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**BEFORE THE SENATE COMMITTEE ON INDIAN AFFAIRS**

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Chairman Akaka, Vice Chairman Barrasso, and distinguished members of the Committee, thank you for this opportunity to testify.

As the Deputy Inspector General for the Small Business Administration (SBA), I oversee an independent office that was established to deter and detect waste, fraud, abuse and inefficiencies in SBA programs and operations. My testimony today focuses on several audits the SBA Office of Inspector General (OIG) conducted regarding the issue of Alaska Native Corporation (ANC) participation in the SBA 8(a) Business Development Program (the "8(a) Program").

The 8(a) Program is designed to help small, minority-owned businesses gain access to Federal contracts and to obtain other business development assistance so that they can successfully compete in the economy. Under the program, 8(a) firms owned by ANCs, American Indian Tribes, and Native Hawaiian Organizations (NHOs) enjoy special procurement advantages beyond those afforded most 8(a) businesses. These advantages were intended to provide economic development opportunities for Alaska natives and other tribal members. Our audits were initiated based on complaints about ANC-owned firms and issues identified by a prior Government Accountability Office (GAO) audit related to SBA's oversight of ANC 8(a) activity.

As an initial matter, I want to emphasize that the OIG is not taking a position on the issue of whether ANCs, Tribes or NHOs should be able to participate in the 8(a) Program. That is a policy determination for Congress to make. There is also no question, as stated in our audit report, that Alaskan natives have benefitted from ANC participation in the 8(a) Program. However, our audit report numbered 9-15, Participation in the 8(a) Program by Firms Owned by Alaska Native Corporations, did raise several questions about ANC participation in the 8(a) Program:

- Is the large percentage of 8(a) contracts obtained by a relatively small number of ANC-owned firms consistent with Congress' objectives for the program?
- Are the revenues from ANC participation in the 8(a) Program going to a broad array of ANC firms or concentrated among only a few ANC-owned companies?
- Are non-disadvantaged individuals inappropriately benefitting from ANC participation in the program and to what extent are benefits from program participation effectively reaching tribal populations?

## **8(A) ADVANTAGES FOR FIRMS OWNED BY ANCS, TRIBES AND NHOS**

ANCs, Tribes, and NHOs enjoy special procurement advantages over most other 8(a) Program participants. Arguably, the most significant of these advantages is their ability to obtain unlimited sole-source awards. Under SBA's recent revisions to the program regulations, 8(a) firms are not entitled to obtain contracts on a sole source basis if the contract exceeds \$6.5 million for manufacturing contracts or \$4 million for other contracts. However, companies owned by ANCs or Tribes are exempt from this requirement, and firms owned by NHOs are exempt for contracts awarded by the Department of Defense. Additionally, 8(a) firms that receive \$100 million in 8(a) awards (awarded on a sole source and/or competitive basis) are not eligible for additional 8(a) sole source awards under SBA regulations. Participants owned by ANCs, Tribes and NHOs, however, are not subject to this cap. These exemptions have allowed certain ANC-owned firms to obtain hundreds of millions of dollars of non-competitive awards.

Another advantage enjoyed by firms owned by ANCs, Tribes and NHOs is that the determination of whether they are considered to be small under SBA regulations is made without regard to the size of their parent company or any other firm owned by the parent company. These entities can own multiple 8(a) companies as long as each business is in a different primary industry, and SBA has determined that the firm does not have or is not likely to have a substantive unfair competitive advantage within an industry. Our 2009 audit confirmed that this advantage has allowed ANC firms that are really large businesses through affiliation with their parent corporations, and which have access to the capital and credit of their parents, to compete against truly small disadvantaged firms. Thus, Congress may want to consider whether the goal of the 8(a) Program – to help small-disadvantaged firms compete in the American economy – is impeded by allowing larger ANC companies participate in order to provide benefits to native populations.

## **BENEFITS ANCS DERIVE FROM THESE ADVANTAGES**

Although ANC firms enjoy substantial advantages over other 8(a) firms, such advantages were intended to help ANCs fulfill a mission that is broader than the bottom line of the corporations; namely to help Alaska Natives achieve economic self-sufficiency. Understandably, ANC firms have attempted to maximize the opportunities afforded them under the 8(a) Program. We visited eleven ANC parent corporations, eight of which told us that they derived at least 50 percent or more of their revenues from the 8(a) Program. Two of the eight relied on the program for 90 percent or more of their revenues.

Unlike other 8(a) businesses whose profits generally go to one or more socially and economically disadvantaged persons, profits from ANC-owned firms go to hundreds, and sometimes thousands, of Native shareholders. ANCs have used profits to pay shareholder dividends, fund cultural programs, and provide employment assistance, jobs, scholarships, internships, subsistence activities, and numerous other services to native communities.

Dollar for dollar, however, there has been no way to trace exactly how much ANC participation in the 8(a) Program has benefited their members. In audit report 8-14, we found that non-native managers of several ANCs were able to obtain millions of dollars through management and other agreements that had not been disclosed to, or approved by, SBA. A similar arrangement was highlighted in the articles that appeared in the Washington Post last Fall. This raises a question as to whether more of the money that is derived from 8(a) participation could be going back to the native members. In the past, ANCs have not been required to report to SBA – or to any other government agency as far as we could tell -- how they use the 8(a) share of their profits to support Alaska Natives.

We are encouraged that SBA has included in its new regulations for the 8(a) Program a requirement that ANCs, Tribes and NHOs must submit annual reports to SBA discussing how their program participation has benefitted the tribal members. This requirement will shed light on the benefits going to tribal members and help SBA – and Congress – make more informed decisions about ANC, Tribal and NHO participation in the 8(a) Program.

The SBA OIG believes that this transparency in the 8(a) Program is long overdue. We are troubled, therefore, that SBA has decided to delay implementation of this reporting requirement for six months, and that the Agency has stated in its regulatory preamble that there is a possibility that it will delay implementation even further if “delay is necessary.” We recommend that SBA not extend this implementation date any further.

### **GROWTH OF ANC ACTIVITY WITHIN THE 8(A) PROGRAM**

Long-term 8(a) contracting trends show a continued and significant increase in obligations to ANC-owned participants, both in value and as a percentage of total obligations to 8(a) firms. Our audit found that from FY 2000 to FY 2008 obligations to ANC-owned participants increased by 1,386 percent, and more than tripled from \$1.1 billion in FY 2004 to \$3.9 billion in FY 2008.

Although the amount of Federal contracting as a whole increased significantly during this time, what stood out from our review was the growth in the percentage of 8(a) contracting dollars going to ANC-owned companies as compared to other participants in the program. Between FYs 2004 and 2008, the percentage of 8(a) obligations to ANC firms doubled. In FY 2008, ANC firms received approximately 26 percent of total 8(a) obligations—even though they constituted just 2 percent of companies performing these 8(a) contracts. These trends suggest that ANC-owned firms may be receiving a disproportionate share of obligations to 8(a) firms.

An additional noteworthy finding from our audit was that a significant portion of the 8(a) obligations made to ANC-owned firms went to a small percentage of the ANC participants. In fact, 50 percent of 8(a) obligations to current ANC participants in FY 2007 went to just 11 (or 6 percent) of the ANC firms reported by SBA to Congress that year. One of these firms accounted for nearly 20 percent of the 8(a) obligations made to active ANC firms, but had only 750 shareholders, or less than 1 percent of the total population of ANC

shareholders. The top four firms, which received collectively about \$600 million in FY 2007, accounted for less than 4 percent of the 105,344 Alaska native shareholders represented by all of the ANC participant firms. Thus, revenues earned from ANC participation in the 8(a) Program may not be evenly distributed to the ANC population.

Finally, of note is that sole-source contracts were the major contracting mechanism used by procuring agencies when obligating 8(a) funds to ANC participants. We found that in FY 2007 the top 11 firms received 82 percent of their 8(a) obligations through sole-source awards. As I have mentioned, ANC participants, like other tribally-owned firms, are exempt from SBA's cap on total sole-source awards. Generally, 8(a) firms that receive \$100 million in total 8(a) awards are ineligible for additional sole-source contracts. Of the top 11 firms, 3 had received contracts in excess of \$100 million over just a 2-year period. One firm received approximately \$527 million, \$422 million of which was sole sourced.

As reported by GAO and others, Federal agencies often made sole-source awards to ANC participants because it is a quick, easy, and legal method of meeting their small business goals. While sole-sourcing contracts to ANC firms may provide an expedient means of meeting small business goals, due to the lack of competitive bidding, such awards often do not result in the best value for the government. Reports by OIGs and GAO have shown that noncompetitive contracts have been misused, resulting in wasted taxpayer resources, poor contractor performance, and inadequate accountability for results. In March 2009, the President issued a memorandum discouraging the use of sole source awards unless their use can be fully justified and safeguards put in place to protect taxpayers. Recently, the Federal Acquisition Regulations were amended to put into place special rules for contracts awarded on a sole source basis that exceed \$20 million. It is unclear what effect the President's memorandum or this \$20 million threshold will have on the scope of sole source awards obtained by ANC participants in the 8(a) Program.

### **SBA'S MANAGEMENT AND OVERSIGHT OF ANC PARTICIPANT ACTIVITY**

Despite the growth in ANC participation in the 8(a) Program, SBA has not performed a review to determine whether such growth is adversely affecting other 8(a) participants. For example, in FY 2008, ANC-owned participants received 66 percent of the 8(a) obligations made under the "facilities support services" industry code, which was the second largest industry code for 8(a) purchasing that year. However, SBA has not assessed the impact this has had on non-ANC-owned program participants. Neither has it determined whether procuring agencies are meeting their small-disadvantaged business procurement goals primarily through sole-source awards to ANC firms that essentially are large through affiliation with their parent and other affiliated companies.

Further, although SBA officials recognize that ANCs typically enter into more complex business relationships than other 8(a) participants, it has not tailored its policies and oversight practices to account for ANCs' unique status and growth in the program. Audits issued by GAO in 2006 and by our office in 2008 and 2009 identified shortcomings

in SBA's oversight of ANC 8(a) activity. These involve monitoring the issues discussed below.

Secondary lines of business for multiple 8(a) participants owned by a single ANC. GAO reported that SBA did not track the business industries in which ANC subsidiaries had 8(a) contracts to ensure that ANCs did not have more than one subsidiary obtaining its primary revenue under the same industry code. GAO recommended that SBA collect information on ANC-owned participants as part of its 8(a) monitoring, to include tracking the primary sources of revenue. In July 2008, SBA began development of a system to collect primary revenue generators for ANC participants, and, in February of this year, we were advised that this system became operational. Neither GAO nor my office has yet had a chance to evaluate this system.

Changes in ownership of ANC participants and review of financial statements for firms owned by ANCs. SBA regulations require that ANC participants be majority-owned or wholly owned by an ANC, and that ANCs must seek SBA's approval before making ownership changes. However, SBA has had difficulty managing the large volume of ownership change requests requiring approval. Our audit report 8-14 identified an instance where an ANC was in violation of SBA's ownership rules and had not reported the ownership change to SBA. Our audit report 9-15 disclosed that approving ownership change requests had dominated the workload of the Alaska District Office, leaving little time for monitoring other aspects of ANC compliance with 8(a) rules or for identifying where ANC-owned firms had not reported ownership changes.

In Report 8-14, we also reported weaknesses in SBA's review of financial information reported annually by ANC participants. Because of these weaknesses, SBA had failed to identify that non-native managers of two 8(a) ANC-owned firms had secured millions of dollars of 8(a) revenue for companies they owned through management agreements that SBA had not approved, as discussed above.

These reports questioned whether SBA's Alaska District Office, which oversees the majority of the ANC participants, was adequately staffed. At the time, the office had only two full-time and one-part time employees to oversee 166 ANC participants. Since then, SBA has advised that it has hired two more employees for this office. We have not had an opportunity to determine whether the additional staff is sufficient to manage the current ANC participant level.

Whether ANC-owned firms have a substantial unfair competitive advantage within an industry. The Small Business Act provides that the size of a tribally owned firm will be determined without regard to its affiliation with the tribe or any other businesses owned by the tribe unless the SBA Administrator determines that one or more of the tribally-owned businesses may have or may obtain a substantial unfair competitive advantage within an industry. GAO reported that SBA was not making these determinations and had no policy or procedures in place to make them. It recommended that SBA clearly articulate in regulation how it would comply with existing law. SBA reported that it had adopted a

different approach involving training of its Business Development Specialists and Federal agencies to ensure that a previous procurement history is provided to facilitate such determinations, which did not appear to adequately address GAO's recommendation. Recently, SBA advised the OIG that it was undertaking a study, with a target completion date of December 31, 2012.

Whether partnerships between ANC participants and large firms are functioning as intended. GAO reported that SBA's oversight of ANC partnerships with other firms and mentor-protégé arrangements was not adequate. When entering into joint ventures, ANC firms must manage the joint venture and receive at least 51 percent of venture profits. However, GAO identified instances either where mentors abandoned ANC participants after the contracts were not won or where mentor firms exploited the ANC partner for its 8(a) status. SBA has acknowledged that 8(a) joint ventures between mentors and their ANC protégés may be inappropriate for sole-source contracts above competitive thresholds.

In response to our 2009 audit, we were advised that SBA headquarters was collecting information to identify the number of joint ventures involving ANC firms. We are currently conducting an audit to determine whether SBA's information collection and monitoring efforts are adequate.

We also are pleased that SBA's new 8(a) regulations contain strengthened requirements for mentor protégé and joint venture agreements and limit certain subcontracting by joint ventures in an effort to limit abuse in the program. However, it is too early to tell whether these provisions will effectively address problems arising from some joint venture arrangements in the 8(a) Program.

## **CONCLUSION**

In conclusion, ANC participation in the 8(a) Program has undeniably benefitted Alaska natives. However, long-term 8(a) contracting trends showed a continued and significant increase in obligations to ANC-owned participants, which may be limiting the ability of firms that are not owned by ANCs, Tribes or NHOs to obtain 8(a) contracts. Further, our audit found that a very small number of ANC participants received a disproportionate share of the 8(a) obligations, and the procurement advantages that ANC-owned firms enjoy, including the relationship between these firms and their parent and other affiliated companies, may be working to the disadvantage of other 8(a) participants.

Our audit report presented several matters for congressional consideration and a number of recommendations to SBA, many of which have now been implemented. SBA has not, however, taken effective action in response to the audit recommendation that the Agency determine whether ANCs have obtained a substantially unfair competitive advantage over other 8(a) participants in particular industry codes.

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