Post-Hearing Questions for the Record
Submitted to
Joseph Jordan, Assistant Administrator, Office of Government Contracting and Business Development, U.S. Small Business Administration
From Senator McCaskill
"SMALL BUSINESS CONTRACTS: HOW OVERSIGHT FAILURES AND REGULATORY LOOPHOLES ALLOW LARGE BUSINESSES TO GET AND KEEP SMALL BUSINESS CONTRACTS"

Tuesday, July 26, 2011, 10:00 A.M.
United States Senate, Subcommittee on Contracting Oversight,
Committee on Homeland Security and Governmental Affairs

1. **QUESTION:** What amount of contract spending represented in the Small Business Procurement Scorecards for the 2009 and 2010 goaling reports is from contract awards to Alaska Native Corporations? Please provide this information in terms of dollars, number of contracts, and percentage of the total for each year, as well as by awarding agency.

   ANSWER: Below is the requested information for fiscal year 2009 and 2010. Please note that due to the manner in which data is captured in the Federal Procurement Data System, the data provided below is for <u>all</u> prime contracting dollars and includes contracts which are excluded from the annual small business goaling report. The data below is shown at the overall government-wide level. For data by awarding agency, please contact the respective agencies.

   FY 2009:

   - Alaskan Native Owned Corporation or Firm Actions: 14,012
   - Dollars awarded to Alaskan Native Owned Corporation or Firm: $3.8 billion
   - Dollars awarded as Percentage of Total Prime Contracting Dollars: 0.71%

   FY 2010:

   - Alaskan Native Owned Corporation or Firm Actions: 19,745
   - Dollars awarded to Alaskan Native Owned Corporation or Firm: $5.0 billion
   - Dollars awarded as Percentage of Total Prime Contracting Dollars: 0.94%

2. **QUESTION:** What does the Small Business Administration (SBA) exclude when counting small business contracts? What are the justifications for these exclusions? (Provide separate justifications for each exclusion.)

   ANSWER: The SBA excludes a select number of contracts from its annual small business procurement goaling report. The primary justification for these exclusions is that these

contracts are not subject to the Federal Acquisition Regulation, which includes regulations on when small business awards and set-asides must be done.

The current contracts excluded from the annual goaling report are the following:

- Javits-Wagner-O'Day Program (JWOD, Sheltered Workshops)
- Federal Prison Industries (commonly referred to as FPI, or by its trade name UNICOR)
- American Institute in Taiwan: Awards with the American Institute in Taiwan designated as the contractor for the award and determined by a DUNS number of '161174503'
- Contracts performed outside of the United States: Awards performed outside of the US are designated when the country in the place of performance is NOT the United States
- Acquisitions by agencies on behalf of foreign governments or entities or international organizations: As designated in FPDS-NG with a “Foreign Funding” value of ‘Foreign Funds FMS’ and ‘Foreign Funds non FMS’
- Contracts funded predominately with agency generated sources. Accordingly, the following Federal Government agencies are excluded:
    - FDIC, 5100
    - Postal Service, 1800
    - Bureau Of Engraving And Printing, 2041
    - United States Mint, 2044
    - Office Of The Comptroller Of The Currency, 2046
    - Office Of Thrift Supervision, 2047
    - Transportation Security Administration, 6965; 7013, (data are included when the signed date is equal to or greater than July 1, 2008)
    - Federal Aviation Administration, 6920
    - Tennessee Valley Authority, 6400
    - Administrative Office of the US Courts, 1027
    - Architect of the Capitol, 0100
    - Bankruptcy Courts, 1021
    - Central Intelligence Agency, 5600
    - Congressional Budget Office, 0800
    - Court Services and Offender Supervision Agency, 9594
    - Pretrial Services Agency, 959P
    - Federal Judicial Center, 1028
    - Overseas Private Investment Corporation, 7100
    - Supreme Court of US, 1001
    - US Courts of Appeals-Judicial Circuits, 1002
    - US District and Territorial Courts, 1012
    - Contracts awarded for the Defense Commissary Agency, (Awards with a Other Than Full and Open Competition value of "RES" for Resale).
    - Product Service codes for Leases in the format X***.
    - Product Service codes for Utilities S112 (Electric).
    - Tricare DODAAC - H94002. (based on Contracting Office Code)

    - Centers for Medicare & Medicaid Services (CMS) non-appropriated funded contracts - 00NAF. (based on Contracting Office Code)
- In addition, there are purchases that are not reported to FPDS and therefore are also not included in the goaling base:
    - Financial assistance actions e.g. grants, cooperative agreements, subsidies, and contributions except for those Agencies who have a special module to accumulate information on these types of actions.
    - Imprest fund transactions, SF 44 purchases, training authorizations.
    - Micro-purchases (contracts valued less than $3,000) including those obtained through the use of the government purchase card.
    - Interagency agreements with other federal agencies (e.g. Tennessee Valley Authority), independent federal establishments (e.g. Export/Import Bank of the US), or federally chartered sources (e.g. Howard University or the Smithsonian Institution).
    - Government Bills of Lading and Government Transportation Requests.
    - Actions using predominantly non-appropriated funds, except pursuant to funds held in trust accounts mentioned.
    - EDSTRIP and MILSTRIP requisitions.
    - Actions involving transfer of supplies within and among agencies and sub-agencies.
    - Orders from GSA Stock and GSA Consolidated Purchase Program.

3. **QUESTION:** Statement. There are NAICS codes for manufacturing, retail trade, wholesale trade, and services. However, in determining size standards, SBA requires contracting officials to use the NAICS codes for manufacturing, and not the NAICS codes for retail trade or wholesale trade, when buying a product from businesses that are not engaged in manufacturing, but are primarily engaged in retail trade or wholesale trade. NAICS codes for manufacturing have a higher size standard than codes for retail trade and wholesale trade. This allows many businesses to be counted as small that may not otherwise qualify as small.

   Please explain the basis for the decision by the SBA to use the North American Industrial Classification System (NAICS) as part of the foundation for establishing small business size standards?

   ANSWER: Section 3(a)(3) of the Small Business Act requires the Administrator to ensure that small business size standards vary by industry to reflect differing characteristics of various industries. Accordingly, SBA utilizes the North American Industry Classification System (NAICS) as the Federal government's comprehensive definition of industries in the U.S. economy instead of attempting to develop its own industry definitions. Prior to NAICS, SBA used Standard Industry Classification (SIC) System as a basis for its size standards.

   Furthermore, the best source of objective industry data available to establish, review and modify size standards is from the U.S. Bureau of the Census' Economic Census, which collects and publishes data by NAICS industry.

Because the NAICS is developed for statistical data collection, SBA and other Federal agencies using NAICS for non-statistical purposes may modify the NAICS to accommodate their program purposes. For example, for Federal procurement, SBA has established special size standards for several sub-industries within the 6-digit NAICS industries, such as environmental remediation services and engineering services for military and aerospace equipment and military weapons.

4. **QUESTION:** There are NAICS codes for manufacturing, retail trade, wholesale trade, and services. However, in determining size standards, SBA requires contracting officials to use the NAICS codes for manufacturing, and not the NAICS codes for retail trade or wholesale trade, when buying a product from businesses that are not engaged in manufacturing, but are primarily engaged in retail trade or wholesale trade. NAICS codes for manufacturing have a higher size standard than codes for retail trade and wholesale trade. This allows many businesses to be counted as small that may not otherwise qualify as small.

   Why does this requirement exist?

   ANSWER: Procurements are classified based on what is being acquired, not who is supplying the goods. The primary goal is for agencies to acquire supplies from small business manufacturers. A non-manufacturer can qualify as a small business if it supplies the product of a small business, so the manufacturing NAICS code and size standard is needed to make a determination as to whether the non-manufacturer is supplying the product of a small business. Most manufacturing industries have a 500-employee size standard, with some manufacturing industries having higher size standards of up to 1,500 employees. The manufacturing NAICS code is also used to conduct market research to determine if small manufacturers exist. If an agency can demonstrate that no small business manufacturers exist, the agency can provide that information to SBA and SBA can waive the requirement that an offeror supply the product of a small business. Finally, the size standard for a non-manufacturer is always 500 employees, so there is no need to assign wholesale or retail codes to a procurement. The size standards that correspond to the wholesale and retail trade NAICS codes are used for financial assistance purposes.

   The SBA established a 500-employee size standard for non-manufacturers for two reasons. First, SBA did not want to require multiple size standards for non-manufacturers (regardless of what specific wholesale or retail trade industries they are in) when Federal government procures manufactured products as small business set asides through distributors (i.e., non-manufacturers). A common size standard for non-manufacturers avoided that situation. Second, it is to recognize and accommodate a relatively common practice for manufacturers to bid on procurements of manufactured products that they do not produce with their own labor force, notwithstanding that they are capable of doing so. Such manufacturers must qualify as small businesses under the non-manufacturer size standard and applicable definition established by SBA (13 CFR 121). Therefore, in an effort to minimize the adverse consequences upon such concerns, the SBA established the 500-employee size standard for non-manufacturers. 500 employees is the predominant size standard for manufacturers.

5. **QUESTION:** The Small Business Jobs Act of 2010 requires SBA to periodically review current small business size standards and modify the standards to reflect changes in market conditions.

   Has SBA reviewed any of the current small business size standards? If so, which standards have been reviewed so far?

   ANSWER: SBA is doing a comprehensive review of all small business size standards to ensure that size standards reflect current industry structure and market conditions. We began this comprehensive review in 2007. Furthermore, the Small Business Jobs Act of 2010 requires SBA to review at least one-third of all size standards at least every 18 months, and complete the entire review in five years. We are doing this review on a sector by sector basis. To date, we have reviewed the receipts-based size standards for a number of sectors, which are at different stages of Federal rulemaking process as follows:

   - **Final rules published** (Oct 6, 2010) – these three rules were effective November 5, 2010.
     - NAICS Sector 44-45: Retail Trade – SBA modified 47 size standards. The modifications included increasing 46 size standards and changing the basis of measurement for New Car Dealers from receipts to number of employees. Size standards in the Retail Trades Sector do not apply to Federal procurement; only to SBA loans and to all other Federal government programs, including Agencies' Regulatory Flexibility Analyses. These changes should have no impact on procurement because the 500 employee non-manufacturer rule applies to Federal procurement.
     - NAICS Sector 72: Accommodation and Food Services – SBA increased five size standards.
     - NAICS Sector 81: Other Services – SBA increased 18 size standards.
   - **Proposed rules published in *Federal Register* for comments**
     - NAICS Sector 54: Professional, Scientific &Technical Services
       - Published proposed a rule on March 16, 2011 – SBA proposed to increase 35 size standards in Sector 54 and one in Sector 81, Other Services (we did not consider this one industry in the above rule for Sector 81 because of its shared businesses with those in Sector 54).
       - Comment period ended on June 15, 2011 (more than 1,400 comments received). SBA is currently evaluating and assessing the comments. With analysis of comments, preparation of the final rule, and review and clearance, it will be about six months before we have a final rule ready for publication in the *Federal Register*.
     - NAICS Sector 48-49: Transportation and Warehousing
       - Published on May 13, 2011 – SBA proposed to increase 22 size standards.

- Comment period ended on July 12, 2011 – We received only three comments. SBA is currently evaluating and assessing the comments. With analysis of comments, preparation of the final rule, and review and clearance, it will be about six months before we have a final rule ready for publication in the *Federal Register*.

- **Proposed rules under review**
  - NAICS Sector 51: Information – This is currently under review by OMB's Office of Information and Regulatory Affairs. They received it on July 29, 2011, and have up to 90 days (normally) to complete the review. When they return it, we will likely have some changes to make. We expect to publish the proposed rule for comments in the *Federal Register* in Fall 2011. The comment period will be 60 days (unless extended).
  - NAICS Sector 56: Administrative and Support, and Waste Management and Remediation Services – This is also currently under review by OMB's Office of Information and Regulatory Affairs. They received it July 29, 2011 as well, and have up to 90 days (normally) to clear our submissions. We expect to publish the proposed rule for comments in the *Federal Register* in Fall 2011. The comment period will be 60 days (unless extended).
  - NAICS Sector 53: Real Estate, Rental and Leasing – This is currently going through internal SBA clearance. After that, we must send it to OMB's Office of Information and Regulatory Affairs for its review. OMB has up to 90 days to complete the review. We expect to publish the proposed rule for comments in the *Federal Register* by the end of 2011. The comment period will be 60 days (unless extended).
  - NAICS Sector 61: Education Services – This is also currently going through internal SBA clearance. After that, we must send it to OMB's Office of Information and Regulatory Affairs for its review. OMB has up to 90 days to complete the review. We expect to publish the proposed rule for comments in the *Federal Register* by the end of 2011. The comment period will be 60 days (unless extended).

- **Proposed rules in progress**
  - NAICS Sector 22: Utilities – We are working on this proposed rule now. However, we are awaiting external industry data, and we have put this on hold for the moment. Once we have industry data, we will move it forward within SBA for clearance.
  - NAICS Sector 62: Health Care and Social Assistance Services – We are currently working on a draft of this proposed rule.
  - NAICS Sector 71: Arts, Entertainment and Recreation – We are currently working on a draft of this proposed rule as well.

6. **QUESTION:** Has SBA made any modifications to the size standards based on its findings? If yes, what modifications have been made? If no, what is the justification for instances where SBA found a change in market conditions but declined to modify size standards?

   ANSWER: As mentioned above, SBA modified several size standards in the first three sectors for which the final rules were published in October 2010. Specifically, SBA increased 46 receipts based size standards in Retail Trade, five in Accommodation and Food Service, and 18 in Other Services. SBA also changed the size standard for New Car Dealers from $29 million in average annual revenue to a 200-employee size standard.

   Similarly, based on the results, SBA proposed to increase 36 size standards for the Professional, Scientific and Technical Services (NAICS Sector 54) and 22 size standards for Transportation and Warehousing (NAICS Sector 48-49). Since SBA is currently working on the final rules for these sectors, at this point it is not possible to say how many modifications SBA will adopt in the final rules. Table below summarizes total numbers of size standards reviewed (or being reviewed) and size standards revised or proposed for revisions.

NAICS Sector	NAICS Sector Title	Status	No. of size standards reviewed	No. of size standards revised or proposed for revisions
44-45	Retail Trade	Final rule published	76	47
72	Accommodation & Food Services	Final rule published	15	5
81	Other Services	Final rule published	48	18
54	Professional, Scientific & Technical Services	Analyzing comments and preparing final rule	49	36
48-49	Transportation & Warehousing	Analyzing comments and preparing final rule	42	22
56	Administrative support & Waste Management Remediation Services	Proposed rule under OMB review	44	37
51	Information	Proposed rule under OMB review	20	15
53	Real Estate& Rental & Leasing	Proposed rule in SBA's clearance	25	20
61	Educational Services	Proposed rule in SBA's clearance	18	9
62	Health Care & Social Assistance	Proposed rule in progress	39	
71	Arts, Entertainment & recreation	Proposed rule in progress	25	
22	Utilities	Proposed rule in progress	9	

7. **QUESTION:** At the hearing, you discussed a process called "NAICS shopping" where contractors and contracting officers actively choose NAICS codes that provide the most beneficial size standard, even if the code doesn't match the actual product or service being sought. This allows contractors to be counted as small that may not otherwise qualify as small and it allows contracting officers to award contracts to 'small businesses' that can be counted towards agency small business contracting goals.

   What actions has SBA taken to combat "NAICS shopping"?

   ANSWER: As I discussed at the hearing, "NAICS shopping" is an issue we are aware of and one that we work quickly to address when indentified. We believe the current system in place is effective when problems and abuses do occur. SBA's regulations and the Federal Acquisition Regulation requires a contracting officer to assign the appropriate NAICS code to contracts and orders that best describes the item or items being procured. SBA's Procurement Center Representatives review procurements set-aside for small businesses, as well as those not set aside for small businesses. Where they feel that a NAICS code has been inappropriately applied, they will challenge that NAICS code. Once a procurement has been advertised, if an interested party or SBA feels that the NAICS code assigned does not properly represent the items being procured, they may appeal the designation to SBA's Office of Hearings and Appeals.

8. **QUESTION:** How does SBA conduct oversight of this issue?

   ANSWER: As described above, SBA closely monitors this issue and potential abuses through our Procurement Center Representatives. In addition, the appeal process provides a powerful tool for enforcement in this area. SBA recently amended its regulations to provide it with additional time to appeal NAICS code designations.

9. **QUESTION:** A report from the SBA Inspector General in February 2005 recommended that SBA work with the Defense Department and GSA to modify the Central Contractor Registration so that contractors would no longer be able to self-certify.

   What has SBA done to implement this recommendation? If nothing has been done, why not?

   ANSWER: SBA worked with the Integrated Acquisition Environment overseen by GSA to revise CCR. A potential contractor that represents itself as a "small business" is now required to submit its number of employees and average annual receipts and enter the applicable NAICS code the represents its primary industry. An algorithm then computes whether that business is a "small business" for its primary NAICS code and any other NAICS code entered by that business as it relates to a federal solicitation (contract).

10. **QUESTION:** When contractors represent their size status, they are supposed to represent the status based on the entire business concern. However, the identification number used to track contractors in all of the government systems (the DUNS number) does not represent a contractor's entire business concern.

If the representation is supposed to reflect the entire business concern, why are all of the government systems which track these representations linked to a number which does not track an entire business?

ANSWER: This is an issue related to firm's DUNS numbers and how they are captured in government systems. The Integrated Acquisition Environment (IAE), which is housed at GSA, is currently working with Dun and Bradstreet to address this issue. SBA defers to our colleagues at GSA for the latest information on this issue.

11. **QUESTION:** What issues, if any, does this create when SBA is investigating contractors who might be misrepresenting their size status?

    ANSWER: Generally, bidders for a federal contract know their competition. Once a contracting agency posts the notice of the apparent successful offeror, an interested party can protest the "size status" of that proposed awardee. SBA will then conduct a review of that business's size status. If it is found to be other than small, their small business size status is revised in CCR. They must be re-certified by SBA as "small" for that size standard before they can represent themselves as small for that NAICS code.

12. **QUESTION:** Do any government agencies have the ability to track the entire business concern? If so, which agencies?

    ANSWER: Agencies can access the Dynamic Small Business Search engine through CCR. They can retrieve a small business's representations to all NAICS codes in CCR. In the system, the firm's status as a small business is listed next to each NAICS code. There are instances where a business is listed as "small" for some NAICS codes and "large" for others.