

February 24, 2005

TO: Allegra McCullough
Associate Deputy Administrator for Government
Contracting and Business Development

FROM: Harold Damelin
Inspector General

SUBJECT: New Management Challenge—*Large Businesses Receive Small Business Awards*, Report # 5-15

We are submitting a new management challenge on Small Business Contracting under the report title *Large Businesses Receive Small Business Awards*. This challenge provides a concise statement of the problems that have been identified in past Office of Inspector General (OIG), Government Accountability Office, and Office of Advocacy reports, as well as in expert testimony to Congress. One of the most important challenges facing the Small Business Administration (SBA) and the entire Federal Government today is that large businesses are receiving small business procurement awards and agencies are receiving credit for these awards.

In accordance with the Reports Consolidation Act of 2000, this challenge will be incorporated with other Agency challenges in our Report on the Most Serious Management Challenges Facing the Small Business Administration in Fiscal Year (FY) 2006, and Agency progress in addressing this challenge will be re-evaluated at that time. The complete FY 2006 report will be included in SBA's annual Performance and Accountability Report this fall. Meanwhile, following OIG practice, the Small Business Contracting challenge report will be available shortly on our Website <http://www.sba.gov/IG/>.

We appreciate the assistance you provided on this important issue.

Attachment

LARGE BUSINESSES RECEIVE SMALL BUSINESS AWARDS

February 24, 2005

Report Number 5-15

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Challenge: Flaws in the Federal procurement process allow large firms to receive small business awards and agencies to receive small business credit for contracts performed by large firms.

The Small Business Act establishes a Government-wide procurement goal that 23 percent of the total value of all prime contract awards for each fiscal year be awarded to small businesses. As the advocate for small business, the Small Business Administration (SBA) should strive to ensure that only small firms obtain small business awards and agencies only receive small business credit for awards to small firms. Too often, however, this is not the case.

Recent studies by the Government Accountability Office, SBA’s Office of Inspector General, and SBA’s Office of Advocacy have found that agencies are counting awards made to large firms towards their small business procurement goals. One recurring problem arises with size certifications on multi-year contracts. Firms receiving contracts certify whether they are small when they respond to a solicitation. For contracts through the General Services Administration’s (GSA) Multiple Awards Schedule (MAS) Program and other GSA multiple award contracts (MAC), these small business certifications are valid until contract renewal (i.e., up to 5 years), even if the firm outgrows its small business status. For all other contracts containing option years, including Government-Wide Acquisition Contracts (GWAC), the procuring office is not required to have the contractor re-certify it is small when exercising each option. Thus, the contractor retains its small business status for the life of the contract (e.g., 20 years) even if it outgrows its small business status. The SBA is attempting to rectify the situation—for example, SBA issued a proposed rule on April 25, 2003, requiring firms with MACs to annually re-certify their size. Yet, this rule has not been issued in final, and additional actions are needed.

Another problem with the MAS Program is that GSA classifies firms as small for the contract even though the firms may not be small for all of the contract’s goods or services. Thus, agencies may obtain small business credit for using a firm classified as small even if the firm is not small for all of the procured goods or services. This is contrary to SBA regulations, which require that a contractor meet the size standard for each product or service for which it submits an offer (13 CFR § 121.407).

Large companies also improperly receive small business contracts due to errors by contracting personnel and failures to enforce small business contracting procedures. For example, contracting personnel, possibly due to a lack of familiarity with small business procedures, have accepted questionable size self-certifications. Moreover, contracting personnel do not always require companies to self-certify their size when responding to a solicitation. Instead, to determine size status, they inappropriately rely on governmental databases with (possibly inaccurate) small business information. Non-compliance with small business contracting procedures permits large companies to obtain small business contracts.

| Actions Needed | Status |
|--|--------|
| Issue a final rule stating that a firm that receives a multi-year contract must annually certify that it continues to be a small business for the specified size standard(s), and that procuring agencies cannot continue to receive small business credit after the firm becomes large. | Yellow |
| Develop and take steps to provide reasonable assurance that GSA follows SBA regulations (13 CFR § 121.407) so that a firm must meet the size standard for each product or service for which it submits an offer. | Red |
| Develop and take steps to provide reasonable assurance that agencies are requiring offerors to self-certify their size for small business contracts and are providing adequate training to contracting personnel on small business contracting procedures. | Red |

Green-Implemented **Yellow**-Substantial progress being made **Red**-Not implemented/no substantial progress

Additional Information

Because this is a newly issued challenge, the following information is included to further illustrate the significance of the issues involved.

- The Small Business Act states that the Federal Government should “aid, counsel, assist, and protect ... the interests of small-business concerns ... to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government ... be placed with small business enterprises.”
- Agencies purchasing from a business classified as small or as being in a small business preference program receive credit towards their small business procurement goals. If contractors are improperly classified as small, then agencies receive credit for purchasing from a “small” company even if the company is not small for the product/service being provided.
- The Federal Government has reported that in FY 2003 \$65.5 billion in contracts was awarded to small businesses. This amount represents 23.6 percent of the total number of prime contract dollars awarded by the Federal Government. Given recent findings, however, these numbers are questionable.¹
- To become a small business contractor with GSA’s MAS Program, businesses must respond to solicitations and self-certify that they are small. However, MAS Program solicitations are not always clearly associated with a specific North American Industry Classification System (NAICS) code and corresponding small business size standard—some solicitations contain either numerous NAICS codes or no NAICS code at all. Further complicating the matter is that, according to a GSA official, when numerous NAICS codes are included in an offer, offerors are expected to self-certify their size to the NAICS code which accounts for the greatest percentage of contract value. This contradicts 13 CFR § 121.407, which states, “If a procurement calls for two or more specific end items or types of services with different size standards and the offeror may submit an offer on any or all end items or types of services [which is the case with some MAS Program solicitations], the offeror must meet the size standard for each end item or service item for which it submits an offer.” Thus, GSA is possibly allowing contractors to self-certify as small when they may not meet the size standards for every item or service for which they submit an offer.
- Although a size re-certification rule (i.e., re-certification at time of contract renewal) for the MAS Program and other GSA MACs has been enacted, it still allows significant time (generally 5 years) for a company to become large and yet be classified as small. Also, businesses that receive GWACs as small businesses remain classified as “small” for the life of the contract.
- The SBA expects to send the proposed rule it issued on April 25, 2003 to the Office of Management and Budget for review and clearance by February 28, 2005. They advise that the rule will propose (1) annual size re-certification for MAS Program contracts, MACs and GWACs, (2) a 5-year size re-certification period for small business set-aside contracts, (3) size re-certification following the merger or acquisition of a small business firm, and (4) correct NAICS codes on all orders (offerors must meet the size standard). While three of the four proposed actions (actions 1, 3 and 4) will improve reporting accuracy, the 5-year size re-certification period for small business set-aside contracts will only continue the possibility of small businesses growing large and procuring agencies still being able to count contract actions as small. Therefore, all multi-year contracts should be held to an annual size re-certification.

¹ See reports and testimonies under Appendix 1.

- The SBA has agreed that, for its own procurements, it will require MAS Program contractors classified as small businesses to certify their size for task orders exceeding \$500,000 to ensure that contractors meet applicable size standards.
- The SBA issued a Final Rule requiring businesses who request contract novation of an existing small business contract to self-certify at the time of contract novation that they continue to be a small business. This must be done in order for the procuring agency to continue to obtain credit towards its small business goals. Effective December 21, 2004, the procuring agency must base new purchases on the current size of the “merged” company.
- On January 1, 2004, a new database for small business sources emerged. Using the Central Contracting Registration’s (CCR) “Dynamic Small Business Search,” contracting officers can search for vendors that are certified in SBA’s 8(a) Business Development, HUBZone Empowerment Contracting, and Small Disadvantaged Business programs. The eligibility of these businesses is verified by SBA. However, other small businesses who self-certified their status, but without SBA verification, can also be found through the “Dynamic Small Business Search.”
- The following statement appears in CCR’s “Dynamic Small Business Search:” “This is generally a self-certifying database. The SBA does not make any representation as to the accuracy of any of the data included, other than certifications relating to 8(a) Business Development, HUBZone or Small Disadvantaged Business status. The SBA strongly recommends that contracting officers diligently review a bidder’s small business self-certification before awarding a contract.”
- The OIG has recommended in Report # 5-14 that SBA continue working with the Department of Defense and GSA to modify CCR so that (1) contractors cannot self-certify as small businesses or as being in small business preference programs, and (2) contracting officers are clearly advised that small businesses can only be found through the “Dynamic Small Business Search.”
- By April 2005, SBA expects that:
 - Firms will no longer be able to self-certify their small business status in CCR. Instead, SBA will populate the small business, 8(a) Business Development, HUBZone and Small Disadvantaged Business fields after each CCR profile is run against the SBA Size Logic and three program lists of certified firms.
 - An Emerging Small Business field (also populated by SBA) will be created.
 - CCR will stop accepting 1997 NAICS codes and will only accept 2002 NAICS codes.

Appendix 1: Relevant Reports and Testimonies

Most SBA OIG reports listed can be found at: www.sba.gov/ig/igreadingroom.html. GAO reports are located on the GAO Website at: <http://www.gao.gov/>. SBA Advocacy reports can be found at: <http://www.sba.gov/advo/>.

- SBA Advocacy, *Analysis of Type of Business Coding for the Top 1,000 Contractors Receiving Small Business Awards in FY 2002*, December 2004.
- The Center for Public Integrity, *The Big Business of Small Business: Top defense contracting companies reap the benefits meant for small businesses*, September 29, 2004.
- The Center for Public Integrity, *The Pentagon's \$200 Million Shingle: Defense data shows billions in mistakes and mislabeled contracts*, September 29, 2004.
- SBA OIG, *Audit of SBA's Administration of the Procurement Activities of Asset Sale Due Diligence Contracts and Task Orders*, Report # 4-16, March 17, 2004, pp. 8-9.
- GAO, *Contract Management: Reporting of Small Business Contract Awards Does Not Reflect Current Business Size*, Report # GAO-03-704T, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, *Are Big Businesses Being Awarded Contracts Intended for Small Businesses?* Testimony of Mr. Fred C. Armendariz, Associate Deputy Administrator, SBA, May 7, 2003.
- The Small Business Committee, U.S. House of Representatives Hearing, *Are Big Businesses Being Awarded Contracts Intended for Small Businesses?* Testimony of Mr. Felipe Mendoza, Associate Administrator, Office of Small Business Utilization, U.S. General Services Administration, May 7, 2003.
- SBA OIG, *SBA Small Business Procurement Awards Are Not Always Going to Small Businesses*, Report # 5-14, February 24, 2005.