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Report to the Chairman, Committee on Government Operations, House of Representatives

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AGENCY FOR INTERNATIONAL DEVELOPMENT

The Minority Shipping Program Is Constrained by Program Requirements

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National Security and International Affairs Division

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The Honorable John Conyers, Jr.
Chairman, Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we review the Agency for International Development's (AID) program to award contracts, under section 8(a) of the Small Business Act, to eligible firms to ship food aid commodities. You were concerned that AID had not followed its procedures for the program and had instituted arbitrary program criteria that served to limit contracting opportunities. Specifically, you asked that we determine whether (1) AID's 8(a) program criteria had limited the number of contracts available for 8(a) shipping firms, (2) the program at AID enhances the competitive viability of 8(a) firms, and (3) new program requirements proposed by AID comply with the Small Business Act and federal procurement regulations.

Background

Section 8(a) of the Small Business Act encourages federal agencies to procure goods and services from small and disadvantaged businesses[1] to the maximum extent practicable. Federal agencies can generally meet this objective by offering a portion of their procurement contracts to 8(a) firms. Contracting officers may use their discretion in selecting particular contracts to offer to 8(a) firms.

The Small Business Administration (SBA) certifies firms as eligible to participate in the 8(a) program under specific industry categories. SBA acts as the prime contractor when federal agencies use 8(a) firms and may provide financial, technical, and management assistance to support the development of 8(a) firms. Within a prescribed period of time, 8(a) firms are expected to "graduate" from the program and enter the competitive marketplace.

Between 1986 and 1990, AID awarded seven shipping contracts to four 8(a) firms at a total shipping cost of $10.6 million. Since April 1991, the

[1]Small firms owned and controlled by socially and economically disadvantaged individuals are eligible for the 8(a) program. Individuals from certain ethnic groups are presumed to be socially disadvantaged (including Black, Hispanic, Asian Pacific, Subcontinent Asian, and Native Americans), while others must demonstrate that they are socially disadvantaged to be eligible.

8(a) shipping program has been suspended while AID reviewed complaints raised by one 8(a) firm.[2] During the suspension, AID has revised its program criteria and procedures. Based on our report, AID planned to resume its 8(a) shipping program in August or September 1992.

Results in Brief

AID's program criteria restricted the type of shipping contracts available to 8(a) shipping firms. However, in 1990, out of 29 cases we reviewed, 9 were offered to 8(a) firms but, for reasons beyond AID's control, only 1 resulted in a contract.[3] A 10th contract was unnecessarily excluded because a U.S.-flag vessel was not available, but AID has changed its requirements to allow 8(a) firms to use foreign-flag vessels under certain conditions.

AID's 8(a) shipping program has not produced any viable entities nor is it likely to because shipments are made on short notice with little opportunity to enter into any long-term commitments. Since 1986, only five firms have participated, and only two firms have remained in the shipping business.

AID's revised procedures add two requirements regarding the calculation of fair market price and the percentage of contract personnel costs that must be paid to employees of the 8(a) firm. These comply with applicable laws and regulations, but will be difficult for 8(a) firms to meet.

AID's 8(a) Shipping Program

In 1985, AID's Transportation Division assumed responsibility from the Department of Agriculture for shipping food aid provided through bilateral agreements under title II of Public Law 480. The Transportation Division agreed to continue the 8(a) shipping program that Agriculture had established.

Under AID's shipping program, for the most part, only bilateral food aid directly shipped by AID is potentially available for 8(a) firms. The tonnage available varies considerably from year to year. Between 1986 and 1990, AID shipped an average of about 483,000 metric tons a year. In 1991, the

[2]The firm complained that AID had (1) not offered contracts through SBA as it was supposed to, (2) offered contracts that required U.S.-flag vessels when U.S.-flag vessels were not available, and (3) put the firm at the bottom of the 8(a) list after failing to arrange a contract due to factors beyond its control.

[3]These nine contract opportunities represented approximately 20 percent of the food aid tonnage AID had direct control over. The one successful contract was less than 3 percent of the tonnage.

year AID suspended the 8(a) program, AID shipped about 756,000 metric tons, or 37 percent of title II commodities. Private voluntary organizations and the United Nations World Food Program shipped the remaining 63 percent.

In 1991, AID was given responsibility to ship food aid under title III of Public Law 480. This responsibility will expand the number of shipping opportunities available through AID. In 1991, for example, AID directly shipped approximately 1.3 million metric tons under title III.

To encourage federal agencies to use 8(a) contractors, SBA sets an annual goal for 8(a) contracting for each agency that represents a percentage of the agency's estimated contract awards.[4] Although AID has not established formal 8(a) contracting goals for individual offices, each office is expected to make a good faith effort to use 8(a) firms. AID's Transportation Division established a voluntary goal of making 10 percent[5] of the tonnage under its direct control available for 8(a) contracting.

AID's policy is to offer 8(a) shipping firms contracts on a noncompetitive, rotational basis. Since 1986, only five firms have participated in AID's program, and only two firms have remained in the shipping business.[6]

AID's Program Criteria Restricted 8(a) Contracting Opportunities

Decisions on whether to offer a shipping contract to an 8(a) firm are made on a case-by-case basis by AID's Transportation Division when (1) adequate time is available to arrange the shipment, (2) contract requirements are not complex, (3) the cargo weighs 40,000 metric tons or less, and (4) a U.S.-flag vessel is available for chartering, since none of the participating firms owned a vessel available for AID use.[7]

[4]AID has met or exceeded its agency-wide goal every year since 1986.

[5]AID officials said the 10-percent figure was "adopted" from a law providing for the use of disadvantaged enterprises when spending development assistance funds. Food aid transportation costs are not subject to this requirement since they are paid from funds appropriated to the Department of Agriculture.

[6]One firm went bankrupt due to unrelated business problems, another was disqualified from shipping due to a conflict of interest, and the third lost interest in the shipping business.

[7]A vessel owned by one 8(a) firm is under long-term charter to the Military Sealift Command and not available for AID shipments.

The Transportation Division met its voluntary 8(a) contracting goal in only 1 year—1986, when 13.6 percent of the title II tonnage available was carried by 8(a) firms. From 1987 through 1990, 8(a) firms transported between 2.6 percent and 6.2 percent a year of the title II tonnage available—well below the 10-percent goal.

To evaluate AID's implementation of its program criteria, we reviewed the 29 food aid charter shipments contracted by AID during 1990. Of the 29 shipments we reviewed, 7 met AID's criteria for 8(a) contracts. In six cases, AID offered the shipment to an 8(a) firm, although, for a number of reasons beyond AID's control, none of these offers resulted in a contract. AID's Chief of Transportation did not know why the seventh contract was not offered to an 8(a) firm.

Of the remaining 22 cases, AID had legitimate concerns about timing or contract requirements in 21 cases, but attempted to arrange three 8(a) contracts anyway—one resulted in a contract.[8] The final contract in our review was not offered to an 8(a) firm because a U.S.-flag vessel was not available to carry the cargo. This lost opportunity is significant given the small size of AID's 8(a) shipping goal. To meet its 10-percent goal, AID needed to award only two or three 8(a) contracts a year.

AID Required 1 Month to Arrange an 8(a) Contract

AID Transportation officials told us that, in general, they made an 8(a) offer only if at least 1 month was available from the time AID was notified of the commodity availability date to the time the cargo was supposed to be at the loading port. In the 1-month period, 10 days are allowed for the 8(a) firm to locate a vessel, arrange the charter contract and financing, and get SBA approval of the contract; about 7 days are needed to award a competitive contract in case the 8(a) contract did not work out; and 14 days are needed to give the commodity supplier advance notice, prior to loading, that a shipping contract was concluded.

The Transportation Division works on a very tight contracting schedule and often has less than 1 month to arrange a shipment. The 8(a) firms said that they needed more time than other shipping firms to make contract arrangements, and we agree that AID's time criteria were reasonable. Our

[8]Regarding the two offers that did not result in a contract, in one case, the firm's offer was above AID's price range and included a contingency that AID found unacceptable. In the other case, the contract offer was withdrawn due to a disagreement between the 8(a) firm and the vessel owner over payment arrangements.

review of the 29 shipments from 1990 showed that insufficient lead time was a factor for not offering the shipments to 8(a) firms in 12 cases.

AID Only Offered Contracts That Were Less Complex

AID officials would not offer contracts to 8(a) firms when the requirements entailed more expertise or financial strength than 8(a) firms had. These requirements included (1) uncertainty about the discharge port until the ship was underway, (2) discharge in a war zone or otherwise troubled port, and (3) inland transportation of the cargo. We found that 17 of the 29 charter shipments we reviewed involved one or more of these requirements.

AID's Chief of Transportation said that these factors, alone or in combination, would normally rule out the use of an 8(a) firm because, in his view, 8(a) firms would not be able to handle unforeseen problems requiring access to additional funds during delays or last minute port changes. On the other hand, officials from 8(a) firms told us they felt capable of handling the uncertainty about discharge ports, but they did not want to handle discharge in a war zone or provide inland transportation.

8(a) Firms Were Restricted to Cargoes of 40,000 Metric Tons or Less

In 1990, under the title II program, only 1 of the 29 shipments was over 40,000 metric tons. In the 5 previous years, only five shipments weighed more. An AID official told us that the tonnage ceiling had been set because AID did not expect to ship cargoes heavier than this. The official added that AID had offered an 8(a) contract for a cargo of 45,000 metric tons in 1990, but financial constraints precluded the 8(a) firm from taking the contract.

AID's revised program guidelines set a new ceiling of 45,000 metric tons on 8(a) shipments. Although this will not substantially affect the title II program, under the title III program, AID will handle more large cargoes, so this ceiling may prove to be a significant restriction. In 1991, for example, 8 out of about 60 title III shipments were over 45,000 metric tons.

8(a) Firms Were Prohibited From Chartering Foreign-Flag Vessels

AID has prohibited 8(a) firms from using foreign-flag vessels, although it did not have a firm basis for this prohibition.[9] This requirement was not in AID's program guidelines, but was acknowledged as a restriction by AID and the four 8(a) firms we spoke with. In our review of the 29 shipments in

[9]By law, 75 percent of food aid cargo must be carried on U.S.-flag vessels. The remaining 25 percent may be carried on foreign-flag vessels.

1990, we found 1 case where the lack of a U.S.-flag vessel may have precluded the award of an 8(a) contract.

AID's Chief of Transportation told us that foreign-flag vessels often operate under a series of simultaneous contracts and that he would have difficulty contacting the ship owner if a contractual problem needed resolution during an 8(a) shipment. However, since AID contracts directly with foreign-flag operators for about 25 percent of its tonnage, the chief agreed that similar problems could arise whether AID contracted directly for the foreign-flag vessel or through an 8(a) firm.

As a result of our inquiries, AID has revised its guidelines to allow 8(a) firms to use foreign-flag vessels in some circumstances. The Chief of Transportation said that on a case-by-case basis he intends to determine for each 8(a) contract whether to require a U.S.-flag or foreign-flag vessel or to leave the choice open. The decision will be based primarily on whether AID's overall transportation requirements to use U.S.-flag vessels have been or will be satisfied. In addition, the price differences for certain types of shipments and the availability of U.S.-flag vessels will be considered.

AID's 8(a) Shipping Program Does Not Promote Competitive Viability

A primary goal of the 8(a) program is to promote the competitive viability of small firms owned and controlled by socially and economically disadvantaged individuals and to ensure their continued existence after graduation from the 8(a) program. According to two shipping industry officials, competitiveness in the ocean transportation industry can only be achieved through acquiring a vessel. However, only one 8(a) shipping firm owns a vessel, which was acquired under a long-term contract with the Military Sealift Command.[10] Due to program constraints, AID was not able to make any long-term commitments of title II cargoes to an 8(a) shipping firm and, similarly, is not in a position to offer such commitments under the title III program. As a result, it is unlikely that any 8(a) shipping firm will become competitive based solely on AID business.

AID's Chief of Transportation said the agency could not keep any one vessel continuously busy due to several factors. First, unlike the Military Sealift Command, AID's cargo needs can vary significantly from shipment to shipment. Second, AID cannot predict the timing of food aid shipments,

[10]According to an AID official, AID and the Military Sealift Command have the government's only programs for small and disadvantaged businesses offering ocean transportation services.

which are generated in response to local emergencies and periodic assessments of local program needs. Third, under the title II program, relatively few AID cargoes are suitable for chartering by 8(a) firms given AID's program criteria. These conditions make it difficult for a shipping firm to set a reasonable price for multiple voyages in advance, particularly when destinations are unknown.

New Program Requirements Comply With Applicable Law and Regulations

In developing its revised program guidelines, AID concluded that it was not in compliance with all required statutes and regulations. As a result, AID will begin requiring that (1) all awards be made in accordance with statutory fair market price guidelines and (2) at least 50 percent of a contract's personnel costs must be spent for employees of the 8(a) firm. Both requirements are consistent with the Small Business Act and federal regulations.

Fair Market Price

AID will require that 8(a) contract prices be at or below the fair market price for the shipment, as calculated by the Transportation Division. The Small Business Act provides that an 8(a) contract "may not be awarded . . . if the award of the contract would result in a cost to the awarding agency which exceeds a fair market price." From 1986 to 1990, AID allowed up to 10 percent to be added to its estimate of the fair market price when it negotiated an 8(a) contract price. This practice was based on a precedent set by Agriculture. According to AID's Director of Procurement, the agency has decided that it was not complying with the Federal Acquisition Regulation in setting a fair market price. He added that adopting this standard will bring the Transportation Division in line with the rest of the agency with regards to pricing 8(a) contracts.

Shipping contracts for 8(a) firms cost more than contracts made directly with vessel owners because the 8(a) firms do not own ships. AID plans to calculate its fair market price solely on the basis of commercial prices for similar voyages negotiated directly with owners of the same or similar vessels. Officials from several 8(a) firms told us they would have difficulty reducing their price to the fair market price unless the vessel owner agrees to a lower profit margin than usual. They said this is unlikely to occur unless the shipping market is slow.

According to an SBA attorney, the contracting officer should consider more than just the commercial price in estimating a fair market price for an 8(a) contract. The attorney said the Small Business Act implicitly acknowledges that 8(a) contracts tend to be priced higher than contracts awarded in open competition. The law states that, for purchases with a satisfactory procurement history, the fair market price should be based on recent award prices, adjusted to include "differences in quantities, performance times, plans, specifications, transportation costs, packaging and packing costs, labor and materials costs, overhead costs, and any other additional costs which may be deemed appropriate." Price analyses for new purchases should consider commercial prices, prevailing market conditions, data from other agencies, and pricing data provided by SBA.

This guidance suggests a certain amount of latitude in estimating the fair market price. Although AID's proposed interpretation of fair market price does not recognize any additional costs incurred by an 8(a) firm, its approach does comply with the Federal Acquisition Regulation. If an 8(a) firm disagreed with AID's pricing of a particular contract, it can request SBA to protest the agency's estimate of fair market price.

AID is also concerned that under the title III program, paying more than necessary for shipping will reduce the amount of food aid available. This is because transportation costs are paid from program funds. Using historical cost data from AID's title II program, we estimated that if 8(a) shipping firms had shipped 10 percent of the available title III food aid during 1991 and had charged 10 percent more than other shipping firms, it would have reduced the amount of food aid by about $875,000.

Personnel Cost Requirement

AID will also require that at least 50 percent of the 8(a) firm's cost of contract performance for personnel (including the crew of the vessel) be for employees of the firm. This requirement is imposed by the Small Business Act. AID Transportation Division officials were unaware of this provision until they began their current review of program procedures.

This requirement will be difficult for 8(a) shipping firms to meet. The type of charter contract that 8(a) firms have used in the past provides a crew hired by the vessel owner. Therefore, the crew, which AID reports is the largest component of personnel costs for contract performance, cannot be counted as employees of the 8(a) firm. The 8(a) shipping firms said they are not sure whether they can meet this requirement. We noted that the Small Business Act provides that SBA's Administrator may change the percentage requirement for personnel costs upon determining that it does not reflect the conventional practice of small businesses in the industry.

Recommendations

Given AID's past difficulty in meeting its voluntary 8(a) contracting goal for minority shippers, we recommend that the AID Administrator increase the number of potential 8(a) contract opportunities by lifting the tonnage ceiling for 8(a) cargoes and by issuing procedures that ensure 8(a) firms are given the opportunity to use foreign-flag vessels whenever possible.

AID officials indicated that they concurred with the recommendations and would implement them when the program is resumed. They also said that the agency would codify and put AID's 8(a) shipping program requirements and procedures in writing and make the document available to 8(a) shipping firms interested in participating in AID's program.

Scope and Methodology

We interviewed officials at AID, SBA, the Military Sealift Command, and the Maritime Administration in Washington, D.C. We also met with officials of four 8(a) shipping firms—Amex International, Washington, D.C.; Double Eagle Shipping Company, Yonkers, New York; Leslie Enterprises, formerly of Baltimore, Maryland; and Red River Shipping Corporation, Rockville, Maryland.

We reviewed AID's 8(a) contract files, program procedures, and other documents. We identified all charter shipments over 5,000 metric tons that AID contracted for in calendar year 1990 (a total of 29) and gathered information on them. We selected 1990 to review in detail because it was the most recent year in which an 8(a) contract had been awarded.

We conducted our review between April and August 1992 in accordance with generally accepted government auditing standards.

As you requested, we did not obtain official agency comments on this report. However, we discussed a draft of this report with responsible agency officials and incorporated their comments where appropriate.

Copies of this report are being sent to the Administrators of AID and SBA, appropriate congressional committees, and the Director of the Office of Management and Budget. We will also make copies available to other interested parties upon request.

Please call me on (202) 275-5790 if you or your staff have any questions concerning this report. Major contributors to this report were Albert H. Huntington, III, Assistant Director; Michael ten Kate, Evaluator-in-Charge; and Ann Baker, Evaluator.

Sincerely yours,

Harold J. Johnson

Harold J. Johnson
Director, Foreign Economic
Assistance Issues

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