



**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20416**

**AUDIT RELATED MEMORANDUM**

**Issue Date: August 21, 1996**

**Number: 6-5-H-006-017**

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*Portions of this report have been withheld pursuant to provisions of the Freedom of Information Act (FOIA).*

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To: Calvin Jenkins  
Associate Administrator for Minority Enterprise Development

From: Peter L. McClintock  
Assistant Inspector General for Auditing

Subject: 8(a) Program Clarification on Ineligible Businesses and Contract Support for Regular Dealers

During our audit of James W. Collins and Associates, Inc. (JWC), we found that 8(a) program regulations needed strengthening with respect to ineligible businesses and contract support to regular dealers. The audit concluded JWC did not qualify as a regular dealer (using Walsh-Healey adapted definitions) of office supplies because the firm did not make substantial sales from inventory. Furthermore, for JWC's 8(a) sales activities, JWC obtained contracts for office supplies, purchased the items from a manufacturer or retailer for a commission or markup on cost, and then had the goods drop shipped to the procuring agency. In other words, they passed the procurement through to another business, which appears to be brokering. In response to the audit, the Washington District Office (WDO) stated that there was no current regulatory basis to implement the audit recommendation because the section of the Walsh-Healey Public Contracts Act applicable to regular dealers was repealed. The WDO also stated that SBA does not have any definitions or interpretations of regular dealers in place at this time.

Although regular dealer sections of the Walsh-Healey Public Contracts Act have been repealed, the provisions are still applicable in SBA regulations. Regulations currently in effect require that 8(a) program participants must be determined to be a regular dealer as defined in the Walsh-Healey Public Contracts Act in order to be

awarded 8(a) contracts to supply materials, supplies, articles, and equipment (13 CFR 124.108(d)). Also, brokers and packagers are currently ineligible to participate in the 8(a) program (13 CFR 124.109(a)). Furthermore, current regulations state that these types of businesses do not satisfy the definitions of a manufacturer or regular dealer as stated in 13 CFR 124.100.

While 13 CFR 124.100 provides an adequate definition of a manufacturer based upon the Walsh-Healey Public Contracts Act, it does not do the same for regular dealers. It merely states a regular dealer is defined by the Walsh-Healey Public Contracts Act and Department of Labor regulations at 41 CFR 50-201.101, 50-206.53, and 50-206.54. Among other requirements, firms must show they have made sales regularly from stock on a recurring basis to qualify as a regular dealer (41 CFR 50-206.53(b)(4)). In addition, there are no regulations that currently define brokers and packagers.

Because of the repeal of Walsh-Healey Public Contracts Act regular dealer provisions (as part of the Federal Acquisition Streamlining Act of 1994), for any Government supply contracts that are awarded after September 30, 1995, contractors are no longer required to be manufacturers of, or regular dealers in, the items to be supplied. In meetings with you and officials from your office, we were told that the Walsh-Healey Public Contracts Act regular dealer definitions and interpretations will continue to be used for 8(a) program purposes until SBA establishes its own definitions and interpretations. The Chief Counsel for Special Programs from SBA's Office of General Counsel confirmed that SBA could continue to use the Walsh-Healey Public Contracts Act definitions and interpretations of regular dealers even though the relevant section of the Act has been repealed.

We recognize that in the current business environment, the Walsh-Healey Public Contracts Act definitions and interpretations of regular dealers have become outdated. It would not be a sound business practice for firms such as JWC to stock substantial inventories when it is more efficient and economical to drop ship orders. We believe the more important issue, however, is whether firms such as JWC, who provide little or no value to the procurement, should be permitted to participate in the 8(a) program. As a matter of sound public policy, we question whether Federal Government assistance should be given to companies that are not engaged in substantial value added activities. We also do not believe that providing government sole-source set-aside contracts to companies that virtually pass through contracts to other companies will help them develop their business skills and become viable businesses. Furthermore, these sole-source procurements provide little or no assurance that the Federal Government is obtaining supplies at fair market value. Although JWC's contracts did not appear to result in higher costs to the procuring agencies, we found instances in an ongoing audit in which the 8(a) contractor marked up the costs, resulting in higher costs to the procuring agencies. Consequently, we believe SBA should issue policy clarifications to make up for the Walsh-Healey Public Contracts Act amendments.

## RECOMMENDATION

We recommend that the Associate Administrator for Minority Enterprise Development (AA/MED) issue policy defining regular dealers and brokers and also provide parameters that wholesalers and retailers must follow to prevent firms who provide little or no value from participating in the 8(a) program.

## SBA MANAGEMENT'S RESPONSE

The AA/MED generally agreed with our finding [ *portion withheld under FOIA Exemption 5.* ]

## EVALUATION OF SBA MANAGEMENT'S RESPONSE

The actions taken and planned by the AA/MED address the concerns raised in our report.

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The finding included in this report is the conclusion of the Office of Inspector General's Auditing Division based on testing of the auditee's operation. **The finding and recommendation are subject to review, management decision, and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.**

Please provide us your proposed management decision within 80 days on the attached SBA Forms 1824, Recommendation Action Sheet. If you disagree with the recommendation, please provide your reasons in writing.

This report may contain proprietary information subject to the provisions of 18 USC § 1905. Do not release to the public or another agency without permission of the Office of Inspector General.

Should you or your staff have any questions, please contact Victor R. Ruiz, Director, Headquarters Operations, at (202) 205-7204.