

**Testimony of  
Debra S. Ritt  
Assistant Inspector General for Auditing  
U.S. Small Business Administration**

**Before the  
Subcommittee on Contracting Oversight  
Committee on Homeland Security & Governmental Affairs  
United States Senate  
July 16, 2009**

Chairwoman McCaskill, Acting Ranking Member Collins, and Members of the Subcommittee:

We appreciate the opportunity to testify today on our audit of Alaska Native Corporation (ANC) participants in the 8(a) program. The 8(a) program is the Federal government's primary vehicle for helping small-disadvantaged businesses compete in the marketplace and gain access to Federal and private procurement markets. Under the program, ANC-owned companies enjoy special procurement advantages beyond those afforded to most other 8(a) businesses. These advantages were intended to provide economic opportunities for impoverished Alaska Natives. Our audit was initiated based on issues identified by prior OIG and GAO audits related to SBA's oversight of ANC participant 8(a) activity.

As requested by the Subcommittee, my statement today will focus on our audit findings relating to three areas:

- Competitive and other advantages enjoyed by ANC firms in obtaining 8(a) contracts and the benefits derived from those advantages;
- The growth of ANC participant activity within the 8(a) program; and
- The Small Business Administration's (SBA) management and oversight of ANC participant activity.

**8(A) CONTRACTING ADVANTAGES FOR ANC-OWNED COMPANIES AND BENEFITS SUCH COMPANIES DERIVE FROM THOSE ADVANTAGES**

ANC and other tribally owned companies 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 of any value. ANC companies are exempt from (1) competitive thresholds in the Small Business Act that limit 8(a) companies from receiving sole source awards in excess of \$5.5 million for manufacturing

contracts and \$3.5 million for other types of contracts, and (2) the regulatory cap on sole-source awards that is triggered once a company receives a total of \$100 million in 8(a) competitively-awarded and sole-source contracts. These exemptions have resulted in ANC-owned companies receiving hundreds of millions of dollars in awards non-competitively.

ANC-owned companies are also not limited in the number of other companies they can be affiliated with for purposes of determining whether they are small, and thus eligible for 8(a) awards. ANCs can own multiple 8(a) companies as long as each business is in a different primary industry, and SBA has determined that the company does not have or is not likely to have a substantial unfair competitive advantage within an industry. Our audit confirmed that this advantage has allowed ANC companies that are large businesses through affiliation with their parent corporations, and who have access to the capital and credit of its parent, to compete against truly small disadvantaged companies. Allowing large ANC companies to compete against other 8(a) companies appears to be inconsistent with the primary purpose of the 8(a) program of helping small-disadvantaged businesses to compete in the American economy.

Although ANC companies enjoy substantial advantages over other 8(a) companies, 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 companies have attempted to maximize the opportunities afforded them under the 8(a) program. We visited 11 ANC parent corporations, 8 of which told us that they derived at least 50 percent or more of their revenues from the 8(a) program. Two of the 8 said they relied on the program for 90 percent or more of their revenues.

While not all ANCs have generated profits in the past, in recent years the overall financial performance of ANCs has significantly improved. According to the *Alaska Native Claims Settlement Act (ANCSA) Regional Association's 2006 Report*, in 2006 total revenues for the 13 regional ANCs grew 22 percent, from \$4.4 billion in 2005 to \$5.4 billion in 2006, and profits increased by 75.6 percent, from \$282.4 million in 2005 to \$495.9 million in 2006. The following year, the *Alaska Economic Performance Report for 2007*, reported that revenues for 12 of the regional corporations totaled \$5.77 billion, with profits of \$483.7 million.

Unlike other 8(a) businesses whose profits generally go to one or two individuals, hundreds, and sometimes thousands, of tribal members or Native shareholders, share the profits from ANCs. ANCs have used their profits to pay shareholder dividends, fund cultural programs, and provide employment assistance, jobs, scholarships, internships, subsistence activities, and numerous other services to their Alaska communities. Dollar for dollar, however, it is difficult to link these benefits to revenues earned from the 8(a) program, as they are financed from profits that have been generated by different revenue

sources. ANCs are also not required to report to SBA how they use the 8(a) share of their profits to support Alaska Natives.

## **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) companies. Our audit found that from FY 2000 to FY 2008 obligations to ANC-owned participants increased by 1,386 percent, and more than tripled in recent years, 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 companies doubled. In FY 2008, ANC companies 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 companies are 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 companies 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 companies reported by SBA to Congress that year. One of these companies accounted for nearly 20 percent of the 8(a) obligations made to active ANC companies, but had only 750 shareholders, or less than 1 percent of the total population of ANC shareholders. The top four companies, which received collectively about \$600 million in FY 2007, accounted for less than 4 percent of the 109,210 Alaska native shareholders represented by all of the ANC participant companies. Accordingly, revenues earned from ANC participation in the 8(a) program are not distributed evenly throughout the ANC population.

Finally, of note is that sole-source contracts continue to be 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 mentioned previously, ANC participants, like other tribally-owned firms, are exempt from SBA's cap on total sole-source awards. Generally, 8(a) companies that receive \$100 million in total 8(a) awards are ineligible for additional sole-source contracts. Of the top 11 companies, 3 had received contracts in excess of \$100 million over just a 2-year period. One company alone received approximately \$527 million, of which \$422 million had been sole sourced.

As reported by GAO and others, Federal agencies favor sole-sourcing 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. Based on similar concerns, 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.

## **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 companies that essentially are large businesses through affiliation with their parent 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 identified shortcomings in five areas of SBA’s oversight of ANC participant 8(a) activity. These involve monitoring:

- Secondary lines of business for multiple 8(a) participants owned by a single ANC. GAO reported that SBA does not track the business industries in which ANC subsidiaries have 8(a) contracts to ensure that ANCs do 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, but this capability will not be developed until a later phase of the project.
- Changes in ownership of ANC participants and the holding companies that manage them. 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. Last year, we identified an instance where an ANC was in violation of SBA's ownership rules and had not reported the ownership change to SBA. Our most recent audit disclosed that approving ownership change requests has 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 companies have not reported ownership changes.

- Whether ANC-owned companies have a substantial unfair competitive advantage within an industry. The Small Business Act provides that the size of a tribally owned company 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 with 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 has 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 does not appear to adequately address GAO's recommendation.
- Partnerships between ANC participants and large companies to ensure that they are functioning as intended. GAO reported that SBA's oversight of ANC partnerships with other companies and mentor-protégé arrangements was not adequate. When entering into joint ventures, ANC companies 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 companies 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. Despite this concern, our audit found that SBA headquarters was unable to identify the number of joint ventures involving ANC companies, and did not have a means for tracking 8(a) sole source contracts involving joint venture partners.
- Reviewing participant financial statements. In August 2008, we reported weaknesses in SBA's review of financial information reported annually by ANC participants. Because of these weaknesses, SBA did not 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. The management agreements were disclosed in footnotes to the financial statements of the ANC-owned firms that had been submitted to SBA.

Our report 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. Although there are now over 200 ANC participants in the program, SBA has not yet increased the size of the district office. SBA has advised that it has is in the process of hiring two more employees for this office; however, these additional positions will not be sufficient to manage the current ANC participant level.

## CONCLUSION

In conclusion, ANC participation in the 8(a) program has undeniably benefited Alaska natives and tribes. However, long-term 8(a) contracting trends show a continued and significant increase in obligations to ANC-owned participants, which may be limiting the ability of non-ANC-owned companies to secure 8(a) contracts. Further, a very small number of ANC participants receive a disproportionate share of the 8(a) obligations. The procurement advantages that ANC-owned companies enjoy, and their ability to get access to capital and credit through their parent companies, may be working to disadvantage other 8(a) participants. All of these factors indicate that changes to ANC participation in the 8(a) Program may be appropriate to ensure that this program works as designed and that taxpayers are receiving the best value from 8(a) contracts.

Because many of the advantages that ANCs enjoy come from statute, Congress may wish to consider whether:

- ANC-owned companies should continue to be exempt from the competitive threshold limits on the amount of individual sole-source awards, or whether there should be a statutory cap on the total amount of sole-source awards they may receive.
- The Small Business Act should be clarified to require SBA to determine that ANC-owned companies do not have a substantial unfair competitive advantage within an industry category before exempting ANC participants from size affiliation rules, or whether other limits should be placed on the affiliation rules applicable to ANC participants.
- ANCs should be required to submit regular reports to SBA identifying the percentage of its profits that are derived from 8(a) contracts, describing how the 8(a) share of its profits are being distributed in dividends or other support for Alaska Natives, and explaining how the distributed benefits assisted the Natives.
- The Small Business Act should be amended to either establish larger small-disadvantaged business contracting goals for procuring agencies that account for

the growth in ANC 8(a) awards; or establish a separate goal for awards to tribally owned companies to ensure that other 8(a) companies are provided maximum opportunity to obtain 8(a) contracts.

We also recommend that SBA:

- Conduct a review to evaluate the impact that the growth in ANC 8(a) obligations has or will have on other 8(a) firms and the overall effectiveness of the 8(a) program; and make the necessary programmatic revisions.
- Determine whether 8(a) companies owned by ANCs and tribes should continue to be exempt from the regulatory cap on total sole source awards, and if not, remove the exemption from this regulation.
- Centrally track the award of 8(a) contracts to joint ventures involving ANC participants and the award of sole-source contracts to ANC participants.
- Expedite the implementation of an automated system to ensure that the Agency has information needed to oversee ANC participant activity.
- Finalize regulations and actions needed to fully implement GAO's recommendations.
- Fully staff the Alaska District Office.

To obtain a copy of our report, interested parties may go to the SBA OIG online library at <http://www.sba.gov/ig/onlinelibrary/index.html>.

Madam Chairwoman, this concludes my prepared statement. I would be happy to answer any questions at this time.