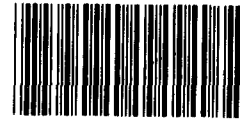


July 1992

# SMALL BUSINESS

## Use of the Surety Bond Waiver Has Been Limited



146996



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**Resources, Community, and  
Economic Development Division**

B-248116

July 7, 1992

**Congressional Recipients**

The Business Opportunity Development Reform Act of 1988 authorized the creation of a pilot Surety Bond Waiver (SBW) Program. This Program, established in June 1989 and scheduled to expire in September 1994, allows the Small Business Administration (SBA) to waive federal surety bond requirements for socially and economically disadvantaged contractors participating in SBA's 8(a) program. Surety bonds ensure that a construction project will be completed if the bonded contractor defaults and/or that employees, subcontractors, and suppliers will be paid for services and materials supplied under the contract. Subsequent legislation directed the Department of Defense (DOD) to make every effort to award a minimum of 30 contracts that used bond waivers in fiscal year 1990 and in fiscal year 1991. Under the 8(a) program, SBA, acting as a prime contractor, enters into contracts with other federal agencies and subcontracts the work to firms participating in the program.

The conference report on the National Defense Authorization Act for Fiscal Years 1990 and 1991 (P.L. 101-189, Nov. 29, 1989) required GAO to examine the pilot SBW Program to determine the impact of the waiver authority and provide the Congress with information that will help it decide whether the pilot Program should be made permanent, modified, or terminated.

As subsequently agreed with your offices, we are providing information on (1) the number of contracts awarded that used bond waivers and, if the number was limited, the reasons for the waivers' limited use; (2) the problems, if any, experienced by DOD and SBA in implementing the Program; (3) the impact, if any, of SBW Program regulations and procedures on contractor participation in the Program; (4) the problems, if any, the defense agencies' contracting officers and 8(a) contractors experienced in obtaining waivers; (5) the problems, if any, experienced when bond waivers were requested but not obtained; and (6) the performance of contractors on contracts that used bond waivers. We determined the extent to which bond waivers have been used by all federal agencies, but, as agreed, we otherwise limited our review to DOD bond waivers because DOD is the only department or agency with congressionally established bond waiver goals.

## Results in Brief

Only 13 contracts awarded in fiscal years 1989 through 1991 used bond waivers—9 of the contracts were awarded by DOD agencies and 4 were awarded by civilian agencies. The DOD agencies fell far short of their congressionally established goal of 30 bond waivers in fiscal year 1990 and in fiscal year 1991. However, because neither DOD nor SBA collects data on the number of 8(a) construction contracts that could potentially use surety bond waivers, it could not be determined whether the Program was being used to the fullest extent possible. The use of bond waivers was limited because

- 8(a) program legislation restricts bond waiver opportunities by requiring SBA to select 8(a) contractors recommended by the procuring agency, which are usually bondable, instead of giving SBA the flexibility to select nonbondable contractors; and if more than one firm is capable of performing a contract, SBA is to give preference to the firm that can obtain bonding;
- in order to implement the SBW Program, the Federal Acquisition Regulations (FAR) had to be revised, and this delayed DOD's issuance of SBW Program guidance; and
- the potential number of 8(a) contracts that could use bond waivers was limited, according to DOD, by (1) the freeze placed on the expenditure of military construction funds from January 1990 to May 1991, (2) the military base closure program, and (3) Operation Desert Storm.

Some aspects of SBA's implementation of the SBW Program also may have contributed to the waiver's limited use—particularly, limited staff training and outreach efforts. SBA has begun to address these problems. In addition, DOD and SBA initially did not have complete data on bond waiver usage, which made their monitoring of Program activity difficult. Contracting officials and contractors said that the SBW regulations and procedures have not limited Program participation. Some contractors experienced problems when bond waivers were requested. SBA attributed these problems to insufficient training of its field office personnel.

SBA was able to identify only one case in which a contractor's bond waiver request was denied. Our efforts to contact the contractor to determine what problems, if any, were experienced by the contractor were unsuccessful.

For the eight bond waiver projects that had been completed as of March 2, 1992, the contractors' performance was considered satisfactory or better.

## Background

The SBW Program affords 8(a) contractors that lack some of the qualifications needed to obtain required surety bonding, such as experience, an opportunity to demonstrate their performance capabilities. It was anticipated that the successful performance of these government contracts would enhance a firm's overall qualifications to obtain bonding for similar work in the future.

Federal construction contracts exceeding \$25,000 are required to have performance and payment bonds. The performance bond ensures that if the contractor does not complete the contracted work, the surety (the entity providing the bond) will either meet the costs of fulfilling the terms of the contract or pay a penal amount of up to 100 percent of the contract price to the government. A payment bond guarantees that subcontractors, suppliers, and employees will be paid for work performed and/or materials provided under the contract.

Two types of sureties—corporate and individual—meet the bonding requirement. A corporate surety is generally a corporation that is licensed under various insurance laws and, under its charter, has the legal power to act as a surety for others. The Department of the Treasury annually publishes a list of companies that it has approved to issue corporate surety bonds. An individual surety is a person, as distinguished from a business entity, who is liable for the amount of the bond obligation. However, unlike corporate sureties, individual sureties are approved directly by the federal agencies' contracting officers.

To be eligible for a bond waiver, a contractor must be in the developmental stage (first 4 years) of its participation in the 8(a) program. (A contractor may participate in the 8(a) program for a total of 9 years.) To be eligible for the 8(a) program, a firm must be a small business that is at least 51 percent unconditionally owned and controlled by one or more socially and economically disadvantaged individuals. In order to determine the firm's business needs, each 8(a) program participant must develop a business plan. The contractor must also be able to satisfy all other contracting requirements for a sole-source (noncompetitive) 8(a) construction contract of \$3 million or less but be unable to obtain bonding. Both the 8(a) and SBW programs are administered by SBA's Office of Minority Small Business and Capital Ownership Development (MSB&COD). (See app. I for a description of 8(a) program eligibility.)

To be considered for a bond waiver, an 8(a) contractor (firm) must make a written request to SBA, provide background information on the firm, and

document that the firm was denied bonding for the contract to which the waiver would apply. In reviewing the request, SBA must obtain the views of the procuring agency—the agency offering the contract—on whether the firm should be given a waiver (but SBA does not have to agree with the procuring agency's view) and determine whether there is a reasonable assurance that the firm can perform the contract if the bonding requirement is waived. When a bond waiver is issued, neither SBA nor the procuring agency is liable for materials or labor provided to the 8(a) contractor by suppliers and subcontractors. (See app. II for a description of the SBW process.)

Section 813 of Public Law 102-190 (Dec. 5, 1991) authorized the Secretary of Defense to delegate to one or more Secretaries of a military department the authority to waive bonding requirements for 8(a) program contractors without approval by or consultation with SBA during fiscal years 1992 and 1993. In addition, it established a departmentwide goal of 30 bond waivers in fiscal year 1992 and in fiscal year 1993. Because DOD has not yet written any Program regulations, we do not know what impact this new legislation will have on the findings contained in this report.

## Use of SBWs Has Been Limited

Use of SBWs has been limited. For fiscal years 1989 through 1991, SBA approved only 13 bond waivers governmentwide. A number of factors contributed to the Program's limited use: certain 8(a) program provisions limit opportunities to use waivers; fewer 8(a) contracts were awarded in fiscal year 1990; and a delay occurred in the issuance of DOD guidance for implementing the SBW Program. However, neither SBA nor DOD knows whether more contracts could have been awarded with bond waivers because the agencies are not collecting certain data that would allow them to make that determination.

## Few Bond Waivers Issued

During fiscal years 1990 and 1991, DOD and civilian agencies awarded 2,820 sole-source 8(a) construction contracts, each valued at \$3 million or less and thus eligible for the bond waiver program. The total value of these contracts, at the time of the contract award, was \$687 million. According to SBA, 13 of these contracts, valued at \$8.9 million at the time of contract award, used surety bond waivers.

DOD agencies awarded 9 of the 13 contracts that used bond waivers. As a result, DOD did not achieve its congressionally established goal of awarding 30 contracts using bond waivers in fiscal year 1990 and in fiscal year 1991.

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Civilian agencies, which had no congressionally established goals, awarded the other four contracts that used bond waivers.

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## 8(a) Program Provisions Limit Waiver Use

SBA's 8(a) program provisions limit the opportunity to use bond waivers. Under 8(a) program legislation, SBA must award contracts to 8(a) firms recommended by the agency offering the contract opportunity. If no recommendation is made, SBA selects the contractor. According to SBA, procuring agencies usually select 8(a) contractors with which they have worked before; these contractors are likely to be able to obtain bonding and thus are ineligible for a bond waiver. According to SBA, approximately 90 percent of all 8(a) construction contracts are awarded upon the procuring agency's recommendation, and, as a result, SBA has limited ability to target contractors that are potential bond waiver candidates for these projects. DOD officials said that it is difficult for the procuring agencies to target projects for contractors that might be eligible for bond waivers because the procuring agencies do not know which 8(a) contractors are in the developmental stage of the program. SBA has not been providing DOD with this information. MSB&COD's Deputy Associate Administrator for Programs said that SBA is not required to provide such information to DOD and that DOD has not requested this information. She agreed that SBA should identify the developmental-stage contractors for DOD but added that DOD and SBA need to decide who is to be provided with this information.

Another 8(a) program provision limits the opportunity to use waivers for the remaining 10 percent of the 8(a) construction contracts when the contractor is selected by SBA. According to SBA's 8(a) program procedures, one factor SBA must consider when selecting a contractor for an 8(a) contract is the contractor's ability to obtain bonding. If more than one contractor is capable of performing a contract, SBA is to give preference to the firm(s) that can obtain bonding.

DOD and SBA officials agreed that it is difficult to target a project for a contractor that is capable of satisfactorily completing the project but may be unable to get bonding. The ability of a contractor to obtain a bond is usually determined on a project-by-project basis (i.e., a contractor may be bondable for one project but not for another). Therefore, the ability of the contractor to obtain a bond is not determined until after the contractor has been selected, the price has been negotiated, and the contractor attempts to obtain bonding for that project.

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**DOD Awarded Fewer 8(a)  
Contracts**

DOD officials said that they have no basis for concluding that the number of bond waivers was lower than it should have been. However, they said that the number of DOD 8(a) contracts that could have potentially used bond waivers was limited in fiscal years 1990 and 1991 because of (1) the freeze placed on the expenditure of military construction funds from January 1990 to May 1991, (2) the military base closure program, and (3) Operation Desert Storm. According to SBA data, the number of 8(a) contracts under \$3 million awarded by DOD decreased from 644 in 1989 to 554 in 1990 but increased to 674 in 1991.

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**FAR Revision Delayed  
DOD Guidance**

An unknown number of bond waiver opportunities were affected in fiscal year 1990 because DOD's procurement offices did not receive guidance for implementing the SBW Program until March 1990, halfway through the fiscal year. The FAR was amended to include the SBW Program on February 5, 1990. DOD sent its guidance to the individual defense agencies on February 8, 1990, and the agencies then sent guidance to their procurement offices. DOD officials said that they were unable to issue any SBW Program guidance until the FAR amendment was published, and one official said that the delayed issuance of guidance minimally affected the number of bond waiver opportunities for fiscal year 1990.

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**Potential SBW Use Is  
Unknown**

Neither DOD nor SBA has its field offices collect data that would help determine the extent to which bond waivers could be used. For example, there is no SBA or DOD requirement that field offices report on 8(a) contractors that are eligible for a waiver and are selected for a contract but are unable to obtain the required bonds. DOD and SBA officials said that they do not collect such information because of other higher-priority work and limited resources. However, both agencies agreed that such data were needed to better determine the extent to which the waiver authority could be used.

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**Implementation  
Problems May Further  
Limit Use**

SBA has encountered implementation problems that may have contributed to the limited use of surety bond waivers. Specifically, (1) SBA has not provided SBW Program training to field staff responsible for implementing the Program and (2) SBA has had limited outreach efforts for the SBW Program. In addition, neither DOD nor SBA managers initially received information on SBW Program activity from all reporting units.



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## SBA Field Office Staff Were Not Trained

As of March 1992, SBA had not trained its regional and district office staff on the SBW Program. According to an SBA Assistant Regional Administrator, SBW training had been scheduled for some regional and district office staff in Washington, D.C., as part of MSB&COD's national training session in August 1991, but there was not enough time for the SBW training. The Office of Program Development has two training sessions planned for fiscal year 1992 that will include material on the SBW Program. However, as of March 9, 1992, specific training dates had not been selected.

Five of the 24 defense agency contracting officials and 8(a) contractors that we contacted reported instances in which SBA officials had difficulty assisting contractors that were trying to obtain waivers. (We contacted 12 agency contracting officials and 12 contractors involved in the nine DOD contracts awarded with waivers and the three DOD projects for which requests for bond waivers were not granted.) For example, one contractor said that the SBA district official did not appear to understand what needed to be included in the bond waiver request and had not provided any guidance on the appropriate format one should use when requesting a bond waiver. The contractor had to make four requests for a bond waiver before the request was accepted by the SBA district office; the contractor told us that the only change in the requests was the format in which the information was provided. According to SBA, the difficulties mentioned to us were probably due to a lack of SBA employee training.

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## SBA's Outreach Efforts Were Limited

SBA's 8(a) program outreach office within MSB&COD is responsible for SBW Program outreach at both headquarters and field offices. However, thus far, SBW Program outreach activities at headquarters have been limited, and MSB&COD managers do not know the extent of the field offices' efforts.

In June 1990, MSB&COD provided written guidance for implementing the SBW Program to the Offices of Small and Disadvantaged Business Utilization (OSDBU)<sup>1</sup> of all defense agencies. Subsequently, MSB&COD officials discussed the establishment of the Program with various trade associations. However, as of March 1992, SBA's headquarters offices, including MSB&COD, had not written any outreach materials on the SBW Program and MSB&COD had discussed the Program with only one civilian agency—the Department of Energy.

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<sup>1</sup>Many civilian federal agencies and departments, as well as DOD and DOD agencies, have OSDBUs. These offices are responsible for ensuring that an equitable share of their agency's or department's total prime contracts and subcontracts are awarded to small businesses, small disadvantaged businesses, women-owned business enterprises, and firms located in areas with substantial unemployment (as determined by the Department of Labor).

According to MSB&COD officials, headquarters' outreach activities have been limited because most of the division's resources were needed to implement all of the changes to the 8(a) program created by the Business Opportunity Development Reform Act of 1988. Moreover, vacancies in key MSB&COD management positions did not allow for the development of outreach activities for the civilian agencies, even though this was a high-priority issue. Finally, no written outreach materials have been developed because MSB&COD officials believe that the SBW Program affects so few 8(a) contractors that it is not cost-effective to use their limited resources to develop written brochures on the SBW Program.

In March 1992, MSB&COD's Deputy Associate Administrator for Programs said that the division was now fully staffed and that the office will have more time to provide outreach to civilian agencies. Toward this end, SBA officials currently meet with the directors of federal agency OSDBUS, including those of civilian agencies, every 2 months. However, some agencies' OSDBU directors do not attend these meetings. In addition, SBA said that it might include information on surety bond waivers in brochures on financial assistance and the 8(a) program when these brochures are revised.

SBA's regions sent a headquarters-produced information letter to all 675 developmental stage 8(a) contractors eligible for the SBW Program. However, SBA headquarters officials did not know what, if any, additional outreach had been done by SBA field offices—regional and district offices. In addition, headquarters has not provided the field offices with any guidance on the amount or type of SBW Program outreach that should occur.

Officials from 8 of the 10 SBA regional offices we contacted said that they had performed some SBW Program outreach to 8(a) contractors, ranging from special, one-time meetings to presentations on the SBW Program at monthly meetings with 8(a) contractors. Six of the 10 SBA regions also had performed similar SBW Program outreach with the procuring agencies.

An SBA headquarters official said that most of the outreach conducted in the field is done by SBA's district offices. In October 1990, MSB&COD asked SBA field offices to report their 8(a) program outreach activities but did not request information on the field offices' SBW Program outreach efforts. According to MSB&COD's General Business and Industry Specialist, a new reporting format is being developed for use during the third quarter of fiscal year 1992. However, the specialist said that the field offices again

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will not be asked to provide any specific information on SBW Program outreach.

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**Program Information  
Provided to SBA and DOD  
Initially Was Incomplete**

Both DOD and SBA established requirements for reporting SBW Program information, including the number of bond waivers approved, but neither initially received complete Program information. DOD established a reporting system to monitor its progress in meeting the congressionally established goal of bond waivers—30 in fiscal year 1990 and in fiscal year 1991. The DOD directive required the Army, Navy, and Air Force to submit quarterly reports for fiscal years 1990 and 1991, beginning in July 1990. Of the 18 reports required as of September 30, 1991, only 13 were submitted. A DOD official said that because DOD had not received all of the military services' bond waiver reports, it was not able to monitor the number of bond waiver contracts. DOD said a lack of resources precluded it from following up on the unsubmitted reports. In addition, Public Law 102-190 established a goal of 30 bond waivers for DOD in fiscal year 1992 and in fiscal year 1993. However, as of February 1992, DOD had not extended its reporting requirement to include fiscal years 1992 and 1993.

SBA established a reporting format for its regional offices to use beginning in April 1991. Prior to that, SBA headquarters had requested data on bond waivers from the regional offices on an as-needed basis but had found it difficult to ascertain the reliability of the data provided. Under the new format, however, the data in the regions' initial reports were incomplete. For example, SBA field offices reported a total of six bond waivers through April 1991, but we identified nine. MSB&COD's Acting Associate Administrator acknowledged that because the reporting requirements were new, not all SBA regions were reporting their bond waivers. We did not assess subsequent reports, but, according to SBA, the regions have been reporting bond waivers accurately since April 1991. SBA plans to replace the current reporting system in fiscal year 1993. At that time it plans to implement a new computer system for reporting 8(a) contract data; the system will include bond waiver data. These data will be entered by the SBA field office executing the contract.

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**SBW Program  
Regulations and  
Procedures Do Not  
Limit Participation**

SBA's SBW Program regulations and operating procedures do not appear to have limited the number of bond waivers approved. DOD and other defense agency officials generally said that the SBW Program regulations and operating procedures were well written and served to protect the government's interest while not unduly restricting 8(a) contractor

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participation in the Program. A representative of a subcontractor association said that the SBW Program requirements were burdensome, but the representative did not identify any particular regulations or procedures that caused contractors not to request bond waivers. Two of the 17 8(a) contractors we contacted said that the SBW Program requirements were burdensome but did not preclude them from requesting a bond waiver.

SBW Program procedures state that to be eligible for a bond waiver, contractors must request and be denied bonding by one corporate surety and one individual surety. We noted one instance in which a contractor had difficulty locating an individual surety. However, in that instance, SBA approved the waiver request without the required denial of individual surety bonding.

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### Problems When Bond Waivers Were Obtained

Contractors and defense agency procurement officials have encountered problems when requested bond waivers have been approved. Nine bond waivers were approved for DOD 8(a) contracts. Three of the nine contractors and three of the nine defense agency procurement officials involved in these contracts said that SBA personnel had been slow or not responsive when asked about the bond waiver program. The remaining contractors and defense agency officials reported no problems. According to MSB&COD's Deputy Associate Administrator for Programs, the reported problems can be attributed to the SBA field office staffs' lack of SBW Program training.

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### Problems When Bond Waivers Were Not Obtained

SBA received four requests for bond waivers that it did not approve. SBA denied one and did not act on the other three. The SBA regional office denied one request because of (1) comments from the procuring agency regarding the contractor's performance on a previous contract and (2) the regional office's own evaluation of the contractor's financial condition and performance. We tried to contact the contractor to determine the effect of the denial, but the contractor's telephone had been disconnected. An SBA official was also unable to reach the contractor.

In two of the other three cases, the contractors and the procuring agencies could not agree upon a contract price; therefore, there was no need for a bond or bond waiver. In the third case, an SBA official said that the waiver request was not acted on because the contractor had not provided all the information SBA required. The contractor said that he read the FAR to determine what information was needed to request a bond waiver. After

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receiving his request, SBA district office personnel told him that he had not provided sufficient information. During the next 6 weeks, the contractor talked with SBA officials several times to determine what additional information SBA needed. However, the procuring agency finally said it could not wait any longer for a bond waiver to be issued; it awarded the contract to another 8(a) contractor that was bondable. MSB&COD's Deputy Associate Administrator for Programs said that lack of training was probably the reason for the contractor's problems with the district office.

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## Contractors Given Bond Waivers Have Performed Satisfactorily

Generally, 8(a) contractors that have been awarded contracts with bond waivers have performed at least satisfactorily on those contracts. As of March 2, 1992, 8 of the 13 contracts awarded using bond waivers, with a total contract value of \$3.4 million, had been completed. According to SBA, the procuring agencies reported that the contractors' performance was satisfactory in six instances, extremely satisfactory in one instance, and excellent in one instance. In addition, two of the eight contracts were completed ahead of schedule. For the five contracts still in progress, no problems were reported.

When establishing the SBW Program, the Congress intended that a contractor's successful performance on contracts that used bond waivers would enhance the contractor's overall qualifications to obtain bonding for similar work in the future. We were able to contact five of the eight contractors that had completed their bond waiver contracts. Three said they had obtained bonding on subsequent contracts and attributed their ability to get bonding, at least in part, to the SBW Program. The other two were optimistic that they would be able to obtain bonding in the future.

A former Acting Associate Administrator, MSB&COD, said that the successful completion of contracts that use bond waivers will help establish the credibility of the SBW Program and make it easier to get agencies to use bond waivers in the future.

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## Conclusions

During the first 3 years of the 5-year pilot SBW Program, few bond waivers were requested and approved by SBA. In addition, DOD did not meet its congressionally established bond waiver goals for fiscal years 1990 and 1991. Several factors contributed to the Program's limited use, including a conflict between requirements in the 8(a) program legislation and requirements in the SBW Program regulations. The legislation establishing the SBW Program requires SBA to select 8(a) contractors that cannot obtain

bonding for a construction project, whereas the 8(a) program legislation directs SBA to select the 8(a) contractors recommended by procuring agencies. Procuring agencies make such recommendations on about 90 percent of construction contracts offered, and most of the recommended firms are bondable. Given this conflict, SBA is limited in its ability to select more contractors that may need to use bond waivers. However, revising the current selection process to ease this limitation could result in fewer contracts for 8(a) firms that can obtain bonds and weaken the safeguards that bonding requirements presently provide the procuring agencies and subcontractors/suppliers.

SBA also encountered implementation problems that may have contributed to the Program's limited use. Specifically, because staff responsible for implementing the Program were not adequately trained, some problems occurred when 8(a) contractors and procuring agencies sought assistance on how to use the Program. In addition, the use of surety bond waivers was probably not maximized because SBA did not perform sufficient outreach to increase the involvement of federal civilian agencies.

Lack of data impairs SBA's and DOD's ability to monitor implementation of the SBW Program and DOD's progress toward meeting legislative goals. Neither DOD nor SBA is collecting certain data needed to determine which 8(a) contractors eligible to obtain bond waivers are having difficulty obtaining bonding. DOD also has not been receiving all the reports on bond waiver activity that the military services have been asked to submit. Furthermore, DOD had not extended its reporting requirement on bond waiver activity to cover fiscal years 1992 and 1993. In addition, better data would help the Congress make an informed decision on whether the pilot SBW Program should be made permanent, modified, or terminated.

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## Recommendations

We recommend that the Administrator, SBA, direct the Associate Administrator, MSB&COD, to

- require SBA field offices to use the annual updates of 8(a) firms' business plans to identify and report the number of developmental-stage contractors that are having problems obtaining the bonding needed for 8(a) contracts;
- provide training to field office staff responsible for implementing the bond waiver program;
- contact those civilian federal agencies that award 8(a) contracts to ensure that they are aware of the SBW Program;

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- determine what SBW Program outreach efforts are being performed in field offices by incorporating questions on these efforts into the MSB&COD field offices' report on outreach activities, and if warranted, provide guidance to the field offices on any additional SBW Program outreach that needs to be performed; and
  - periodically provide DOD and civilian agencies with a list of all contractors in the developmental stage of the 8(a) program.

We also recommend that the Secretary of Defense extend the requirement that the military services submit quarterly SBW Program activity reports for the remainder of fiscal year 1992 and fiscal year 1993 and ensure that all three defense agencies comply with the requirement.

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## Matter for Consideration by the Congress

When considering reauthorization of the pilot SBW Program, the Congress needs to be aware of the preferences given to bondable contractors in the current 8(a) program legislation and operating procedures. Specifically, the 8(a) legislation gives the procuring agency the ability to recommend to SBA the contractor that is to be used for a sole-source 8(a) contract. In most cases, the procuring agency recommends a contractor that is able to obtain bonding, which protects the government's interests and the interests of subcontractors and suppliers. Furthermore, 8(a) program operating procedures state that bondable contractors are to receive preference when SBA selects a contractor. As long as these preferences exist, the use of bond waivers is unlikely to increase appreciably.

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## Agency Comments

We discussed the facts contained in this report with officials from SBA's Office of Minority Small Business & Capital Ownership Development, who generally agreed with the findings, conclusions, and recommendations. They said that procuring agencies generally recommend 8(a) contractors that can obtain bonding in order to protect the government's interest. Furthermore, most 8(a) contractors are selected by the procuring agency. Therefore, to increase the number of bond waivers, SBA needs to receive more open requirements so that it can select contractors that may not be able to obtain bonding and that would be good candidates for the SBW Program.

We also discussed the findings, conclusions, and recommendations with officials from DOD and the military services' Office of Small and Disadvantaged Business Utilization. They generally agreed with the information presented.

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SBA's, DOD's, and the military services' comments have been incorporated where appropriate. However, as agreed with your offices, we did not obtain written agency comments.

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To obtain the information presented in this report, we (1) reviewed SBW Program legislation, regulations, and procedures; (2) interviewed DOD and SBA officials; (3) interviewed 8(a) contractors; and (4) analyzed DOD and SBA Program data. Details on our objectives, scope, and methodology are presented in appendix III. We performed our audit work between January 1991 and April 1992 in accordance with generally accepted government auditing standards.

Copies of this report are being sent to the Administrator of SBA, the Secretary of Defense, the Director of the Office of Management and Budget, and other interested parties. We will also make copies available to others upon request.

This report was prepared under the direction of Judy A. England-Joseph, Director, Housing and Community Development Issues, who may be reached on (202) 275-5525. Major contributors to this report are listed in appendix IV.



J. Dexter Peach  
Assistant Comptroller General



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List of Recipients

The Honorable Dale Bumpers  
Chairman

The Honorable Robert W. Kasten, Jr.  
Ranking Minority Member  
Committee on Small Business  
United States Senate

The Honorable Sam Nunn  
Chairman

The Honorable John W. Warner  
Ranking Minority Member  
Committee on Armed Services  
United States Senate

The Honorable John J. LaFalce  
Chairman

The Honorable Andy Ireland  
Ranking Minority Member  
Committee on Small Business  
House of Representatives

The Honorable Les Aspin  
Chairman

The Honorable William L. Dickinson  
Ranking Minority Member  
Committee on Armed Services  
House of Representatives

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## Abbreviations

BOS	business opportunity specialist
DOD	Department of Defense
DOE	Department of Energy
FAR	Federal Acquisition Regulation
MSB&COD	Minority Small Business & Capital Ownership Development
OSDBU	Office of Small and Disadvantaged Business Utilization
SBA	Small Business Administration
SBW	surety bond waiver



# Eligibility Requirements for the 8(a) Program

Section 8(a) of the Small Business Act, as amended, gives the Small Business Administration (SBA), acting as prime contractor, the authority to enter into procurement contracts with other agencies for the purpose of subcontracting work to firms in the 8(a) program. Firms in the 8(a) program are eligible for financial, technical, managerial, and other types of assistance from SBA to help their business develop.

To be eligible for the program, a firm must be a small business that is at least 51 percent unconditionally owned and controlled by one or more socially and economically disadvantaged individuals. A business is considered small if it meets the SBA-established size standard for its particular Standard Industrial Classification code. These codes are used to define and classify business activities by industry categories. The size standard is generally expressed in terms of the number of employees or the average annual gross revenues of the firm.

The Small Business Act, as amended, defines socially disadvantaged individuals as those subjected to racial or ethnic prejudice or cultural bias because of their membership in a certain group without regard to their individual qualities. The legislation specifically identifies Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, or Native Hawaiians); and Asian-Pacific Americans as groups whose members are presumed to be socially disadvantaged.

The legislation also provides that SBA may designate other groups as socially disadvantaged. In August 1982, SBA included Subcontinent-Asian Americans as a designated group presumed to be socially disadvantaged. Individuals who are not members of one of the designated groups are eligible for the 8(a) program if they can provide clear and convincing evidence, on a case-by-case basis, that they have suffered racial, ethnic, or cultural bias and are therefore socially disadvantaged.

According to SBA, economically disadvantaged individuals are socially disadvantaged individuals whose ability to compete in the open market has been impaired because their credit or capital opportunities have been more limited than those individuals who are not socially disadvantaged in the same or similar business lines and market areas. The 8(a) regulations provide that any individual whose personal net worth exceeds \$250,000 (excluding the equity in his or her primary personal residence and ownership interest in the applicant 8(a) firm) is not economically disadvantaged for purposes of entry into the 8(a) program.

# The Surety Bond Waiver Process

The Business Opportunity Development Reform Act of 1988 (P.L. 100-656, Nov. 15, 1988) authorizes SBA to grant certain participants in the 8(a) program up to five waivers from the federal surety bond requirements for construction projects. These waivers are available only for use on 8(a) sole-source construction contracts having a face value of \$3 million or less. SBA and the procuring agency are to protect persons furnishing materials or labor to the 8(a) program participant by arranging for the disbursement of funds due to such persons either directly from the procuring agency or through a bank that has its depositors insured by the Federal Deposit Insurance Corporation. Further, the participants must be in the developmental phase (first 4 years) of the 8(a) program and must be unable to obtain bonding for the contract for which the waiver is being requested.

SBA procedures implementing the bond waiver program include the following requirements for obtaining a bond waiver:

- An eligible 8(a) participant must submit a written request for a bond waiver for a specific contract to the appropriate SBA regional administrator, or his/her designee, through a business opportunity specialist (BOS) located in the local SBA field office.
- Within 5 working days after receiving the request, the BOS is to notify the requester of the supporting documentation that is needed. This documentation must include sufficient information to demonstrate that the requester cannot obtain a bond for the contract. That is, the requester is required to submit to SBA written denials of bond requests, including the basis for the denial, from at least two sureties, a corporate surety and an individual surety.
- SBA is to obtain the written views of the procuring agency on whether the requester should be granted a waiver. However, SBA may grant the waiver even if the procuring agency does not believe that a waiver should be granted.
- The BOS then determines whether the requester should be given a waiver and prepares a detailed justification and recommendation based on factors such as the requester's performance history and financial condition, the experience of the proposed project management team, and the requester's largest bonded job. According to the procedures, a bond waiver should generally not be granted for a contract that exceeds twice the size of the largest contract previously performed by the requester. Also, there must be reasonable assurance that the contract can be successfully performed and that the requester has the potential to become bondable if assisted by the bond waiver.

- The BOS' analysis, justification, and recommendation is then forwarded to the regional administrator, or his/her designee, who makes the final decision on whether to approve the bond waiver request.

After a waiver request has been approved, SBA procedures require that the 8(a) contractor receiving the waiver (1) provide SBA with written documentation that material suppliers, subcontractors, and laborers have been notified that the contract is exempt from the federal bonding requirements and that SBA and the procuring agency will not be liable for payment for materials or labor and (2) make arrangements that ensure timely payments to all entities furnishing materials or labor to the 8(a) contractor in the performance of the contract in accordance with the Prompt Payment Act.

The latter requirement may be fulfilled either by the establishment of a special bank account in an institution insured by the Federal Deposit Insurance Corporation, into which the procuring agency will deposit all payments relating to the performance of the contract, or the procuring agency may opt to directly disburse the contract proceeds to the suppliers, subcontractors, laborers, etc. If the special bank account option is selected, all checks written on the account must be countersigned by an SBA representative or a third party approved in writing by the Associate Administrator of the Office of Minority Small Business & Capital Ownership Development (MSB&COD).

# Objectives, Scope, and Methodology

The conference report (H.R. 101-331) for Public Law 101-189 mandated us to report to the Committees on Small Business and Armed Services of the Senate and House of Representatives on the SBW Program. In subsequent meetings with the Committees' offices, we agreed to provide information on (1) the number of contracts that used bond waivers and, if the number was limited, the reasons for the waivers' limited use; (2) problems, if any, experienced by DOD and SBA in implementing the Program; (3) the impact, if any, of SBW Program regulations and procedures on contractor participation in the program; (4) problems, if any, the defense agencies' contracting officers and 8(a) contractors experienced in obtaining bond waivers; (5) problems, if any, experienced when bond waivers were requested but not obtained; and (6) performance of contractors on contracts that utilized bond waivers. In addition, it was agreed we would limit our review to SBA and DOD activities and exclude other civilian agencies because (1) in fiscal year 1990, Public Law 101-189 directed DOD to make every effort to award a minimum of 30 contracts that utilized bond waivers in fiscal year 1990 and in fiscal year 1991, but there was no such goal for civilian agencies and (2) at the time of our review, only SBA had authority to approve bond waivers.

To address the first objective, we obtained copies of SBA's and the defense agencies' SBW Program activity reports and compared these reports with information we obtained from interviews with officials from SBA's MSB&COD and the defense agencies' headquarters' Offices of Small and Disadvantaged Business Utilization.

To address the second objective, we interviewed officials from SBA headquarters (MSB&COD), SBA's 10 assistant regional administrators, DOD officials, and officials from the Army, Navy, and Air Force OSD/BU offices. We also reviewed SBA and DOD written program guidance and bond records. We also obtained and reviewed copies of SBA's program outreach materials prepared by, and available at, SBA headquarters. We reviewed the Public Law 100-656 provision that established the 8(a) program, its legislative history, and the SBA procedure that implements this provision. We also interviewed headquarters officials responsible for SBA's SBW Program outreach efforts. In addition, we also interviewed defense agency contracting officials and 8(a) contractors who had been involved with bond waiver requests.

To address the third objective, we reviewed (1) SBW Program regulations, (2) SBA's implementing procedures, (3) transcripts of the two public hearings that were held on the proposed regulations, and (4) the written

comments received in response to the proposed regulations published in the Federal Register. We also interviewed officials from SBA, DOD, and associations that represent 8(a) contractors to obtain their opinions on the requirements of the SBW Program regulations and procedures.

To address the fourth objective, we interviewed the contractors who obtained waivers on DOD contracts and the defense agencies' contracting officers who awarded the contracts that made use of the bond waivers. We also interviewed officials from all nine district offices located in SBA's Atlanta Region. We selected the Atlanta Region because it had more (17 percent) 8(a) developmental-stage contractors (those eligible to participate in the SBW Program) than any other region and the Atlanta Region had both approved (4) and denied (1) requests for a bond waiver.

To address the fifth objective, we interviewed the 8(a) contractors whose requests for bond waivers were not acted upon, as well as the contracting officers who were involved in the contract awards. We attempted to contact the contractor who was denied the bond waiver but were unsuccessful.

To address the last objective, we reviewed SBA status reports, which included comments from the procuring agencies on the contractors' performance. When additional performance information was needed, we contacted the contracting officials.

In addition, we reviewed the SBA Administrator's 1990 annual statement and report required by the Federal Managers Financial Integrity Act of 1982 to identify internal control weaknesses related to the SBW Program. None of the internal control reviews included in the report for 1990 looked at the SBW Program.



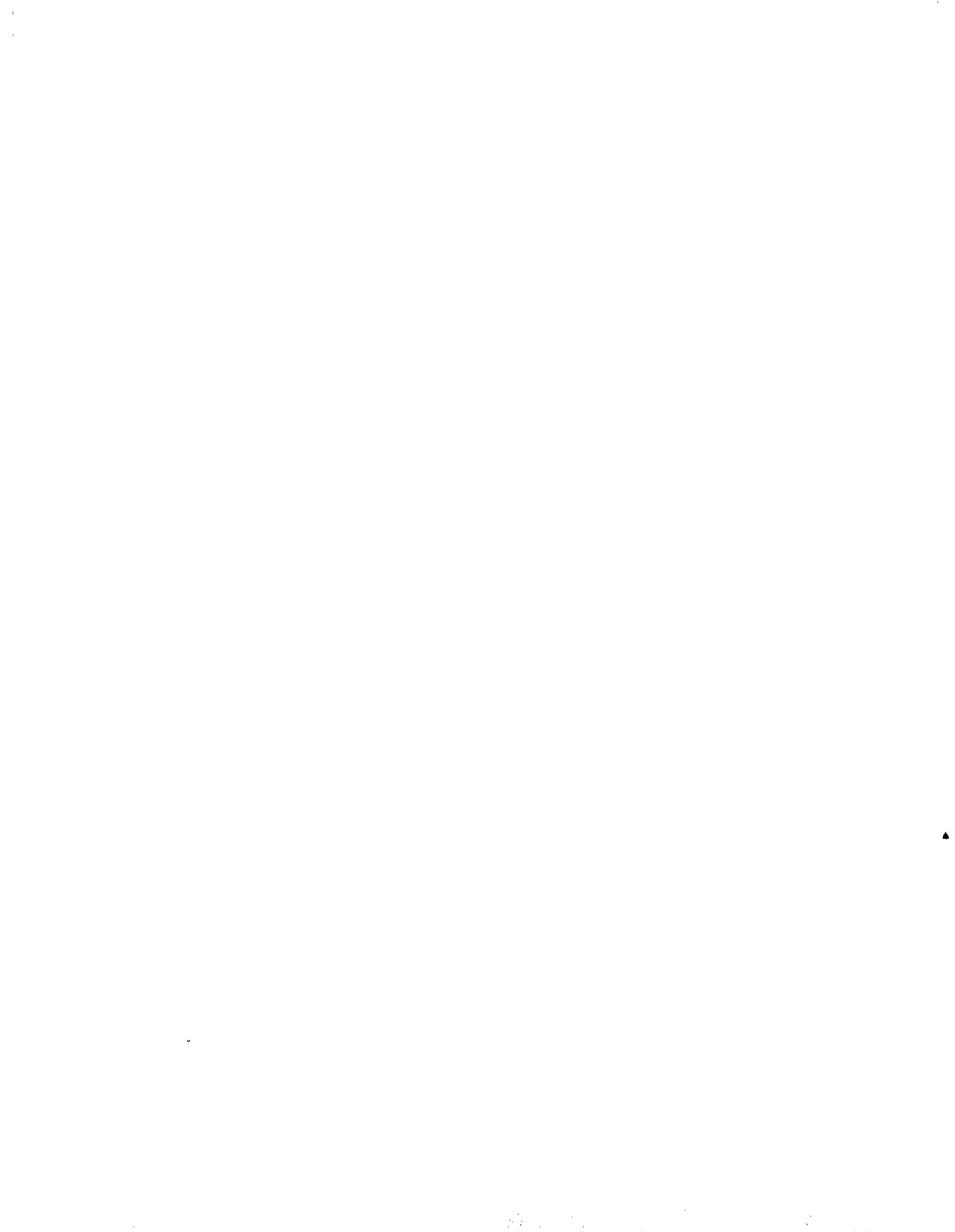
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