

**SMALL BUSINESS PROCUREMENT ACT
SET-ASIDE PROGRAM
FOLLOW-UP STUDY**

Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota

Program Evaluation Division

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APRIL 1985

**Program Evaluation Division
Office of the Legislative Auditor
State of Minnesota**



STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

April 26, 1984

Senator Randolph W. Peterson, Chairman
Legislative Audit Commission

Dear Senator Peterson:

In February 1982 the Program Evaluation Division of the Office of the Legislative Auditor issued a report on the Department of Administration's set-aside program for socially and economically disadvantaged (SED) small businesses.

This follow-up study examines DOA's progress in addressing the problems we identified in 1982 and evaluates the degree to which the department has achieved the goals of the set-aside program and complied with statutory requirements and provisions in effect from FY 1982 through FY 1984.

The report finds that DOA has made some progress and concludes that the experimental preference program implemented in 1984 shows real promise as a new means of meeting the state's procurement goals. This program places SED vendors in competition with non-SED vendors on a limited basis.

We wish to thank the Department of Administration and members of the Small Business Procurement Advisory Council for their help and cooperation.

This study was conducted by Elliot Long (project manager) and Susan Job.

Sincerely,

A handwritten signature in cursive script, appearing to read "James R. Nobles".

James R. Nobles
Legislative Auditor

A handwritten signature in cursive script, appearing to read "Roger A. Brooks".

Roger A. Brooks
Deputy Legislative Auditor
for Program Evaluation

TABLE OF CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY	ix
A. INTRODUCTION	1
B. SET-ASIDE PROCUREMENT TARGETS	7
C. BROADENING PARTICIPATION IN THE SET-ASIDE PROGRAM	10
D. COMPLIANCE WITH THE FIVE-PERCENT REQUIREMENT	20
E. THE PREFERENCE PROGRAM	22
F. VERIFICATION OF VENDOR ELIGIBILITY	28
G. ADMINISTRATIVE RULES	29
H. PROMOTION OF THE SET-ASIDE PROGRAM	30
I. THE SMALL BUSINESS PROCUREMENT ADVISORY COUNCIL	32
J. APPROPRIATENESS OF SET-ASIDE GOALS	35
K. ADMINISTRATION OF THE SET-ASIDE PROGRAM	35
STUDIES OF THE PROGRAM EVALUATION DIVISION	37

LIST OF TABLES

		<u>Page</u>
Table 1	Small Business and Set-Aside Procurement	8
Table 2	Total SED Awards	11
Table 3	Participation in the Set-Aside Program	11
Table 4	Breakdown of Set-Aside Awards by SED Category	12
Table 5	The Ten Most Active Set-Aside Vendors Ranked by Dollar Volume of Awards	14
Table 6	The Ten Most Active Set-Aside Commodity Vendors	15
Table 7	The Five Most Active Set-Aside Service and Commodity Contract Vendors	16
Table 8	The Ten Most Active Preference Vendors Ranked by Volume of Awards	17
Table 9	The Ten Most Active Preference Commodity Vendors	17
Table 10	Set-Aside Awards as a Percent of Total Procurement	19
Table 11	Number of Requisitions Set Aside Compared to Actual Awards	22
Table 12	The Preference Program: Number of Requi- sitions and Value of Awards	25
Table 13	Percentage Distribution of Preference Awards by SED Category	26
Table 14	The December Preference Experiment	26
Table 15	Competitiveness of SED Vendors in the Preference Program	27

EXECUTIVE SUMMARY

In February 1982 the Program Evaluation Division of the Legislative Auditor's Office issued an evaluation report on the Department of Administration's (DOA's) procurement set-aside program for socially and economically disadvantaged (SED) small businesses. The set-aside program allocates a share of central procurement for exclusive bidding by eligible SED businesses. In 1982 this share was three percent and it is now six percent. The Small Business Procurement Act, which governs the set-aside program, also states that awards to SED vendors may not exceed DOA's estimated price for the goods or services by more than five percent.

The 1982 study found that the program, while achieving statutory procurement targets, was plagued by administrative problems and was not serving well, either the broader goals of the Small Business Procurement Act, or standards of good procurement practice. Specific findings were that awards were going to a small number of individual vendors; estimates of market value used in the program were inaccurate; contrary to statute, many SED awards were more than five percent over the estimated price, the vendor certification process was too informal; and cases existed where SED vendors were subcontracting all or part of the work to non-SED vendors.

In our 1982 report we recommended improved program outreach and publicity, a limit on the amount of set-aside business performed by individual vendors, verification of information provided by vendors, and clarification of program rules and policies. Because we did not see a solution to the problem of establishing accurate market prices in the absence of competitive bidding, we recommended that the Legislature seriously consider allowing SED vendors to compete with other small businesses at a five-percent advantage.

The Small Business Procurement Act has been amended since our earlier study and DOA has implemented changes in response to some of the problems we observed earlier. The most significant developments include increases in SED procurement goals and awards, and the establishment of an experimental program which places SED Firms in competition with non-SED businesses but grants them a five-percent preference in the evaluation of bids.

In this follow-up study, we asked:

- Are the set-aside and preference programs achieving the procurement targets set in law?
- Has participation in the program been broadened?

- Are set-aside and preference awards kept within the five-percent targets?
- Does experience with the preference program to date, justify its continued use?
- Does DOA take reasonable steps to verify the eligibility of participants?
- Are DOA's administrative rules clear and up-to-date?
- Are DOA and the Department of Energy and Economic Development (DEED) adequately promoting the set-aside program?
- Is the Small Business Procurement Advisory Council functioning effectively?
- Are the statutory goals for the set-aside program appropriate and realistic?
- Is the set-aside program effectively administered?

We first examined whether DOA met the statutory targets for SED procurement in fiscal years 1982 through 1984. We found that in FY 1982 and FY 1983 the department exceeded the requirement that three percent of total procurement be set aside for SED vendors. In FY 1984, three new targets went into effect: a six-percent target for the set-aside program, a 1.5-percent maximum target for each of two experimental preference programs, and an additional 10-percent SED subcontracting goal on certain contracts over \$200,000. We found that DOA met and exceeded the preference and subcontracting goals in effect for the first time in FY 1984 but did not achieve the six-percent set-aside target.

- In FY 1984 total SED procurement was \$15.0 million, up from \$5.9 million in FY 1983. This includes set-aside, preference, and sub-contracting awards. Considering the overall expansion of the program and the increase in the statutory targets, we believe that DOA made good progress in FY 1984, despite failing to meet the six-percent goal for the set-aside program.

We also examined trends in the number of certified SED vendors. We found:

- In fiscal years 1983 and 1984, the program achieved large increases in the number of certified SED vendors, mainly attributable to the inclusion of vendors in federally-designated labor surplus areas and increased participation by women-owned businesses. This resulted in a substantial decrease in the share of SED business going to minority vendors in FY 1984 although the

dollar volume of procurement from minority-owned businesses actually increased slightly.

In our 1982 study, we found that a high percentage of set-aside procurement was going to a relatively few individual vendors. In reviewing vendor awards since FY 1981, we found that:

- DOA made progress in reducing the concentration of awards to individual vendors only in FY 1984. However, several of the most active set-aside vendors in FY 1984 were also major beneficiaries under the preference program. In FY 1984 the 10 most active SED vendors received 43 percent of all set-aside dollars, compared to 57 percent, 55 percent, and 59 percent in fiscal years 1981, 1982, and 1983, respectively. In addition, three of the 10 most active vendors in the set-aside program in FY 1984 were also in the top 10 for the preference program.

We are concerned that the department has not implemented a statutory provision which limits to five years the time a vendor can remain in the set-aside program. We also find that DOA is not monitoring the provision of the Small Business Procurement Act which limits the dollar volume of awards that may go to an individual vendor during any fiscal year.

In order to evaluate whether DOA complies with the statutory requirement limiting set-aside awards to an amount five percent over the estimate, we examined a representative sample of 102 set-aside requisitions from FY 1984. We found:

- Ninety-five percent of the awards were within the five-percent limit, as opposed to 73 percent in FY 1980. The five awards which exceeded the limit ranged from six percent to 25 percent over the estimate. DOA agrees that this is a violation of the statute but justifies exceptions in circumstances where the administrative cost of re-bidding a set-aside requisition on the open market would be greater than the amount by which the bid exceeds 105 percent of the estimate.

We also examined a sample of 90 awards to SED vendors under the preference program to see whether these awards were kept within 105 percent of the low open market bid, as required by statute.

- We found two cases in which preference awards to SED vendors exceeded the limit.

Our examination of FY 1984 set-aside purchases showed continuing problems with inaccurate price estimates, limited competition among SED vendors, and a high rate of re-bidding. In FY 1984, one-quarter of all requisitions set aside for SED vendors had to be re-bid on the open market because there was no SED bid within five percent of the estimate.

The expense and time delays introduced by re-bidding under the set-aside program are major reasons the department is recommending increased use of the preference approach which the 1983 Legislature authorized DOA to use on an experimental basis starting in FY 1984. In order to evaluate the preference program which gives SED vendors a five-percent advantage when bidding on the open market against non-SED vendors, we examined summary statistics, analyzed data from a representative sample of 90 awards, and talked to department staff and advisory council members.

We found that the department awarded \$3.3 million, or 1.9 percent of total procurement under the preference program in 1984. This was accomplished by assigning every purchase order to the preference program during December 1983 and assigning selective purchases to it for the remainder of FY 1984. The results show that SED vendors actually submitted the low bid in 78.7 percent of the cases in the December experiment, and in 73.3 percent of the cases in our sample of awards for the remaining 11 months. Thus, we conclude that in many cases SED vendors are able to compete on an equal footing with non-SED vendors, despite a widespread assumption to the contrary.

DOA exceeded the limit of 1.5 percent of total procurement legally allowed for the program implemented in FY 1984. Despite this lapse in technical compliance we believe, on the whole, that the preference experiment has been a success. We conclude that:

- The preference approach appears to be a promising means for DOA to achieve the objectives of the Small Business Procurement Act while overcoming some of the enduring problems of the set-aside program, namely costly delays and inaccurate estimates.
- Experience with the program shows that it can work, and we believe the evidence supports increased use of the program to achieve the aims of the set-aside program.

We therefore endorse the department's proposal for additional discretion in using the preference approach to meet overall set-aside goals.

In 1982 we criticized DOA for not adequately verifying the information provided by vendors on their certification applications. Current procedures do not appear to be materially different from what we observed during our earlier study, and in many cases the participant files we examined contain outdated information. Although DOA will require firms to provide updated eligibility information each year under a proposed revision of the set-aside rules, we question the department's capacity to implement the provision given the administrative and clerical resources currently available to the set-aside program.

Because we have not closely examined current proposals to centralize vendor certification for all state agencies in one location, we can not offer a recommendation on the matter. However, we do believe that DOA's existing certification procedure can and should be strengthened.

In our 1982 report we found that the administrative rules governing the set-aside program were unclear in a number of respects. Despite changes in the rules and statutes, our follow-up work shows that the rules are still out-of-date and do not include the preference program, the five-year vendor certification provision, an appeals process for certification decisions, and needed clarification of eligibility requirements. Although we were told that these issues will be addressed in a forthcoming revision of the rules, we believe that DOA's continuing operation of the set-aside and preference programs without adequate rules is a serious administrative shortcoming.

According to the Small Business Procurement Act, DOA and DEED are each responsible for promoting the set-aside program. DOA is primarily responsible for the set-aside program and DEED's role is limited to general promotion and publicity incidental to its other small business development responsibilities. In 1982 both agencies acknowledged our criticism that neither department was active enough in publicizing the program and attracting new participants. We find little improvement in 1984, and observe that cooperation between the two agencies appears to be virtually non-existent. Therefore, we renew our 1982 recommendation that both departments devote significantly more staff and budget to regularly publicizing the program in SED-oriented publications, and more aggressively targeting outreach to particular segments of the SED community.

In 1983 the Legislature created a 13-member Small Business Procurement Advisory Council appointed by the Governor to advise DOA on matters relating to the small business procurement program, to review complaints or grievances from vendors, and to review required reports from DOA and DEED to ensure compliance with program goals. Given the problems we identified in 1982, we believe that the council has the potential to provide a needed communication channel between DOA, the vendor community, and others concerned with the small business procurement program. However, we found:

- The advisory council has not organized itself effectively to carry out its statutory mission.

In reviewing the council's record, we observed a pattern of poor attendance, high turnover, hostility to the department, and lack of direction. At present, five out of 11 members of the advisory council are certified participants of the set-aside program and two members are among the program's most active participants. We believe that formal policies are necessary to ensure

that participants in the set-aside program do not dominate the council on matters where a conflict of interest may exist. Therefore we recommend that policies be instituted:

- prohibiting program participants from holding a majority of the seats on the advisory council, and
- requiring that individual council members disqualify themselves from grievance or appeals decisions where they may have a personal interest.

Finally, we conclude that the set-aside program does not receive sufficient clerical support within the Procurement Division of DOA. The division continues to be behind in record keeping and statistical reporting on the program. The Legislature does not review a separate budget for the program, which is a small part of DOA's procurement function. We recommend that:

- DOA analyze its staffing and equipment requirements for the program and arrange to meet these needs by drawing on resources within the department or by making a request to the Legislature for needed additional resources.

A. INTRODUCTION

In February 1982 the Program Evaluation Division of the Legislative Auditor's Office issued an evaluation report on the Small Business Procurement Set-Aside program for socially and economically disadvantaged (SED) small businesses. The set-aside program allocates a specified share of central procurement for exclusive bidding by eligible SED businesses. In 1982 this share was three percent and it is now six percent. The Small Business Procurement Act, which governs the set-aside program, also states that awards to SED vendors may not exceed DOA's estimated price for the goods or services by more than five percent.

Between 1982 and the present, the Legislature enacted significant changes in the Small Business Procurement Act and the Department of Administration (DOA) undertook a number of administrative reforms. The most significant developments include increases in SED procurement goals and awards, and the establishment of an experimental program which places SED firms in competition with non-SED businesses at a five-percent advantage.

The key conclusions of our 1982 study were:

- Awards through the set-aside program had generally met targeted levels, but the program was not working as intended to expand business opportunities for SED businesses.
- The program was very difficult to administer.
- Set-aside awards were going to a small number of individual vendors, contrary to the statutory intent of the program.
- The set-aside program in general and individual procurement opportunities in particular were not adequately promoted by the Department of Administration and the Department of Energy and Economic Development (DEED).
- Estimates of market value for set-aside purchases were often highly inaccurate.
- The department frequently ignored the statutory requirement that set-aside purchases be made at a price within five percent of market value.
- The process by which vendors were certified as eligible for participation in the set-aside program was too informal. DOA did not systematically verify the information provided by vendors even on a selective basis.

- Some recipients of set-aside awards subcontracted all or part of the work to non-SED vendors, a practice contrary to the spirit, if not the letter of the law.

We recommended that:

- DOA implement an improved outreach program and better approach for advertising procurement opportunities;
- A limit be established on the amount of set-aside business awarded to any individual vendor;
- Targets for the set-aside program be set at a reasonable level: high enough to create new opportunities, but low enough to be realistic in light of the actual and potential availability of vendors;
- DOA verify information provided by vendors on ownership, size, and other qualifications; and
- DOA clarify its own rules and policies for the set-aside program, particularly those relating to subcontracting and eligibility for participation in the program.

In our original report, we did not see any easy solution to the problem of establishing an accurate market price for goods and services in the absence of competitive bidding. Consequently we recommended that:

- Serious consideration be given to allowing SED vendors to compete with other small businesses at a five-percent advantage in situations where competition would not exist within the set-aside program.

A number of changes were made in the Small Business Procurement Act since our 1982 study, and important administrative changes have been implemented within DOA as well. In 1983 the following changes were enacted in the program:

- The required value of total procurement to be set aside for small businesses was increased from 20 to 25 percent.
- The quota for setting aside purchases through the SED program was increased from three to six percent of central procurement.
- A provision was enacted requiring that 15 percent of designated set-aside procurement be awarded, if possible, to Minnesota correctional industries.
- DOA was directed to designate set-aside procurement opportunities in a way that encourages proportionate

distribution of awards among the state's geographic regions;

- Agency purchasing authorization was increased to \$1,000 in July 1983 and \$1,500 in July 1984 for agencies submitting a plan to make 10 percent of their annual purchases from SED vendors.
- A new requirement was added stating that no more than 20 percent of any commodity class could be designated for purchasing through the set-aside program.
- A further requirement specified that an individual vendor participating in the set-aside program was limited to five percent of total anticipated set-aside procurement in any fiscal year.
- A provision was passed requiring that 50 percent of the value of set-aside awards be performed either by the business to whom the award is made or by another SED vendor.
- Two pilot preference programs were authorized: 1) a five-percent preference to SED businesses bidding against non- SED vendors, and 2) the opportunity for SED businesses to match any bid on a procurement contract. These programs were each limited to 1.5 percent of the total annual value of state procurement.
- Another provision was passed requiring that 10 percent of the value of construction, consultant, professional, or technical service contracts in excess of \$200,000 be subcontracted to SED businesses, if possible.
- Every state agency was required to set aside 25 percent of anticipated consultant, professional, or technical procurements for small Minnesota businesses.
- A 13-member small business procurement advisory council was created to advise the Commissioner of Administration on small business procurement and to review complaints against vendors.

In 1984, the following changes were made:

- Instead of requiring that approximately 25 percent of state procurement be *set aside* for small businesses, new language required that at least 25 percent be *awarded* to small businesses.
- The preference program was changed to require that three percent of total state procurement be set aside

for this purpose without reference to a particular approach.

- The set-aside for Minnesota correctional industries was discontinued.
- The subcontracting requirement pertaining to contracts over \$200,000 was removed as it applied to SED prime contractors.
- The limit on individual SED vendors was re-defined from five percent of anticipated set-aside procurement to three-tenths of one percent of total anticipated procurement for any fiscal year, which is approximately equivalent.
- A target of six percent of agency consultant, professional, and technical contracts was established for SED vendors.

Since an evaluation of the set-aside program logically rests on a comparison of actual program experience to agreed-upon program objectives, we believe that we must make explicit our interpretation of the goals of the program. While the statutes establishing the small business procurement program for socially and economically disadvantaged businesses do not contain a general statement of goals and objectives, these may be reasonably inferred.

We believe that the set-aside program has two broad goals:

- to ensure that women-owned, minority-owned, and other eligible SED businesses receive a fair share of state procurement; and
- to generally enhance economic and business opportunities for SED vendors.

In our view, the goals of the set-aside program are met if:

- procurement is widely distributed among the largest possible number of qualified vendors;
- there is maximum possible variation in the kinds of procurement opportunities offered through the program; and
- sufficient emphasis is placed on outreach and recruitment of new vendors to the program.

We do not believe the goals of the set-aside program are best met if:

- SED procurement is concentrated among a small number of individual vendors;
- permanent business relationships are established with individual SED vendors, leading to their dependency on the state for survival or prosperity; and
- situations exist where a few vendors develop and maintain an inside track and position of influence, thereby effectively locking-in the status quo and making reform and improvement of the program difficult.

Therefore, we believe that the key to a successful set-aside program lies in encouraging as many SED vendors to do business with the state as possible, thus increasing business opportunities for vendors who have historically been denied equal opportunity. We believe that this can and must be done without compromising sound procurement practices, as happens when the state purchases goods and services from vendors who cannot perform well, or at a price which is significantly higher than fair market value.

Our support for these views rests in the provisions of the Small Business Procurement Act (Minn. Stat. 1984 §16B.19-22) that say:

- DOA should attempt to vary procurements included in the set-aside program so that a variety of goods and services produced by different small businesses are obtained each year (16B.19, subd.1).
- DOA should designate set-aside awards proportionately among the geographic regions of the state (16B.19, subd.5).
- DOA should not award more than 20 percent of any commodity class through the set-aside program (16B.19, subd.5).
- An individual vendor who has received more than three-tenths of one percent of total anticipated procurement in a fiscal year is disqualified from receiving additional awards in that year (16B.19, subd.5).
- The amount of a set-aside award cannot exceed by more than five percent the commissioner's estimated price for the goods or services if they were to be purchased on the open market (16B.19, subd.3).
- DOA should adopt rules limiting certification of SED vendors to a period of five years from the date of the first set-aside award, and requiring a five-year ineligibility period after five years of participation in the program (16B.22).

In summary, the Small Business Procurement Act says that awards are to be made close to the market price and are not to be concentrated in certain commodity categories, or awarded to only a few individual vendors. Because vendors are not intended to participate in the program indefinitely, the law emphasizes developing opportunities for new vendors and introducing as large a number of vendors as possible.

In this follow-up study we examined how well the set-aside program is working, both in relation to our previous findings and to 1983 changes in the Small Business Procurement Act. We asked:

- Are the set-aside and preference programs achieving the targets set in law?
- Has participation in the set-aside program been broadened since 1982? Do particular vendors or procurement categories dominate the program?
- Are set-aside awards kept to an amount no more than five percent over the estimate? Are preference awards kept within five percent of the low open-market bid?
- Does the department's experience with the preference program in FY 1984 justify its continued use as a means of enhancing opportunities for SED vendors?
- Does DOA take reasonable steps to verify the eligibility of participants in the set-aside program?
- Are the administrative rules governing the program clear and up to date?
- Does the department adequately promote set-aside procurement opportunities? Are DOA and DEED effectively carrying out their responsibilities to promote the program?
- Is the advisory council established in 1983 functioning effectively?
- Are statutory set-aside, preference, and subcontracting goals appropriate and realistic?
- Is the department administering the set-aside program in an efficient manner?

B. SET-ASIDE PROCUREMENT TARGETS

Provisions of the Small Business Procurement Act in effect from FY 1981 through FY 1983 required that 20 percent of total anticipated procurement be designated and set aside for award to small businesses. Another provision specified that three percent of total procurement be set aside and awarded if possible to businesses owned and operated by socially and economically disadvantaged persons. The definition of socially and economically disadvantaged persons includes members of racial minority groups, women, the handicapped, and persons with businesses located in federally-designated labor surplus areas.

As Table 1 on page 8 shows, actual procurement from small businesses represented 24.2 percent, 27.4 percent, and 28.0 percent of total procurement in FY 1981, FY 1982, and FY 1983. Thus, procurement exceeded the 20-percent goal in each of these years. As in the past, a special set-aside effort was not required in order for the department to meet its general small business procurement goal.

From FY 1981 through FY 1983, DOA was also required to set aside three percent of total procurement for award, if possible, to SED vendors. Table 1 indicates that in FY 1981, FY 1982, and FY 1983, the department set aside 4.2 percent, 3.1 percent, and 5.6 percent of total procurement for SED vendors, thus exceeding the three-percent target. In fact, the table shows that in FY 1981 and FY 1983, actual awards to SED vendors were 3.3 percent and 4.7 percent of total procurement respectively.

In 1983 the Legislature changed and substantially increased set-aside program goals in a number of ways. First, a provision was passed requiring that 25 percent rather than 20 percent of total anticipated procurement be designated and set aside for award to small businesses and Minnesota correctional industries.¹ A second change specified that six percent of total procurement be awarded, if possible, to SED businesses. In addition, the law targeted an extra 10 percent in SED subcontracting on all construction, professional, and technical services contracts over \$200,000.

The law also authorized the department to implement two experimental programs, each limited to 1.5 percent of total procurement which would allow SED vendors a five-percent preference on open-market bids. One option gave SED vendors a five-percent advantage in bidding against non-SED vendors on selected state purchases, and the second allowed SED vendors to

¹The Legislature deleted the provision relating to correctional industries in 1984.

TABLE 1
SMALL BUSINESS AND SET-ASIDE PROCUREMENT

FY 1981-FY 1984
(Dollars in Millions)

	1981	1982	1983	1984
TOTAL PROCUREMENT	\$88.1	\$129.7	\$123.7	\$174.7 ^a
SMALL BUSINESS PROCUREMENT	\$21.3	\$ 35.6	\$ 34.6	\$ 48.1 ^b
Percent Required	20%	20%	20%	25%
Percent Awarded	24.2%	27.4%	27.9%	27.5%
SED PROCUREMENT SET ASIDE	\$ 3.7	\$ 4.0	\$ 6.9	\$ 10.9
Percent of Total Required	3%	3%	3%	6%
Percent Set Aside	4.2%	3.1%	5.6%	6.2%
SED PROCUREMENT AWARDED ^c	\$ 2.9	\$ 2.7	\$ 5.9	\$ 8.6
Percent of Total Awarded	3.3%	2.1%	4.7%	4.9%
Percent of Total Set Aside	79.7%	67.0%	85.0%	79.2%
SED PROCUREMENT RE-BID	\$ 0.3	\$ 1.3	\$ 1.0	\$ 2.3
Percent of Total Set Aside	8.0%	33.0%	15.0%	20.8%

Source: Department of Administration.

^{a,b}Include contracts over \$200,000 which carry an additional 10-percent SED sub-contracting requirement.

^cDoes not include preference or SED subcontracting.

match any open-market bid. The department implemented the first, but not the second of these options in FY 1984.²

As Table 1 shows, total small business procurement in FY 1984 equalled \$48.1 million, or 27.5 percent of the \$174.7 million total central procurement. This exceeded the 25-percent standard in effect for the year. The table also shows that total FY 1984 awards to SED vendors were \$8.6 million, or 4.9

²Legislation passed in 1984 requires that three percent of total procurement be designated for award under a preference program in which SED vendors receive a five-percent advantage in the bid amount on selected state purchases.

percent of total procurement. This does not meet the six-percent goal for FY 1984 specified by the 1983 Legislature.

Overall, Table 1 indicates that total procurement almost doubled from \$88.1 million in FY 1981, to \$174.7 million in FY 1984. During this period, the value of awards to small businesses more than doubled from \$21.3 million, to \$48.1 million; and SED awards almost tripled from \$2.9 million, to \$8.6 million.

Table 1 also shows that the dollar value of re-bids grew from \$0.3 million to \$2.3 million between FY 1981 and FY 1984. According to the table, re-bids amounted to about one-fifth of the value of all requisitions set aside for SED vendors in FY 1984. Re-bids occur when requisitions which are set aside and let out for bids are not ultimately awarded to SED vendors because there is no responsive SED bid within five percent of the estimate. These requisitions are then re-bid on the open market. Re-bids add considerable delay and expense to the procurement process.

Our figures for FY 1984 in Table 1 do not correspond to the numbers in DOA's FY 1984 annual report on SED procurement. The department's report indicates that total procurement for the year was \$148.1 million and that small business awards were \$45.0 million, or 30.4 percent of the total. According to the report, SED awards under the set-aside program were \$8.6 million, or 5.8 percent of total procurement; and preference awards were \$3.3 million, or 2.2 percent of total purchases.

These discrepancies stem from the fact that the procurement total cited by DOA does not include \$26.6 million in construction contracts over \$200,000. According to the law, a 10-percent subcontracting goal applies to such contracts. Our view, but apparently not the department's, is that these contracts must be included in the base for computing the six-percent SED target. Minnesota law states that SED subcontracts awarded on contracts over \$200,000 in order to meet the ten-percent goal may not be included in determining the overall six-percent target for SED procurement.³ Therefore, for contracts over \$200,000, the 10-percent subcontracting goal is in addition to, not a substitute for the six-percent overall SED target.⁴ The impact of omitting these amounts from the tabulations is that DOA's report understates total procurement; overstates small business, set-aside, and preference awards as a percent of total

³Minn. Stat. §16B.19, Subd. 6.

⁴We also note that DOA included one SED construction contract over \$200,000 in reporting awards made under the six-percent target. Under the law in effect in FY 1984, this award also carried a 10-percent SED subcontracting goal.

procurement; and excludes subcontracting awards from summary SED procurement data.⁵

Table 2 on page 11 summarizes aggregate SED procurement in FY 1984 under the set-aside, preference, and subcontracting provisions of the Small Business Procurement Act. The table shows that total SED procurement was \$15.0 million, or 8.6 percent of the \$174.7 million total for central procurement. It also indicates that the department exceeded the 1.5-percent ceiling in the one preference option which it implemented in FY 1984. According to the table, awards under the preference program were \$3.3 million, or 1.9 percent of total procurement. Unlike the six-percent set-aside procurement goal for FY 1984, the 1.5-percent preference standard is set as a maximum permissible limit. In addition, SED vendors received \$3.1 million, or 11.7 percent percent of all construction contracts over \$200,000, thus exceeding the ten-percent subcontracting goal in effect for the first time in FY 1984.

To summarize, as a result of the new set-aside, preference, and subcontracting requirements, total SED procurement went from \$5.9 million in FY 1983 as shown in Table 1, to \$15.0 million in FY 1984, shown in Table 2. In addition, we note that SED preference and subcontracting awards met and exceeded their targets in FY 1984. Considering this, and the fact that overall SED vendor participation grew substantially while aggregate SED procurement almost tripled, we believe that DOA made good progress in FY 1984, despite its failure to meet the six-percent goal for the set-aside program.

C. BROADENING PARTICIPATION IN THE SET-ASIDE PROGRAM

Our 1982 study indicated that a relatively small number of individual vendors were dominating the set-aside program. We also found that set-aside awards were concentrated in a few procurement categories, such as printing. Therefore in our follow-up study we looked at trends in the number of certified SED vendors and at the concentration of awards in terms of individual vendors and broad procurement categories.

As Table 3 on page 11 shows, the increased dollar volume spent through the set-aside program which occurred in FY 1983 and FY 1984 accompanied large increases in the number of certified SED vendors. According to the table, there were 187 certified participants in FY 1982, 442 in FY 1983, and 604 in FY 1984. In fiscal years 1982 and 1983 the increases are primarily attribut-

⁵A footnote to DOA's annual report makes it clear how the numbers are calculated, so we are not suggesting that the department is attempting to mislead.

TABLE 2
TOTAL SED AWARDS
(Dollars in Millions)
1984

TOTAL PROCUREMENT	\$174.7
SED SET-ASIDE AWARDS ^a	8.6
Percent of Total Procurement	4.9%
SED PREFERENCE AWARDS ^b	3.3
Percent of Total Procurement	1.9%
SED CONSTRUCTION SUBCONTRACTS ^c	3.1
Percent of Contracts over \$200,000	11.7%
Percent of Total Procurement	1.8%
TOTAL SED AWARDS	15.0
Percent of Total Procurement	8.6%

Source: Department of Administration.

^aSix-percent target.

^bCeiling of 1.5 percent.

^cGoal of 10 percent on contracts over \$200,000; total reported was \$26.6 million.

TABLE 3
PARTICIPATION IN THE SET-ASIDE PROGRAM
FY 1982 - 1984

	<u>1982</u>	<u>1983</u>	<u>1984</u>
Number of Certified SEDs	187	442 ^a	604 ^b
Number Receiving Awards ^b	88	129	222

Source: Department of Administration.

^aIncludes 140 participants from federally-designated labor surplus area.

^bIncludes 147 participants from federally-designated labor surplus area; does not include preference or subcontracting figures.

able to the inclusion of vendors in federally-designated labor surplus areas and increased participation by women-owned businesses. The table also shows that since FY 1982, the number of certified vendors actually receiving awards has grown from 88 in FY 1982, to 222 in FY 1984, an increase of 134.

Information in Table 4 indicates that minority (70 percent) and women-owned businesses (29 percent) accounted for 99 percent of SED procurement in FY 1983. Businesses owned by disabled persons (0.3 percent) and residents of labor surplus areas (0.7 percent) made up the remainder. However in FY 1984, awards to businesses in labor surplus areas constituted close to 30 percent of the program; and minority and women-owned businesses accounted for approximately 50 and 21 percent respectively. Procurement from businesses owned by disabled persons increased slightly in FY 1984. Even though the share of set-aside business going to minority-owned firms declined between FY 1983 and FY 1984, the actual dollars spent went up slightly, as Table 4 shows.

TABLE 4
BREAKDOWN OF SET-ASIDE AWARDS BY SED CATEGORY
FY 1983-1984

	1983	1984*
Total Set-Aside Awards	\$5,863,595	\$8,634,862
Minorities	\$4,103,860	\$4,280,441
% of SED Total	70.0%	49.6%
Female	\$1,701,578	\$1,776,827
% of SED Total	29.0%	20.6%
Disabled	\$ 18,382	\$ 44,560
% of SED Total	0.3%	0.5%
Labor Surplus Area	\$ 39,775	\$2,533,034
% of SED Total	0.7%	29.3%

Source: Department of Administration.

*Does not include preference or subcontracting figures.

The question of the geographic distribution of set-aside awards is of interest since the 1983 Legislature directed DOA to make efforts to ensure a fair geographic distribution of procurement

through the set-aside program. However, the department did not monitor or report on the geographical distribution of awards for FY 1984 although it is required to do so under amendments to the Small Business Procurement Act passed in 1983.

Perhaps the most critical point of our 1982 study was that a high percentage of procurement through the set-aside program consisted of awards to a relatively few individual vendors. Table 5 on page 14 examines what has happened between FY 1981 and FY 1984 regarding the extent to which set-aside business as a whole is concentrated among individual vendors. Table 5 shows that 10 vendors received 57 percent of all SED purchasing in FY 1981 and that 55 percent, 59 percent, and 43 percent of all set-aside dollars went to the 10 most active vendors in fiscal years 1982, 1983, and 1984, respectively. Thus, FY 1984 was the first year in which DOA made clear progress in reducing the concentration of set-aside spending among a few individual SED vendors. It should be noted, however, that awards exceeding \$1 million were made to single vendors in FY 1983 and FY 1984.

Table 6 on page 15 also shows a continuing high concentration of awards among a few vendors in the commodities category of procurement. Despite a significant increase in the total number of vendors receiving awards, 10 vendors received 61 percent of the total awarded for commodities in FY 1984. Six vendors received more than 50 percent of the total awarded. However, in FY 1982 concentration was greater. In that year, the six most active vendors did 62 percent of the commodities business and the top 10 did 79 percent, so there has been some improvement.

Tables 5 and 6 also indicate that a few vendors continued to dominate the program over time. Table 5 shows that four of the 10 most active vendors in 1982 maintained a position on the 10 most active list in FY 1983 and FY 1984. As Table 6 shows, four vendors also remained in the top 10 for commodities awards in fiscal years 1982, 1983, and 1984.

Table 7 on page 16 identifies the five most active vendors for service and commodities contracts for the period FY 1982 through FY 1984.⁶ In FY 1984 three vendors accounted for 54 percent of the business in this area of procurement. This is an improvement over FY 1982 and FY 1983 when three vendors did 58 percent and 79 percent of total set-aside business in this area.

In Tables 8 and 9 on page 17, we examine the concentration of awards among vendors in the preference program in FY 1984. Table 8 shows that 10 vendors received 63 percent of all spending under the preference program. Three of these vendors were also in the top 10 for the set-aside program in FY 1984. Table 9, which lists the top 10 preference vendors for commodi-

⁶Service and commodity contracts are used by the Procurement Division to purchase goods and services used in volume by many state agencies.

TABLE 5
THE TEN MOST ACTIVE SET-ASIDE VENDORS RANKED BY DOLLAR VOLUME OF AWARDS
Fiscal Years 1981-1984

Vendor	1981		1982		1983		1984	
	Amount Awarded	Cum. Percent	Amount Awarded	Cum. Percent	Amount Awarded	Cum. Percent	Amount Awarded*	Cum. Percent
1. Steele	\$ 275,726	9%	\$ 197,334	7%	\$ 1,275,000	22%	\$ 1,330,090	15%
2. Printing Productions	233,867	8	186,770	7	434,452	7	398,740	5
3. Tom Harris	217,779	7	180,735	7	293,553	5	336,978	4
4. TCH	202,131	7	176,463	7	247,121	4	329,062	4
5. Sand Graphics	178,770	6	141,578	5	243,474	4	228,326	3
6. Floor Covering Ctr.	139,034	5	137,251	5	217,533	4	224,036	3
7. Empire	138,349	5	131,300	5	205,036	3	223,467	3
8. H & W	124,375	4	116,930	4	193,226	3	221,272	3
9. Thomas	110,237	4	106,395	4	174,100	3	211,838	2
10. CSI	74,385	3	104,355	4	153,312	3	195,851	2
All Others	1,252,627	42.5	1,218,002	45	2,426,788	41	4,935,202	57
Total	\$2,947,280		\$2,697,113		\$5,863,595		\$8,634,862	

Sources: Department of Administration.

*does not include preference or subcontracting awards.

TABLE 6
THE TEN MOST ACTIVE SET-ASIDE COMMODITY VENDORS
FY 1982-1984

1982		1983		1984*	
Vendor/Awards	Percent of Total	Vendor/Awards	Percent of Total	Vendor/Awards	Percent of Total
1. Don's T.V. \$141,578	18%	Audio Visual Wholesalers \$214,755	13%	Thomas Pontiac \$1,330,090	28%
2. Audio Visual Wholesalers \$88,287	11	Wakefield Implement \$193,226	12	United Truck Body \$398,740	8
3. Brown's Office Machines \$84,316	11	Brown's Office Machines \$150,832	9	Collier Business Equipment \$221,272	5
4. Office Machines \$75,789	10	Don's T.V. \$128,174	8	Don's T.V. \$185,103	4
5. Scott \$55,691	7	Shirlike \$118,911	7	Audio Visual Wholesalers \$182,136	4
6. Everything for the Office \$49,928	6	Office Machines \$111,537	7	Office Machines \$137,487	3
7. Floor Covering Center \$37,961	5	Everything for the Office \$104,926	6	Brown's Office Machines \$123,767	3
8. J.B. Larson \$34,293	4	Aldon Distributing \$56,368	3	Shirlike \$119,966	3
9. Lake's Enterprises \$30,567	4	Sexton Data Products \$50,441	3	Mesabi Office Equipment \$98,999	2
10. Shirlike \$25,691	3	Scott \$46,734	3	Haugen Brown \$96,238	2
Thirty-Seven Others \$168,779	21	Eighty Others \$477,836	29	One Hundred Fifty-Eight Others \$1,851,204	39
Total \$792,880		\$1,653,740		\$4,745,002	

Source: Department of Administration.

*Does not include preference or subcontracting awards.

TABLE 7

THE FIVE MOST ACTIVE SET-ASIDE SERVICE AND COMMODITY CONTRACT VENDORS

FY 1982-1984

	1982		1983		1984*	
	Vendor/Awards	Percent of Total	Vendor/Awards	Percent of Total	Vendor/Awards	Percent of Total
1. Battle Electric						
\$197,334	25%	\$1,275,000	64%	25%	\$244,560	27%
2. Everything for the Office						
\$130,808	17	Aldon Distributing	7	42	Aldon Distributing	17
		\$148,668			\$156,493	
3. Aldon Distributing						
\$127,988	16	Everything for the Office	7	58	Office Machines	10
		\$142,195			\$85,980	54
4. Foster X. Weston						
\$116,240	15	Office Machines	5	73	Mel's Security Service	8
		\$105,996			\$72,232	62
5. Office Machines						
\$100,675	13	Faber-Spencer	3	86	Brown's Office Machines	8
		\$51,540			\$72,084	70
Ten Others						
\$109,880	14	Twelve Others	13	100	Fourteen Others	30
		\$262,105			\$264,472	100
Total						
\$782,925		\$1,985,504			\$895,821	

Source: Department of Administration.

*Does not include preference or subcontracting awards.

TABLE 8

THE TEN MOST ACTIVE PREFERENCE VENDORS
RANKED BY DOLLAR VOLUME OF AWARDS

FY 1984

Vendor	Awards	Percent of Total	Cumulative Percent
1. Arrowhead Paint	\$ 559,462	17%	17%
2. Thomas Pontiac	434,803	13	30
3. Arrow Sprinkler	198,200	6	36
4. Politano Construction	186,253	6	42
5. Shirlike	124,433	4	45
6. Mora Steel Fabricators	121,325	4	49
7. Audio Visual Wholesalers	121,176	4	53
8. Mavo Systems	114,782	3	56
9. Printing Productions	109,636	3	59
10. Margaret's Construction	109,442	3	63
All Others	<u>1,236,234</u>	37	100
TOTAL	\$3,315,746		

Source: The Department of Administration.

TABLE 9

THE TEN MOST ACTIVE PREFERENCE COMMODITY VENDORS

FY 1984

Vendor	Awards	Percent of Total	Cumulative Percent
1. Arrowhead Paint	\$ 559,462	37%	37%
2. Thomas Pontiac	434,803	29	66
3. Mora Steel Fabricators	121,325	8	74
4. Audio Visual Wholesalers	66,913	4	78
5. Everything For the Office	45,457	3	82
6. Don's T.V.	43,434	3	84
7. West Photo Shop	33,034	2	87
8. Compuata Corp.	20,570	1	88
9. Wilson Electric	13,000	1	89
10. Merit Electronics	8,720	1	89
Seventy-One Others	<u>159,824</u>	11	100
TOTAL	\$1,506,542		

Source: The Department of Administration.

ties, indicates that 10 out of 81 vendors received 89 percent of all commodities spending for the preference program. Three of these vendors were also in the top 10 for commodities in the set-aside program in FY 1984.

As was the case for the set-aside program, a small number of vendors received a large share of state spending under the preference program in 1984. We also note that several vendors were very active in both programs.

The Small Business Procurement Act contains two provisions designed to prevent concentration of awards to individual vendors. The first says that certification of SED businesses will be for a maximum of five years from the date of receipt of the first set-aside award and that after the expiration of the certification period, a business may not again be certified for a five-year period. Although this provision was passed in 1983, the department has not implemented it.

The second provision, also passed in 1983, disqualifies an SED vendor from further awards during the fiscal year once it has been awarded five percent of the total value of anticipated set-aside procurement for the year. Five percent of total FY 1984 SED procurement equals \$431,743.⁷ Table 5 on page 14 shows that one vendor exceeded this limit with awards totaling \$1.3 million.

Another 1983 amendment to the Small Business Procurement Act addresses the problem of set-aside awards being concentrated within commodity classes, a problem which we also identified in our original study. This amendment prohibits the department from designating more than 20 percent of any commodity class for set-aside to SED vendors.

According to DOA, the director of the Procurement Division monitors this type of concentration with the buyers for each of 400 commodity classes on a monthly and quarterly basis. Although we did not examine data on individual categories, we understand both from minority vendors and DOA staff that this sort of concentration can be a problem. The department says that problems occur because vendors are not equally available across procurement categories. The annual report provides summary information based on a few broad categories.

Table 10 on page 19 examines the distribution of actual SED awards for FY 1982 through FY 1984 across four categories: commodities, printing, service and commodity contracts, and con-

⁷The 1984 Legislature re-defined this as three-tenths of one percent of total anticipated procurement.

TABLE 10

SET-ASIDE AWARDS AS A PERCENT OF TOTAL PROCUREMENT
BY CATEGORY

FY 1982-1984

	<u>Commodities</u>	<u>Printing</u>	<u>Service and Commodity Contracts</u>	<u>Construction</u>	<u>Total</u>
<u>FY 1982</u>					
TOTAL PROCUREMENT	\$48,810,274	\$4,325,728	\$51,817,737	\$24,716,130	\$129,669,869
SET-ASIDE AWARDS	\$ 792,880	\$ 692,300	\$ 782,925	\$ 429,009	\$ 2,697,113
Percent of Category	1.6%	16.0%	1.5%	1.7%	2.1%
Percent of Total Set- Aside Procurement	29.4%	25.7%	29.0%	15.9%	100.0%
<u>FY 1983</u>					
TOTAL PROCUREMENT	\$55,049,182	\$4,001,171	\$48,000,000	\$16,661,319	\$123,711,672
SET-ASIDE AWARDS	\$ 1,653,740	\$ 868,257	\$ 1,985,504	\$ 1,356,094	\$ 5,863,595
Percent of Category	3.0%	21.7%	4.1%	8.1%	4.7%
Percent of Total Set- Aside Procurement	28.2%	14.8%	33.9%	23.1%	100.0%
<u>FY 1984</u>					
TOTAL PROCUREMENT	\$70,181,840	\$4,581,467	\$62,000,000	\$37,953,764	\$174,717,071
SET-ASIDE AWARDS*	\$ 4,745,002	\$ 564,069	\$ 895,821	\$ 2,429,970	\$ 8,634,862
Percent of Category	6.8%	12.3%	1.4%	6.4%	4.9%
Percent of Total Set- Aside Procurement	55.0%	6.5%	10.4%	28.1%	100.0%

Source: Department of Administration.

*Does not include preference or subcontracting awards.

struction.⁸ It also shows the share of total procurement spent through the set-aside program in each category. The table indicates that in FY 1983, SED printing awards represented 21.7 percent of total printing procurement. However in FY 1984, the year in which the 20-percent limit went into effect, SED procurement did not exceed 20 percent of the category for any of these four groups.

Our general conclusion is that the department is making progress in broadening the distribution of SED awards, although a relatively small number of vendors continues to dominate the program. This is not likely to be rectified until DOA:

- begins monitoring and reporting on the vendor and commodity class concentration provisions specified in the law,
- promulgates rules limiting vendor certification to five years, and
- is allowed greater administrative flexibility in assigning SED purchases to either the set-aside program, or the preference program.

D. COMPLIANCE WITH THE FIVE-PERCENT REQUIREMENT

Our 1982 study showed that 27 percent of FY 1980 set-aside awards were more than five percent above the estimate. According to department officials, most awards now fall within the limit, although they sometimes make exceptions if the administrative cost of re-bidding a set-aside requisition on the open market would be greater than the amount by which the bid exceeds 105 percent of the estimate.

In order to evaluate the degree to which the department now complies with the five-percent law in making SED awards, we examined a representative sample of 102 set-aside requisitions for FY 1984. We found that:

- Ninety-five percent of the awards were within the limit and five percent exceeded it. The five awards which exceeded the limit ranged from six percent to 25 percent over the estimate.

We also examined a representative sample of 90 awards to SED vendors under the preference program. According to the Small

⁸The 20-percent provision specifies that DOA may not designate more than 20 percent of a commodity class for the set-aside program. We examined actual procurement, rather than designated procurement because of data availability problems.

Business Procurement Act, SED vendors are also allowed a five-percent advantage in competing against open-market bidders under the preference program. We found:

- two requisitions, or about two percent of all cases, in which awards to SED vendors exceeded 105 percent of the low open-market bid. The awards were nine and 14 percent over the low open-market bid.

Even though DOA's practice of accepting these bids makes some sense since re-bidding requisitions costs money and time, it is a clear violation of statutory provisions requiring SED awards to be within five percent of the estimate in the set-aside program and within five percent of the low open-market bid in the preference program.

However, it is also true that accurate estimates of fair market value are hard to obtain. Our sample of set-aside awards also showed that the average award was 89 percent of the estimate and that three-quarters of all awards were less than the estimate. In 1981 we found that price estimates made by buyers were highly inaccurate. Our follow-up work supports this finding. The department agrees with this finding and points out that prices for certain light commodities may vary as much as 40 percent throughout the year depending on inflation, time of year, demand, supplier inventories, and a number of other market factors. Under these conditions, fair market value is virtually impossible to establish in the absence of competitive bidding.

Our original study indicated that 30 percent of the SED awards made in FY 1980 were on the basis of one bid. In the 1984 sample, 27 percent had only one bid and there were two or more bid responses in 73 percent of the cases.

We continue to believe that the state is best served in the set-aside program when competitive bidding establishes a fair market price and an SED vendor submits a responsive bid. However, many cases still occur in which there is no SED bid within five percent of the estimate. In these cases, the requisition is re-bid on the open market, which results in time delays and increased administrative costs. Table 11 on page 22 shows that 27.5 percent and 25.7 percent of all requisitions set aside for SED vendors in FY 1983 and FY 1984 had to be re-bid on the open market for this reason. According to Table 1 on page 8, the total value of these re-bids was \$3.3 million over the two-year period.

Since our original study, the SED set-aside program has grown in terms of dollar volume, certified vendors, and active participants. However, we find that:

- a relatively small number of vendors continues to dominate the program,
- a few awards are still being made which exceed five percent of the estimate,

TABLE 11
NUMBER OF SED REQUISITIONS SET ASIDE COMPARED TO ACTUAL AWARDS
FY 1983 and 1984

	<u>1983</u>	<u>1984*</u>
TOTAL REQUISITIONS	23,591	28,493
SED REQUISITIONS SET ASIDE	2,703	4,416
Percent of Total	11.5%	15.5%
SET-ASIDE REQUISITIONS AWARDED	1,961	3,283
Percent of Total	8.3%	11.5%
Percent of Set-Aside	72.5%	74.3%
SET-ASIDE REQUISITIONS RE-BID	742	1,133
Percent of Total	3.1%	4.0%
Percent of Set-Aside	27.5%	25.7%

Source: Department of Administration.

^aDoes not include preference or subcontracting awards.

- the estimation process continues to be highly inaccurate,
- a high percentage of requisitions set aside for SED vendors must be re-bid, and
- the program continues to be difficult to manage because of complex administrative problems.

Within a few months we understand that DOA's procurement process will be automated. Although this will allow the department to monitor the program more effectively, we do not believe it will solve the basic problems with estimation and competition that we identify in this and our earlier study.

E. THE PREFERENCE PROGRAM

In our 1982 report, we criticized DOA because it:

- used estimates that were obviously inaccurate; and

- contrary to a statutory requirement, made many awards that exceeded 105 percent of the estimated price.

We also found, not surprisingly, that the more vendors bid on a purchase order, the lower the market price is in relationship to the estimated price.

We concluded that it was difficult, if not impossible, to estimate market prices in the absence of competitive bidding. Moreover, competition within the set-aside program was further limited because of the scarcity of SED vendors in many areas of procurement. This created administrative problems for which we did not see an obvious solution.

Therefore, we concluded that a preference program which placed SED vendors in competition with non-SED small business vendors, but gave them an extra five-percent advantage in the evaluation of bids was an option meriting careful consideration by the Legislature.

In 1983 the Legislature established a limited preference program on an experimental basis. As part of this follow-up study, we reviewed DOA's experience with the preference program. We examined summary statistics on the preference program, reviewed data on a representative sample of awards made through the program, and talked to department staff and advisory council members about the program. We found that:

- The preference program has been implemented on an experimental basis in a way that is responsive to legislative direction.
- Experience with the program shows that it can work, and we believe the evidence supports increased use of the program to achieve the aims of the set-aside program.

We therefore endorse DOA's proposal for additional flexibility in using the preference approach to meet overall set-aside goals.

In FY 1984 DOA made purchases totalling \$174.7 million; \$3.3 million, or 1.9 percent of central procurement was awarded through the preference program.

As we noted earlier, a 1983 amendment of the Small Business Procurement Act permitted DOA to adopt rules establishing a preference program whereby SED businesses are allowed a five-percent advantage in the bid amount on selected state procurements. The amendment stipulated a maximum of 1.5 percent of total procurement for this program and designated an additional 1.5 percent of total procurement as eligible for a second type of preference program in which SED vendors would be permitted to match low bids by non-SED vendors. This second approach was never implemented because, according to DOA, it would engender extreme opposition among non-SED vendors. A 1984 amendment

required that three percent of total procurement be designated for award under the preference program without reference to a particular approach.

DOA has not adopted rules establishing the preference program, as required by statute. It also technically exceeded the 1.5-percent limit placed on the preference program for 1984.⁹ But of greater importance, in our view, than a close consideration of these questions of technical compliance is the question of whether the preference experiment has been a success, and whether the preference approach deserves to be used along with other approaches to achieve the goals of the Small Business Procurement Act. In a word, our conclusion is yes, it should.

During 1984 DOA carried out the preference experiment in two ways. First, in December 1983, every purchase order was considered eligible for the preference program. This meant that in purchasing areas where certified SED vendors were operating, bid requests went out to each of the SED vendors and to several non-SED vendors. Second, for the remainder of the year selective purchases were assigned to the preference program at the discretion of individual buyers.

Tables 12 and 13 on pages 25 and 26 summarize preference program results for the year. As Table 12 shows, 569 preference program awards were made in FY 1984 with a total value of \$3.3 million. This represents 1.9 percent of total procurement and, in our view, constitutes a successful implementation of legislative direction given in 1983 and 1984. As Table 13 shows, the distribution of awards among SED groups in the preference program was similar to the distribution in the set-aside program in FY 1984.

Although the department's limited experience with the preference program does not answer every concern about the program's long-term impact on businesses owned by socially or economically disadvantaged groups in Minnesota, the evidence we have been able to review suggests that:

- The preference program is an effective tool by which the state can do business with SED vendors;

Tables 14 and 15 on pages 26 and 27, provide data on the December experiment in which all purchases for the month were assigned to the preference program. As Table 14 shows, during December 1983, DOA total procurement was \$7.7 million. Awards

⁹DOA exceeded its statutory authority in awarding 1.9 percent of procurement through the preference program. This exceeds the limit of 1.5 percent set in Minn. Laws (1983) Ch. 301 §79 that governed administration of the program in FY 1984. Minn. Laws (1984) Ch. 654, Art. 2, §48, Subd. 4a, now requires that three percent of procurement be designated for the preference program.

TABLE 12

THE PREFERENCE PROGRAM:
NUMBER OF REQUISITIONS AND VALUE OF AWARDS*

FY 1984

	<u>Commodity and Printing</u>	<u>Service & Commodity Contracts</u>	<u>Construction</u>	<u>Total</u>
TOTAL PROCUREMENT:				
Number	27,769	425	299	28,493
Value	\$74,763,307	\$62,000,000	\$37,953,764	\$174,717,071
SED PREFERENCE AWARDS:				
Number	535	9	25	569
Value	\$ 1,670,540	\$ 331,717	\$ 1,313,490	\$ 3,315,747
PERCENT OF TOTAL PROCUREMENT	1.0%	0.2%	0.8%	1.9%

Source: The Department of Administration.

*Numbers do not correspond to DOA's FY 1984 set-aside report; see pages 9 and 10 for an explanation of the discrepancies.

TABLE 13
 PERCENTAGE DISTRIBUTION OF PREFERENCE AWARDS
 BY SED CATEGORY

	<u>Commodity and Printing</u>	<u>Service and Commodity Contracts</u>	<u>Construction</u>	<u>Total</u>
Minority	39.3%	72.2%	49.6%	46.7%
Female	21.8%	20.0%	23.0%	22.1%
Disabled	0.2%	-	-	0.1%
Labor Surplus	38.7%	7.8%	27.4%	31.1%
Total	100.0%	100.0%	100.0%	100.0%

Source: The Department of Administration.

TABLE 14
 THE DECEMBER PREFERENCE EXPERIMENT
 FY 1984

	<u>Value</u>	<u>Number of Awards</u>
Total Procurement	\$7,695,208	1,396
SED Preference Awards	\$1,651,070	239
Percent of Total	21.5%	17.1%

Source: The Department of Administration.

TABLE 15
COMPETITIVENESS OF SED VENDORS IN THE PREFERENCE PROGRAM

	<u>December</u>	<u>Sample*</u>
SED vendor low bid	188	66
Non-SED vendor low bid	<u>51</u>	<u>24</u>
Total	239	90

Source: The Department of Administration.

*The sample is representative of preference awards made in FY 1984, excluding December.

to SED vendors through the preference program equalled \$1.7 million or 21.5 percent of total procurement for the month.¹⁰

Table 15 shows that when SED vendors competed against other vendors in the preference program, they frequently won the bid outright because they submitted what turned out to be the low bid. Table 15 shows that this happened in 188 out of 239 requisitions, or 78.7 percent of the cases in the December experiment. In the remaining preference awards, SED vendors submitted bids within five percent of the low non-SED bid.

We also drew a sample of 90 requisitions from the remaining 11 months of FY 1984 and data from the sample confirms the general finding from the December experiment: in 73.3 percent of the cases, SED vendors submitted the low bid in absolute terms.

Thus, one important finding from our review of the preference program is that:

- SED vendors are often able to compete on an equal footing when placed in competition with non-SED vendors.

¹⁰Caution should be exercised in interpreting these numbers. There is some imprecision in DOA's definition of December procurement and thus, some December purchases were not included in the experiment. These qualifications do not detract from our basic finding that the preference program is an effective tool in meeting the objectives of the set-aside program.

Table 14 also shows that 78.5 percent of all contracts in December 1983 went to non-SED vendors because there was no responsive SED vendor. In the set-aside program, contracts which are set aside but not awarded to SED vendors are re-bid on the open market, thus incurring costly delays. In FY 1984, 25.7 percent of regular set-aside requisitions had to be re-bid. But an advantage of the preference program is that when no responsive bid is received from an SED vendor, the department makes the award to the low non-SED bidder. Thus, the agency making the purchase does not incur a delay and DOA does not incur the delay and expense of putting out a re-bid on the same purchase order.

In conclusion, we believe that the preference program shows real promise as a means for DOA to achieve the objectives of the set-aside program without introducing costly delays into the system, or otherwise compromising good business practice. Specifically, the preference program solves a major problem of the set-aside program that we observed both in 1982 and 1985:

- the difficulty, if not the impossibility of establishing an accurate estimated price for goods and services in the absence of competitive bidding.

F. VERIFICATION OF VENDOR ELIGIBILITY

In our 1982 study, we criticized the fact that eligibility for DOA's set-aside program was decided on the basis of self-certification without adequate verification of the information provided by applicants.

The procedure used today is not materially different. The department now requires a variety of documentary evidence to support the information provided by firms in their applications. This includes financial statements, employer's quarterly tax reports, resumes, and other documents which establish proof-of-ownership. In addition, the small business coordinator interviews applicants in the Twin Cities area and makes site visits on a selective basis. DOA does not conduct interviews or site visits for applicants outside the Twin Cities area, and in many cases, potential participants in labor surplus areas have received on-the-spot certification at informational seminars sponsored by the department.

When we examined participant files, we found that they contain outdated information in many instances. DOA points out that the Procurement Division does not have adequate staff resources to regularly monitor the eligibility of program participants and that they investigate continuing eligibility questions only on an exceptional basis.

We were told that certified SED vendors will be required to provide updated eligibility information each year under a proposed revision of the set-aside rules. While we support the intent of the provision, we are skeptical about the department's capacity to implement it, given the resources currently devoted to the set-aside program.

We are also aware of current proposals to centralize vendor certification for all state agencies in a single location, such as the Department of Human Rights, the Department of Administration, or the Department of Energy and Economic Development. The theoretical benefit of centralization is that a comprehensive certification program which would be more thorough and more responsive to vendors could be established by pooling the resources of several state agencies that now run separate programs. We have not considered the merits of these proposals in enough detail to offer a recommendation, but we believe that DOA's certification procedure can and should be strengthened.

DOA has generally avoided the criticism leveled against some other state and local agencies that its program includes firms which are fronts for businesses otherwise ineligible for set-aside status. In our view, the effectiveness of set-aside programs rests primarily on the considerations we address in this report, rather than on the possibility that a few ineligible vendors are operating, although procedures must be in place to deter and detect such vendors.

All organizations administering set-aside programs with limited resources are faced with a dilemma over broadening vendor participation at the risk of increasing the chance that a new vendor will either not perform well, or will, in fact, turn out to be ineligible for the program. In the past, DOA worked with a relatively small pool of vendors which it knows fairly well. The result is that set-aside business is concentrated in a relatively few hands. We have criticized DOA for this practice, but one of its benefits is a lower risk of doing business with an ineligible vendor, or with one who cannot perform satisfactorily.

However, DOA staff told us that they now have inadequate resources for monitoring vendor eligibility, given recent increases in the number of certified and active vendors. This is an area where we believe the department has attempted to implement new statutory provisions in good faith, but without adequate consideration of necessary administrative resources and procedures.

G. ADMINISTRATIVE RULES

In our 1982 study we found that the administrative rules governing the set-aside program were unclear in a number of

areas. One specific point of concern was our finding that certain SED vendors were subcontracting most or all of the business they were awarded through the set-aside program to non-SED vendors. DOA argued that this was consistent with its rules. We offered a different interpretation of the rules, and argued that, at a minimum, the rules needed to be clarified.

Both the statutes and rules governing the set-aside program have been changed since 1982. But the rules are still out-of-date and do not implement parts of the program.

For example:

- The authority of DOA to operate a preference program requires rules to be promulgated. However, the department has implemented the program without promulgating rules.
- Legislation passed in 1984 calls on DOA to establish rules providing that SED vendor certification be for a maximum of five years from the date of the receipt of the first set-aside award, after which a vendor may not be certified for a five-year period. This provision has not been implemented by administrative rule, or otherwise.
- Rules are needed to define what "owned and operated" means, and to otherwise clarify eligibility requirements and the process for appealing decisions relating to certification.

DOA agrees that the administrative rules implementing the Small Business Procurement Act need to be revised and has prepared a draft of the rules for promulgation by July 1985. We believe that DOA's long-standing operation of the set-aside and preference programs without adequate rules is a serious administrative lapse.

H. PROMOTION OF THE SET-ASIDE PROGRAM

According to the Small Business Procurement Act, the Department of Administration and the Department of Energy and Economic Development are each responsible for promoting the set-aside program. DOA is primarily responsible for the set-aside program and DEED's role is limited to general promotion and publicity incidental to its other small business development responsibilities. Our view is that an effective program requires aggressive outreach efforts to attract new participants to the program, as well as systematic procedures for informing already-certified SED vendors about specific procurement opportunities.

In 1982, we found that DOA was not active enough and that DEED was expending minimal effort to publicize the program and attract new participants. Both agencies acknowledged this criticism. We find little improvement by 1984, despite growth in other areas of the set-aside program. At present, cooperation between the agencies appears to be virtually non-existent and, as in the past, neither department dedicates specific staff or budget for promoting the program, or for publicizing set-aside procurement opportunities.

According to Minnesota law, the Commissioner of DEED must report annually to the Governor and the Legislature on: efforts to publicize the provisions of the set-aside program; efforts taken to identify small businesses, including those owned by SED groups, and to encourage participation in the set-aside program; efforts taken to remedy the inability of small businesses to perform on potential set-aside awards; and recommendations for strengthening the set-aside program and delivery of services to small businesses.¹¹

At the time of our follow-up study, DEED had not published a report for 1984. However, we learned that at present, the Small Business Assistance Office within DEED publishes and distributes information about state procurement in general and the set-aside program in particular through a variety of documents, workshops, and seminars in much the same way it did in 1981. It also assists small businesses, including SED firms which request assistance in completing certification forms. The office provides technical assistance to SED businesses although it does not specifically target set-aside vendors.

Within DOA, we examined activities to promote the set-aside program and to publicize individual procurement opportunities. At present, as in the past, the small business coordinator is responsible for certifying vendors and for promoting the set-aside program in general. In addition to monitoring set-aside procurement within DOA, the coordinator also interviews business owners, conducts site visits, organizes seminars and workshops, works with the advisory council, and implements the state bonding program. Although some outreach does occur, most of this effort is concentrated in the metropolitan area.

When we studied the program in 1981, the small business coordinator also determined which DOA purchases should be assigned to the program. These decisions were based on statutory set-aside goals, the coordinator's general knowledge of purchasing, and his identification of set-aside vendors in particular procurement categories. At that time, we felt that the state and the set-aside program would be better served if the buyers in each procurement area were held accountable for using their profes-

¹¹Minn. Stat. §16B.21, Subd. 2.

sional procurement expertise to decide which requisitions should be set aside for SED vendors.

The department, consistent with this recommendation, made the buyers rather than the small business coordinator responsible for assigning purchases to the set-aside program. Judging from our sample of FY 1984 set-aside awards, delegating these decisions may well have had a positive impact on promoting individual purchases among already-certified SED vendors.

In general, the department uses the same procedures for informing known SED vendors about procurement opportunities that were in effect in 1982. For purchases under \$5,000, the buyers send bid invitations to selected certified vendors; purchases over \$5,000 are posted in the Procurement Division reception area and are published in *Finance and Commerce Daily*. We believe that these procedures favor metropolitan-area vendors and firms already known to the buyers.

Our conclusion, on the basis of follow-up interviews, is that DOA and DEED are continuing to take a passive approach in promoting the set-aside program and in publicizing specific procurement opportunities. We do not believe that this satisfies the intent of the Small Business Procurement Act. Therefore, we repeat our 1982 recommendation that both departments devote more staff and budget to:

- regularly publicizing the set-aside program in SED-oriented publications, and
- more aggressively targeting outreach to particular segments of the SED community, including labor surplus areas.

Although these are not new avenues for informing groups about the set-aside program, we continue to think that identifying new procurement sources among minority and women-owned businesses and other SED vendors is an important part of the program.

I. THE SMALL BUSINESS PROCUREMENT ADVISORY COUNCIL

The 1983 Legislature established a 13-member small business procurement advisory council appointed by the Governor.¹² The council was charged with the following mission:

- to advise the Commissioner of Administration on matters relating to the small business procurement program,

¹²Minn. Stat. §16B.20.

- to review complaints or grievances from vendors, and
- to review required reports from DOA and DEED to ensure compliance with the goals of the program.

The establishment of an advisory council made a lot of sense, given the problems in the program that we identified in 1982. We believe that the council can provide a needed communication channel between DOA, the vendor community, and others with a stake in the small business procurement program.

In order to assess the effectiveness of the advisory council, we reviewed the minutes of its past meetings, attended two recent meetings, and interviewed several council members and DOA officials. We found that:

- In the two years since its creation, the advisory council has not developed or carried out a constructive work program and has only recently applied itself to its mandated tasks.
- The advisory council and the department have had difficulty establishing a productive working relationship.
- Five out of 11 currently seated advisory council members are certified SED vendors and two members are active participants in the set-aside program. In our view, this creates a potential conflict of interest.

A review of advisory council minutes since its establishment in the fall of 1983 reveals a pattern of spotty attendance, high turnover, and lack of direction. According to council minutes and interviews with council members and DOA staff, an atmosphere of skepticism, if not actual mistrust between the two groups has prevailed for most of this time.

While differences of perspective between the advisory council and the department are to be expected on a variety of issues, we feel that a patently adversary relationship does not fulfill the purpose of the statute which established the council as an advisory group without independent authority.

For instance, the advisory council as a whole has resisted DOA's efforts to reform the program by moving toward increased use of the preference approach rather than set-asides, and individual council members have opposed the implementation of a statutory provision enacted in 1983 that would limit the participation of individual vendors in the set-aside program to a five-year period, after which they would be ineligible for recertification for another five years.

Both the preference program and the five-year limit on participation make a lot of sense, given the objectives of the Small

Business Procurement Act, and our findings in 1982 and in this report. We feel these provisions are in the interest of the SED vendor community as a whole, although they may not be in the interest of the vendors who are prospering under the present system.

Thus, we feel that on the questions of the preference proposal and the five-year limit, the strong vendor representation on the advisory council may represent a conflict of interest between the general goals of the set-aside program and the particular interest of individual vendors.

Another possible conflict of interest relates to the advisory council's role in hearing appeals or grievances of vendors denied contracts or certification. Although we do not know of cases where this has happened, vendors on the advisory council could be called upon to judge the credentials or qualifications of competitors.

We think it is unrealistic to exclude certified set-aside vendors from the advisory council since it should represent the concerns of current and potential participants in the program. However, we recommend that:

- program participants not be allowed to make up a majority of the advisory council, in order to ensure that the general interests of the SED vendor community are properly represented; and
- individual members, as a matter of policy, be required to disqualify themselves from participating in decisions relating to grievances or appeals by vendors in the same, or a closely-related line of business.

As we noted earlier, the advisory council has experienced difficulty in setting and accomplishing a work program. In response, some have suggested that the council should be appointed by the Commissioner of Administration rather than the Governor. We do not think that this is the source of the problem. The advisory council has not organized itself effectively either to work for or against DOA's proposals. Nor has it worked effectively in areas of mutual interest. It is true that individual advisory council members have lobbied legislators for proposals that differ from the department's. However, we believe that, as the advisory council becomes better organized, and its positions are established, these efforts will be unacceptable. They will also be more easily recognizable as motivated by individual interests rather than the general interest of the vendor community.

J. APPROPRIATENESS OF SET-ASIDE GOALS

In our previous study, we found that DOA had not analyzed the the availability of SED vendors throughout the state. Therefore, we prepared our own estimates based on information in the *1977 Survey of Minority-Owned Business Enterprises* published by the U.S. Bureau of the Census. For 1982 we estimated that minority firms made up about one percent of all Minnesota businesses and that women-owned businesses constituted about seven percent. Although we did not analyze the distribution of these businesses by geographical area or by type, we thought it was reasonable to conclude that a much smaller subset of the total would be in businesses supplying the kinds of goods and services bought by the state and, therefore be likely to participate in the program. We learned recently that the census information has not been updated, and that the department has not done any subsequent research in this area.

Nevertheless, we continue to believe that analysis of this type is a critical element in setting effective and realistic goals for the program. It is particularly important in light of recent substantial increases in SED procurement goals; the inclusion of new SED groups, such as the labor surplus areas in the program; and concerns that more should be done to promote the program. Therefore, we recommend that:

- the department and the Legislature acquire greater understanding of the pool of SED businesses before making further adjustments to the goals of the small business procurement program.

In any case, the goals now set in law do not place an upper limit on small business, or set-aside procurement.

K. ADMINISTRATION OF THE SET-ASIDE PROGRAM

In 1982 we did not write much about the administration of the set-aside program, but we discussed the problems, as we saw them, with the department and with others concerned about the program. We thought that the program needed additional support within the department, and concluded that the best way of adding needed resources was to introduce a microcomputer for record keeping and statistical reports, and to have Procurement Division buyers help achieve procurement targets in various specialized areas of purchasing.

Since 1982 the program has been improved and additional staff resources have been made available by giving Procurement Division buyers, rather than the small business coordinator, more

responsibility for set-aside decisions. The small business coordinator now focuses his attention on outreach, recruitment, and eligibility determinations. Today, however, we still find administrative problems:

- The clerical processes of the set-aside and preference programs are not being handled in a completely accurate and timely fashion due to poor data processing support and/or insufficient clerical staff support.
- The reports required by the Legislature have recently been submitted late and with important inaccuracies.
- Required updates of financial data from vendors are not obtained and put on file.

In part, the growth and success of the set-aside program is the cause of some of the problems we observed in the follow-up, although we observed similar problems in 1982. The department does not maintain a separate budget for the set-aside program. We recommend that:

- The Department of Administration analyze the staff and budget requirements for correcting these problems, compare these needs to existing resources within the Procurement Division, and make a well-considered request to the Legislature or Legislative Advisory Commission if additional resources are needed.

Since we have observed similar administrative problems in the set-aside program over a period of years, we believe it is no longer reasonable for the department to simply complain about inadequate resources without taking stronger action to remedy the situation.

In our view, substantial progress could be made--even within the limits of existing resources--if DOA used a microcomputer to keep records and generate the periodic reports that are required.

STUDIES OF THE PROGRAM EVALUATION DIVISION

Final reports and staff papers from the following studies can be obtained from the Program Evaluation Division, 122 Veterans Service Building, Saint Paul, Minnesota 55155, 612/296-4708.

1977

1. Regulation and Control of Human Service Facilities
2. Minnesota Housing Finance Agency
3. Federal Aids Coordination

1978

4. Unemployment Compensation
5. State Board of Investment: Investment Performance
6. Department of Revenue: Assessment/Sales Ratio Studies
7. Department of Personnel

1979

8. State-sponsored Chemical Dependency Programs
9. Minnesota's Agricultural Commodities Promotion Councils
10. Liquor Control
11. Department of Public Service
12. Department of Economic Security, Preliminary Report
13. Nursing Home Rates
14. Department of Personnel, Follow-up Study

1980

15. Board of Electricity
16. Twin Cities Metropolitan Transit Commission
17. Information Services Bureau
18. Department of Economic Security
19. Statewide Bicycle Registration Program
20. State Arts Board: Individual Artists Grants Program

1981

21. Department of Human Rights
22. Hospital Regulation
23. Department of Public Welfare's Regulation of Residential Facilities for the Mentally Ill
24. State Designer Selection Board
25. Corporate Income Tax Processing

26. Computer Support for Tax Processing
27. State-sponsored Chemical Dependency Programs, Follow-up Study
28. Construction Cost Overrun at the Minnesota Correctional Facility - Oak Park Heights
29. Individual Income Tax Processing and Auditing
30. State Office Space Management and Leasing

1982

31. Procurement Set-Asides
32. State Timber Sales
33. *Department of Education Information System
34. State Purchasing
35. Fire Safety in Residential Facilities for Disabled Persons
36. State Mineral Leasing

1983

37. Direct Property Tax Relief Programs
38. *Post-Secondary Vocational Education at Minnesota's Area Vocational-Technical Institutes
39. *Community Residential Programs for Mentally Retarded Persons
40. State Land Acquisition and Disposal
41. The State Land Exchange Program
42. Department of Human Rights: Follow-up Study

1984

43. *Minnesota Braille and Sight-Saving School and Minnesota School for the Deaf
44. The Administration of Minnesota's Medical Assistance Program
45. *Special Education
46. *Sheltered Employment Programs
47. State Human Service Block Grants

1985

48. Energy Assistance and Weatherization
49. Highway Maintenance
50. Metropolitan Council
51. Economic Development Programs
52. Post Secondary Vocational Education: Follow-Up Study
53. County State Aid Highway System
54. Procurement Set-Asides: Follow-Up Study

*These reports are also available through the U.S. Department of Education ERIC Clearinghouse.