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ALASKA NATIVE CORPORATIONS

Increased Use of Special 8(a) Provisions Calls for Tailored Oversight

Statement of David E. Cooper, Director
Acquisition and Sourcing Management

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Highlights

Highlights of GAO-06-874T, a testimony before the Committees on Government Reform and Small Business, House of Representatives

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Why GAO Did This Study

Alaska Native corporations (ANC) were created to settle land claims with Alaska Natives and foster economic development. In 1986, legislation passed that allowed ANCs to participate in the Small Business Administration's (SBA) 8(a) program. Since then, Congress has extended special procurement advantages to 8(a) ANC firms, such as the ability to receive sole-source contracts for any dollar amount and to own multiple subsidiaries in the 8(a) program. We were asked to testify on an earlier report where we identified (1) trends in the government's 8(a) contracting with ANC firms, (2) the reasons agencies have awarded 8(a) sole-source contracts to ANC firms and the facts and circumstances behind some of these contracts, and (3) how ANCs are using the 8(a) program. GAO also evaluated SBA's oversight of 8(a) ANC firms.

GAO made recommendations aimed at improving SBA's oversight of 8(a) ANC contracting activity and ensuring that procuring agencies properly oversee 8(a) contracts they award to ANC firms. The procuring agencies generally agreed with our recommendation. SBA expressed concern with aspects of the report and disagreed with several of our recommendations.

We believe implementation of our recommendations would provide better oversight of 8(a) ANC contracting activity and provide decision makers with information to know whether the program is operating as intended.
www.gao.gov/cgi-bin/getrpt?GAO-06-874T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David Cooper at (202) 512-4841 or cooperd@gao.gov.

What GAO Found

While representing a small amount of total federal procurement spending, obligations for 8(a) contracts to ANC firms increased from $265 million in fiscal year 2000 to $1.1 billion in 2004. Over the 5-year period, agencies obligated $4.6 billion to ANC firms, of which $2.9 billion, or 63 percent, went through the 8(a) program. During this period, six federal agencies—the departments of Defense, Energy, the Interior, State, and Transportation and the National Aeronautics and Space Administration—accounted for over 85 percent of 8(a) contracting activity. Obligations for 8(a) sole source contracts by these agencies to ANC firms increased from about $180 million in fiscal year 2000 to about $876 million in fiscal year 2004.

ANCs use the 8(a) program as one of many tools to generate revenue with the goal of providing benefits to their shareholders. Some ANCs are heavily reliant on the 8(a) program for revenues, while others approach the program as one of many revenue-generating opportunities. GAO found that some ANCs have increasingly made use of the congressionally authorized advantages afforded to them. One of the key practices is the creation of multiple 8(a) subsidiaries, sometimes in highly diversified lines of business. From fiscal year 1988 to 2005, ANC 8(a) subsidiaries increased from one subsidiary owned by one ANC to 154 subsidiaries owned by 49 ANCs.

In general, acquisition officials at the agencies reviewed told GAO that the option of using ANC firms under the 8(a) program allows them to quickly, easily, and legally award contracts for any value. They also noted that these contracts help them meet small business goals. In reviewing selected large sole-source 8(a) contracts awarded to ANC firms, GAO found that contracting officials had not always complied with certain requirements, such as notifying SBA of contract modifications and monitoring the percentage of work that is subcontracted.

SBA, which is primarily responsible for implementing the 8(a) program, has not tailored its policies and practices to account for ANCs' unique status and growth in the 8(a) program, even though SBA officials recognize that ANCs enter into more complex business relationships than other 8(a) participants. Areas where SBA's oversight has fallen short include determining whether more than one subsidiary of the same ANC is generating a majority of its revenue in the same primary industry, consistently determining whether awards to 8(a) ANC firms have resulted in other small businesses losing contract opportunities, and ensuring that the partnerships between 8(a) ANC firms and large firms are functioning in the way they were intended.

Mr. Chairmen and Members of the Committees:

I am pleased to be here today to discuss our work on Alaska Native Corporation (ANC) 8(a) firms. In December 1971, Congress enacted the Alaska Native Claims Settlement Act to resolve long-standing aboriginal land claims and to foster economic development for Alaska Natives. This legislation created ANCs, which would become the vehicle for distributing land and monetary benefits to Alaska Natives in lieu of a reservation system. As of December 2005, there were 13 regional ANCs and 182 village, urban, and group corporations.

In 1986, legislation was enacted that allowed ANC-owned firms to participate in the Small Business Administration's (SBA) 8(a) program—one of the federal government's primary means for developing small businesses owned by socially and economically disadvantaged individuals. Since then, Congress has extended special procurement advantages to ANC firms. For example, ANC firms are permitted to receive noncompetitive contracts for any amount, whereas other 8(a) companies are subject to competitive thresholds of $3 million or $5 million for manufacturing contracts. ANCs can also own multiple subsidiaries participating in the 8(a) program,[1] unlike other 8(a) firms that may own only one and no more than 20 percent of another 8(a) firm.

I want to make it clear up front that we are not challenging the policies or legislation that provided ANCs with their special advantages. Congress made the advantages available, and it will be a congressional decision about what, if any, changes should be made.

Our recent report on 8(a) ANC contracting identified (1) trends in contracting with ANC firms, (2) the reasons agencies have awarded 8(a) sole-source contracts to ANC firms and the facts and circumstances behind some of these contracts, and (3) how ANCs are using the 8(a) program.[2] We also evaluated SBA's oversight of 8(a) ANC firms. Today I will discuss some of the information in our report and needed improvements in SBA's oversight of ANC 8(a) contracting activity.

[1]Each 8(a) ANC firm must be in a different primary industry.

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

To address the objectives of our recent report, we obtained data on federal 8(a) contracting with ANCs from the Federal Procurement Data System and agencies. We also analyzed 16 sole-source 8(a) contracts awarded to ANC firms from the departments of Defense, Energy, the Interior, State, Transportation, Homeland Security and National Aeronautics and Space Administration (NASA). We met with executives of 13 regional ANCs and 17 village or urban corporations. Our April 2006 report, on which this testimony is based, was prepared in accordance with generally accepted government auditing standards.

ANC Trends in and Use of 8(a) Contracting

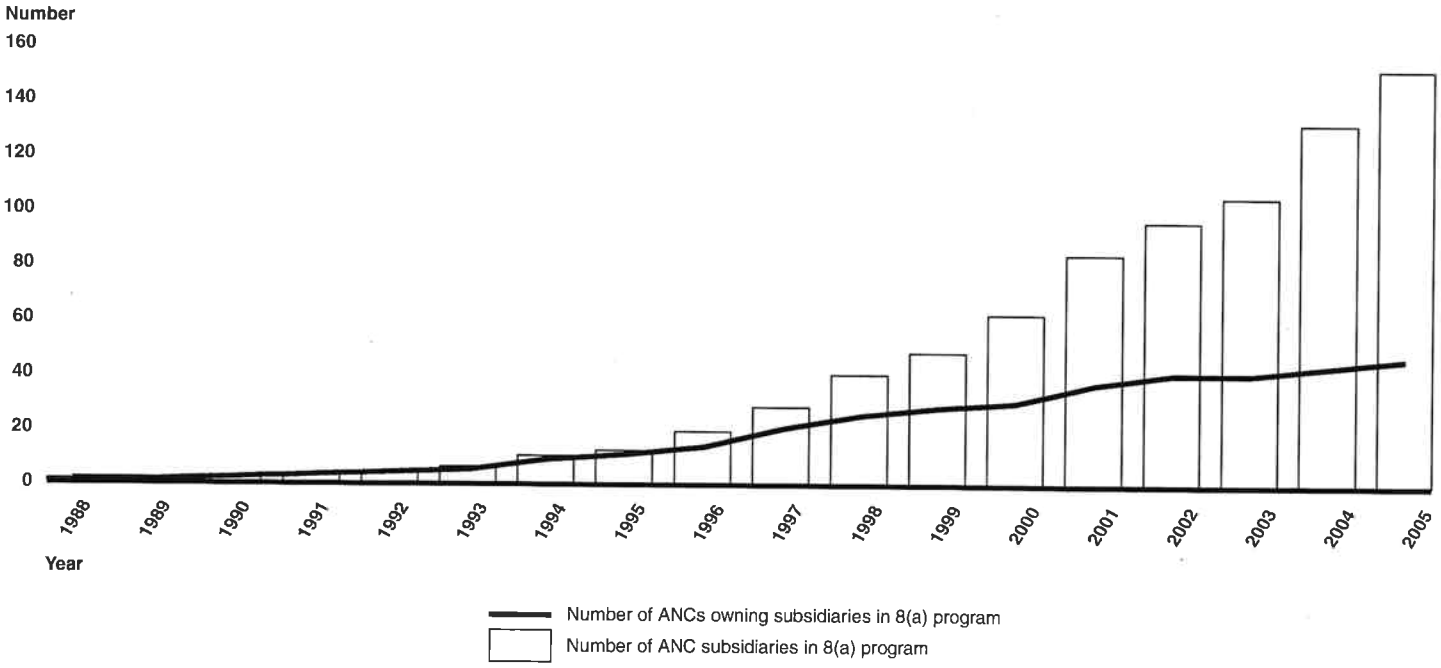
While 8(a) ANC contracting represents a small amount of total federal procurement spending—which totaled more than $341 billion in fiscal year 2004—dollars obligated for ANC firms' contracts through the 8(a) program grew from $265 million in fiscal year 2000 to $1.1 billion in 2004. Overall, during the 5-year period, the government obligated $4.6 billion for ANC firms' contracts, of which $2.9 billion, or 63 percent, went through the 8(a) program.

During this period, six federal agencies—the departments of Defense, Energy, the Interior, State, and Transportation and the National Aeronautics and Space Administration—accounted for over 85 percent of 8(a) ANC contracting activity. Obligations for 8(a) sole source contracts by these agencies to ANC firms increased from about $180 million in fiscal year 2000 to about $876 million in fiscal year 2004.

ANCs use the 8(a) program as one of many tools to generate revenue with the goal of benefiting their shareholders. Some ANCs are heavily reliant on the 8(a) program for revenues, while others approach the program as one of many revenue-generating opportunities, such as investments in stocks or real estate. ANCs are using the congressionally authorized advantages afforded to them, such as ownership of multiple 8(a) subsidiaries[3], sometimes in diversified lines of business. From fiscal year 1988 to 2005, numbers increased from one 8(a) subsidiary owned by one ANC to 154 subsidiaries owned by 49 ANCs. Figure 1 shows the recent growth in ANCs' 8(a) subsidiaries.

[3] In this testimony, "ANC" refers to the parent corporation. The term "ANC firm" denotes a business owned by an ANC. We use the term "ANC firm" and "subsidiary" interchangeably.

Figure 1: Number of ANC Parent Corporations and Subsidiaries Active in the 8(a) Program, 1988 to 2005



Source: GAO analysis of SBA data.

ANCs use their ability to own multiple businesses in the 8(a) program, as allowed by law, in different ways. For example, some ANCs

- have created a second subsidiary to win follow-on work from a graduating subsidiary;[4]
- wholly own their 8(a) subsidiaries, while others invest in partially-owned subsidiaries; and

[4] There is a 9-year limit to participation in the 8(a) program; firms could graduate earlier if they outgrow the industry size standards.

- diversify their subsidiaries' capabilities to increase opportunities to win government contracts in various industries.

Contract Execution Issues

Our review of 16 large sole-source contracts awarded by 7 agencies found that agency officials view contracting with 8(a) ANC firms as a quick, easy, and legal way to award contracts while at the same time helping their agencies meet small business goals.[5]

SBA delegates the contract execution function to federal agencies, although SBA remains primarily responsible for implementing the 8(a) program. We found that contracting officials had not always complied with requirements to notify SBA when modifying contracts, such as increasing the scope of work or the dollar value, and to monitor the percentage of the work performed by 8(a) firms versus their subcontractors. For example:

- Federal regulation requires that when 8(a) firms subcontract under an 8(a) service contract, they incur at least 50 percent of the personnel costs with their own employees.[6] The purpose of this provision, which limits the amount of work that can be performed by the subcontractor, is to insure that small businesses do not pass along the benefits of their contracts to their subcontractors. For the 16 files we reviewed, we found almost no evidence that the agencies are effectively monitoring compliance with this requirement. In general, the contracting officers we spoke with were confused about whose responsibility it is.

- Agencies are also required to notify SBA of all 8(a) contract awards, modifications, and exercised options. We found that not all contracting officers were doing so. In one case, the Department of Energy contracting officer had broadened the scope of a contract a year after award, adding 10 additional lines of business that almost tripled the value of the contract. These changes were not coordinated with SBA.

Two reports we recently issued further illustrate the need for diligence on the part of contracting officers when considering 8(a) awards to ANC firms. One report addressed the Army's three-phased approach for hiring

[5]ANC firms in the 8(a) program are deemed by law or statute as socially and economically disadvantaged. Awards to these firms are credited to agencies' small business goals.

[6]For general construction, the 8(a) firm is required to incur at least 15 percent of the personnel costs.

contract security guards. In the first phase, the Army awarded noncompetitive 8(a) contracts to two ANC firms; these firms in turn subcontracted with large security guard companies.[7] In the second phase, the Army obtained guards under full and open competition, but turned again to the 8(a) noncompetitive contracts for the third phase, despite knowing that it was paying about 25 percent more for these contracts than for the competitively awarded ones. The total value of the contracts with the ANC firms is almost $495 million, accounting for about two-thirds of the Army's total procurement activity for security guards.

In response to a tip we received on our fraud hotline about potentially inflated prices for temporary Mississippi school classrooms after Hurricane Katrina, we looked into the facts and circumstances of the contract award.[8] We found that the Army Corps of Engineers (the Corps), faced with a compressed time frame for acquiring classrooms and no prior knowledge about the acquisition, had turned to an 8(a) ANC firm. The Corps accepted the firm's proposed price of $39.5 million, even though it had information that the cost for the classrooms was significantly less than what the firm was charging.

SBA Lacks Oversight of 8(a) ANC Activity

SBA has not tailored its policies and practices to account for ANCs' unique status and growth in the 8(a) program, even though officials recognize that ANC firms enter into more complex business relationships than other 8(a) participants. SBA officials told us that they have faced a challenge in overseeing the activity of the 8(a) ANC firms because ANCs' charter under the Alaska Native Claims Settlement Act is not always consistent with the business development intent of the 8(a) program. The officials noted that the goal of ANCs—economic development for Alaska Natives from a community standpoint—can be in conflict with the primary purpose of the 8(a) program, which is business development for individual small, disadvantaged businesses.

SBA's oversight has fallen short in that it does not:

[7]GAO, *Contract Security Guards: Army's Guard Program Requires Greater Oversight and Reassessment of Acquisition Approach*, GAO-06-284, (Washington, D.C.: Apr. 3, 2006).

[8]GAO, *Hurricane Katrina: Army Corps of Engineers Contract for Mississippi Classrooms*, GAO-06-454,(Washington, D.C.: May 1, 2006).

- track the business industries in which ANC subsidiaries have 8(a) contracts to ensure that more than one subsidiary of the same ANC is not generating the majority of its revenue under the same primary industry code;
- consistently determine whether other small businesses are losing contracting opportunities when large sole-source contracts are awarded to 8(a) ANC firms;
- adhere to a statutory and regulatory requirement to ascertain whether 8(a) ANC firms, when entering the 8(a) program or for each contract award, have, or are likely to obtain, a substantial unfair competitive advantage within an industry;[9]
- ensure that partnerships between 8(a) ANC firms and large firms are functioning in the way they were intended under the 8(a) program; and
- maintain information on ANC 8(a) activity.

SBA officials from the Alaska district office reported to headquarters in the most recent quality service review that the makeup of their 8(a) portfolio is challenging and requires more contracting knowledge and business savvy than usual because the majority of the firms they oversee are owned by ANCs and tribal entities. The officials commented that these firms tend to pursue complex business relationships and tend to be awarded large and often complex contracts. We found that the district office officials were having difficulty managing their large volume and the unique type of work in their 8(a) portfolio. When we began our review, SBA headquarters officials responsible for overseeing the 8(a) program did not seem aware of the growth in the ANC 8(a) portfolio and had not taken steps to address the increased volume of work in their Alaska office.

Conclusion and Recommendations

ANCs are increasingly using the contracting advantages Congress has provided them. Our work shows that procuring agencies' contracting officers are in need of guidance on how to use these flexible contracting methods while exercising diligence to ensure that taxpayer dollars are spent effectively. Equally important, significant improvements are needed in SBA's oversight of the program. Without stronger oversight, there is the potential for abuse and unintended consequences.

[9] This requirement is set forth in the Small Business Act (15 U.S.C. § 636(j)(10)(J)(ii)(II)).

We made recommendations to SBA on actions that can be taken in revising its regulations and policies as well as ways to improve practices pertaining to its oversight of ANC 8(a) procurements. We also recommended that procuring agencies provide guidance to contracting officers to ensure proper oversight of ANC contracts. The procuring agencies generally agreed with the recommendation. SBA took issue with some aspects of the report and disagreed with several of our recommendations. We believe implementation of our recommendations would provide better oversight of ANC 8(a) activity and provide information that would allow decision makers to know whether the program is operating as intended.

This concludes my testimony. I would be happy to answer any questions you may have.

Contacts and Staff Acknowledgements

For further information regarding this testimony, please contact David E. Cooper at (202) 512-4841 or cooperd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Key contributors were Michele Mackin, Sylvia Schatz, and Tatiana Winger.

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