENTIFIED  
DO NOT MEET PILOT PROGRAM OBJECTIVE

In April 1980 SBA embarked on an effort to place as many procurements as possible in the pilot program. Although only three contracts had been signed by April 1980, SBA had identified 38 additional Army procurements for the pilot. Most of these procurements had not been officially requested from Army using the formal notification process spelled out in the interagency agreement.

We believe that SBA, in assembling the list of 38 procurements, tried to make the pilot program look successful rather than to develop disadvantaged firms. Our review of the list showed that many of the 38 procurements were regular 8(a) program procurements arbitrarily picked for the pilot program. <sup>1/</sup> SBA officials in the Office of Minority Small Business and Capital Ownership Development agreed with our analysis that many of these procurements were regular 8(a)-type procurements.

The results of our review were discussed with the Associate Administrator for Minority Small Business and Capital Ownership Development and his staff on June 12, 1980. They had no comments regarding why SBA has chosen a course of action to expand the use of the pilot program in this manner.

ARMY OPINIONS ON THE USEFULNESS  
OF THE PILOT PROGRAM

Officials of the Office of Small and Disadvantaged Business Utilization of the Office of the Secretary of the Army told us that the pilot program could prove to be useful if SBA directs its application of the pilot toward identifying only those procurements that offer development opportunities to 8(a) firms. Complicated, high-dollar contracts cannot benefit a firm if it cannot do the work. For example, on February 8, 1980, SBA used the pilot program to request a contract for the production of a high-mobility, multipurpose wheeled vehicle. The contract was projected to be worth about \$1 billion. These officials told us that after lengthy deliberations with SBA, SBA's request was denied by Army headquarters since Army was convinced this contract far exceeded the capabilities of the 8(a) firm recommended by SBA. The firm would have been required to change its entire line of business--from engineering consulting to major manufacturing.

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<sup>1/</sup>See chapter 3, pages 14 and 15, for a more detailed discussion of this list of procurements.

manufacturing the trailers and frames had been notified that SBA intends to gradually reduce its 8(a) contractual support through September 30, 1982, at which time the firm will be considered to have reached program completion. Under these circumstances, we question why SBA awarded it a new contract in an entirely different field from its line of business.

### THE THIRD CONTRACT

The third contract--for \$4 million--was awarded to a joint venture between an 8(a) firm and a non-8(a) firm for installing insulation and storm windows at Fort Leonard Wood, Missouri.

#### Regular 8(a) procurement

Our review showed that this procurement was originally offered to SBA for the regular 8(a) program--SBA turned it down. Because of lack of communication between SBA's central office, district offices, and the Army, the Army Corps of Engineers proceeded to routinely process this procurement. The Army did not receive SBA's formal request to reserve the procurement until a few days before bid opening. Because the Army was faced with an embarrassing situation of withdrawing the project immediately before bid opening, it was unlikely to comply with SBA's request under the regular 8(a) program. Accordingly, SBA demanded the procurement under the mandatory provisions of the pilot program.

#### Limited development potential of the Fort Leonard Wood contract

Our review of this contract raises serious questions about its potential to develop the 8(a) firm. The 8(a) firm is a one-man shop with no equipment or trucks. At the time of our review, the firm had failed to perform any work at all on its only previous 8(a) contract, for \$70,000, which had been awarded a year before the award of the \$4 million Fort Leonard Wood contract.

In addition, our review showed that the non-8(a) firm partner in the joint venture intended, along with a non-8(a) subcontractor, to perform the majority of the work on the Fort Leonard Wood contract.

Further details on the three contracts are discussed in appendix I.

## CHAPTER 2

### SBA HAS NOT MET ITS OVERALL

#### OBJECTIVE FOR THE PILOT PROGRAM

Our review of the pilot program showed that SBA has not met its overall objective of improving its ability to obtain procurements which were not currently offered by the Army under the regular 8(a) program. We believe that SBA is attempting to make the pilot program look more successful than it is.

Our review of the initial three contracts selected and awarded under the pilot program showed that they could have been handled through the regular 8(a) program. This is also true of many other Army contracts that have been reserved for the pilot.

In addition, our review of the initial three contracts raises doubts that these contracts will contribute to the development of the 8(a) firms that received them.

#### SBA's OVERALL OBJECTIVE FOR THE PILOT PROGRAM

On September 4, 1979, SBA's Associate Administrator for Minority Small Business and Capital Ownership Development issued operating procedures for the pilot program to all SBA regional administrators. In the operating procedures, SBA stated that its overall objective for the pilot program is to seek procurement opportunities which are not currently offered by the Army under the regular 8(a) program. This objective appears to be consistent with the legislative history of the pilot program, which indicates that the purpose of the pilot is to increase SBA's ability to develop disadvantaged firms.

#### THE INITIAL THREE PILOT CONTRACTS DO NOT MEET SBA'S OVERALL OBJECTIVE

Our review of the initial three contracts selected and awarded under the pilot program showed that they were regular 8(a)-type contracts that could have been handled under the regular 8(a) program. In addition, we question the contribution these contracts will make to the development of the 8(a) firms that received them.

#### THE FIRST TWO CONTRACTS

The first two pilot program contracts relate to a single procurement--the production of 30 trailer-mounted water

stated that its overall objective for the pilot program is to seek Federal procurement opportunities which are not currently offered by the Army under the regular 8(a) program.

#### ACTIVITIES OF THE PROGRAM

Since the interagency agreement, nine contracts totaling about \$34.3 million have been awarded under the pilot program. A total of 19 other contracts had been reserved by SBA, and some have progressed to various stages in the contract negotiation process. SBA has withdrawn others. These contracts are listed in appendix II.

Two of the awarded contracts we reviewed received business development expense (BDE) funds. One received BDE funds to pay the difference between the fair market value and the price at which the 8(a) contractor was willing to perform and to purchase capital equipment needed to perform the contract. The other received BDE funds for capital equipment only.

SBA also used funds under section 7(j)(10) of the Small Business Act to hire consultants to provide services to 8(a) firms receiving pilot contracts. As of June 30, 1980, it had obligated a total of \$260,458 for services related to the pilot contracts.

Originally, authority for the pilot program was to expire on September 30, 1980. However, Public Law 96-481, passed on October 21, 1980, extended the pilot program an additional year.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

Public Law 95-507 requires us to evaluate SBA's implementation of the pilot program. Our objectives during the review were to determine

- how effectively SBA and Army have used the pilot program to meet the act's requirements and
- whether SBA has improved its efforts to secure procurements for the 8(a) program.

These objectives were discussed with the staff of the Senate and House small business committees, as well as with SBA and Army headquarters officials prior to our review.

We reviewed SBA's use of the pilot program from its inception through the completion of our field work on May 30, 1980. During this period only three contracts

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#### ABBREVIATIONS

BDE	Business development expense
DOD	Department of Defense
GAO	General Accounting Office
MERADCOM	Mobility Equipment Research and Development Command
PCR	Procurement center representative
ROWPU	Reverse osmosis water purification unit
SBA	Small Business Administration
SOP	Standard operating procedure

about the 8(a) firms to which it intends to award pilot contracts. SBA believes its record in selecting pilot contracts is satisfactory. It said it would welcome other agencies' participation in the pilot program.

Army said that GAO did an excellent job of uncovering the facts, analyzing them, and setting them forth in the proper perspective in the report. Furthermore, it said the report reflects a keen understanding of the way SBA administered the pilot program. It also said that the report's central theme realistically presents SBA's inability to properly assess and match an 8(a) firm's capabilities with procurement opportunities.

SBA's and Army's comments pertinent to each chapter and GAO's detailed evaluation are included at the end of the chapters. Their complete comments are included as appendixes III and IV, respectively.

The three firms discussed in the case studies, summarized in appendix I, were given the opportunity to review and comment on the factual material that bears directly on their firms. Two of the three firms responded. GAO scrutinized these comments and reevaluated all evidence obtained from SBA and Army; as a result, GAO did not have to make any substantive changes in developing the final report.

GAO believes that the pilot program should be more fully tested in an agency that has not yet demonstrated its complete support for the 8(a) program. (See p. 19.)

#### CONCLUSIONS

GAO believes that the Congress authorized the pilot program to increase SBA's ability to develop viable firms in the 8(a) program.

The successful use of the pilot program depends, in part, on SBA's ability to have information available on the qualifications of 8(a) firms. It also needs to know enough about procurement opportunities to judge whether the firm can do the job. Nevertheless, these requirements can only be fulfilled if SBA has a workable system ensuring that its field personnel are used in critical decisions regarding the selection and certification of firms, and procurement center representatives are used to locate procurement opportunities.

In addition, because the Army, the leading agency in offering contracts to the 8(a) program, was selected for pilot program participation, GAO believes that the legislative objective of using the pilot to help SBA secure 8(a) procurements has not been fully tested.

The selection and award of the three initial contracts are associated with several problems which could adversely affect the 8(a) firms' ability to discharge their responsibilities. Therefore, an independent evaluation needs to be made to determine the effectiveness of the firms' performance.

#### RECOMMENDATIONS TO THE ADMINISTRATOR

Before any further contracts are selected and awarded by the pilot program, the Administrator, SEA, should:

--Direct program officials to diligently enforce the pilot program's objective by demanding contracts only when Army is reluctant to offer

PILOT PROGRAM OBJECTIVE  
NOT MET

Authorizing legislation--and its history-- suggest that the pilot program is meant to help SBA secure 8(a) procurements for disadvantaged businesses. SBA's stated objective for the pilot program is to seek procurement opportunities which are not currently offered by the Army under the regular 8(a) program. It has not yet met this objective.

GAO found that the three initial contracts awarded under the pilot program, as well as several other contracts subsequently selected, could have been handled under the regular 8(a) program. SBA began in April 1980 to place as many procurements as possible in the pilot. Many of these were regular 8(a) program-type procurements, while others were procurements that represented work far beyond the capabilities of the 8(a) firms selected for the contracts. GAO questions the contribution these contracts will make toward the development of the 8(a) firms that received them. (See pp. 4 to 10.)

In April 1980, SBA issued criteria that 8(a) firms must meet before they can be selected for the pilot program. It also issued criteria for contracts selected for the pilot program. GAO believes that SBA's intent to use the pilot program to upgrade the quality of procurements available to participants in the 8(a) program is laudable. (See pp. 7 and 9.)

BETTER PROGRAM CONTROLS NEEDED

Before SBA uses the pilot program, it must certify that an 8(a) firm can perform. GAO found that SBA lacks sufficient information at its central office--where the pilot is administered--to properly assess and match 8(a) firms' capabilities with procurement opportunities. SBA approved the 8(a) firms receiving the three initial contracts without adequately assessing the firms' capabilities. (See p. 12 and app. I.)





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