ARE BIG BUSINESSES RECEIVING CONTRACTS THAT WERE INTENDED FOR SMALL BUSINESSES?

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HOUSE OF REPRESENTATIVES

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ARE BIG BUSINESSES BEING AWARDED CONTRACTS INTENDED FOR SMALL BUSINESSES?

WEDNESDAY, MAY 7, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Committee met, pursuant to call, at 2:02 p.m. in Room 2360, Rayburn House Office Building, Hon. Donald Manzullo presiding.

Present: Representatives Manzullo, Velazquez, Bartlett, Graves, Schrock, Akin, Shuster, Musgrave, Ballance, Napolitano, Case, Majette, Sanchez, and Miller.

Also Present: Representative Lynn Woolsey.

Chairman MANZULLO. Good afternoon and welcome to this hearing on the Committee on Small Business, and a special welcome to those who have come some distance to participate and to attend.

Is there a scandal going on in the federal procurement arena? Are big businesses being awarded contracts that were intended to be awarded to small businesses? A recent article in the L.A. Times would indicate that this is the case. The article states that "large companies are improperly getting billions of dollars in government contracts meant for small businesses."

It is imperative that this Committee look into what is going on and investigate the truth of these allegations. We have asked GAO to investigate this matter, and they have agreed to testify here today.

To answer these allegations, we have invited as witnesses the highest official in the administration responsible for federal procurement policy, the investigative arm of Congress, the United States General Accounting Office, persons in the private sector, and members of the Executive Branch responsible for seeing that small businesses are fairly treated in the federal procurement process.

At the end of this hearing, it is my hope that we will have an answer to this question: Are big businesses receiving contracts intended for small businesses? It is my understanding that some agencies have already taken steps to correct the situation, and we will find out today.

One recommendation is that small businesses be required to certify their size annually. The Committee is willing to work with the SBA and propose regulations to that effect and changes to statutory law, if necessary, and obviously we welcome SBA's input on that.

The bottom line is that this Committee is very much concerned with faulty information that results in an agency awarding to a big business a contract intended for a small business. This Committee is equally concerned with the accuracy of the data by which Congress evaluates agencies' performance against established, small business procurement goals. This Committee intends that the benefits of small business laws go to real-life, small business owners and employees, not to large companies.

Sometime in the fall, this Committee intends to revisit this issue to evaluate the conclusion raised in the GAO's final report.

As a matter of procedure here, the Honorable Angela Styles will be able to stay for a part of the questioning, but then she has to run off to another meeting. So, obviously, you would be excused whenever you have to leave, and we appreciate your coming here.

I now yield for an opening statement by my good friend and colleague, the Ranking Member, Ms. Velazquez of New York.

[Mr. Manzullo's statement may be found in the appendix.]

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Mr. Chairman, I would like to take two seconds to introduce our newest member, Mr. Brad Miller from North Carolina's 13th Congressional District. In his short tenure in Congress, he has already demonstrated a dedication to improving the economic environment of our nation's small businesses. He also serves on the Committee on Financial Services. I know that Mr. Miller will quickly become an active member of this Committee.

Welcome.

Chairman MANZULLO. Welcome to our Committee. Glad to have you here.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. With the economy in a slump, small businesses need all the help they can get. A good way for small businesses to grow is to have the federal government as a customer. What small businesses may not realize is their biggest marketplace is not overseas but right here in their own back yard.

The federal government spends approximately $220 billion on goods and services each year, from food and uniforms to airplanes and artillery, yet this billion-dollar marketplace remains largely closed to small businesses. Even though the United States Government is the largest customer in the world, small businesses find they have no luck when making sales calls to federal agencies. In fact, for the last two years, our government has failed to meet its small business goals, costing small firms an estimated $12.4 billion in lost opportunities.

To make matters worse, today, we find yet another reason why federal agencies are unable to meet their small business goal. If contract bundling, poor oversight, and lack of accountability weren't big enough obstacles, now small businesses are losing out on even more contracts intended for them because they are going to large businesses instead. This is yet another example of how the federal procurement system is fraught with inequities.

Shortly after these allegations were brought to our attention, this Committee directed the GAO to investigate the situation. During this hearing, we will learn the findings of the General Accounting

Office report and what actions federal agencies with oversight responsibilities are doing to address this issue.

Not only is it wrong and unfair that large businesses win small business contracts, but it also inflates the federal government's track record for achieving its small business goals. In 2001, the most recent year data was available on contracts awarded, the federal government missed its small business goal of 23 percent. Now, with the latest General Accounting Office findings, we will learn that the government didn't just miss the small business mark, but it missed it by more than what we had originally thought since, the large business contracts were miscounted and misrepresented as small ones.

The truth is, large businesses receiving contracts intended for small businesses is just part of a larger, more prevalent problem. What we have here is a federal procurement system that is fatally flawed. It is riddled with practices of contract bundling, weak oversight, no real appeal process, and little commitment to small businesses from top agency heads and other officials.

Small businesses lose out, but so do the American taxpayers because, in effect, what the government buys may not be the best quality at the best price. Even the president acknowledges that there is a problem. More than a year ago, President Bush unveiled his five-point small business agenda. Along with health care, tax incentives, and regulatory relief, opening opportunities in federal contracting for small businesses topped his list.

The rhetoric coming out of the White House is definitely pro-small business, but the reality is that little action has been taken to deliver on the promises made to help this nation's entrepreneurs. The administration did outline its contracting strategy last fall, but it was just like the rhetoric: empty. Unfortunately, it will become clear today that it will take more than the minor regulatory changes and increased reporting requirements contained in the administration proposal to bring about any real change.

I can tell you what we need to bring about some real change: a complete and comprehensive overhaul of the entire federal procurement system. We need to start with strengthening the appeals process and empowering small businesses to fight and actually win when they are treated unfairly. We need to put in place a regulatory body that can truly police federal agencies. We need to hold these agencies accountable. It is only then that we will see small businesses get their fair shake and their fair piece of the $220 billion procurement pie.

The General Accounting Office report is yet another symptom of our ailing federal procurement process. Small businesses all over this nation can provide the federal government with quality goods and services at competitive prices. Agencies need to understand and embrace this. If they refuse to, which is usually the case, then safeguards will have to be put in place to protect small businesses, and more power will have to be given to those responsible for enforcing the law, which mandates that the federal government work with small businesses.

It is the American way, and small businesses are the backbone of this economy. They deserve fairness and equity, especially from their own government. Thank you, Mr. Chairman.

[Ms. Velazquez's statement may be found in the appendix.]

Chairman MANZULLO. Thank you for that excellent statement.

Our first witness is the Honorable Angela Styles, administrator, Office of Federal Procurement Policy. We have a clock right there. When it gets to yellow, you have got a minute, and when it gets to red, you are supposed to stop. And if you could pull the microphone as close to your mouth as possible, we would appreciate it. I look forward to your testimony.

STATEMENT OF ANGELA B. STYLES, ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY

Ms. STYLES. Thank you, Chairman Manzullo and Congresswoman Velazquez and members of the Committee. I am pleased to be here today to discuss why the large businesses are improperly receiving contracting opportunities intended for small businesses. This issue is of great concern, particularly at a time when this administration is working hard to create an environment where small business can flourish.

We share your interest in making sure that small businesses do, in fact, have access to federal contracting opportunities. When small businesses are excluded from federal opportunities, our agencies, small businesses, and the taxpayers lose. With this in mind, the administration is taking steps to ensure that large businesses are not improperly receiving contracting opportunities intended for small businesses.

We have heard of instances where large businesses are taking advantage of contracting opportunities intended for small businesses. While we do not have hard evidence that this is happening, we want to make sure that the various actions the administration is taking do, in fact, increase small business access to contracting opportunities. We are particularly concerned about larger contractors masquerading as small businesses in large, long-term contracts, thus depriving small businesses of significant opportunities to compete against their peers.

We welcome SBA's recent issuance of a proposed rule to amend its regulations on small business size status. SBA has proposed amendments to make sure that large businesses do not take advantage of opportunities intended for small businesses. This action should help protect against misrepresentation of small business status.

In the meantime, there are other protective measures we can and should take. I understand that GAO has found that in some cases agencies are relying on inaccurate or misleading data to make decisions about small business contract awards. If that is the case, we need to take corrective action.

We want to make sure that small businesses do, in fact, have access to contracting opportunities intended for their benefit. In particular, my office is taking steps to prevent misrepresentations under government-wide acquisition contracts for information technology, known by their acronym as "GWACs." GWACs are awarded by executive agents designed by OMB under the Clinger-Cohen Act. Typically structured as multiple-award contracts, GWACs are popular vehicles for satisfying agency needs, in large part because they provide quick access to the marketplace and can save cus-

tomers the cost and burden of establishing their own separate contracts.

Today, four agencies serve as executive agents: the General Services Administration, the Department of Commerce, the National Aeronautics and Space Administration, and the National Institutes of Health. These agencies maintain a total of 15 GWACs: GSA has 10, NIH has three, and the other two agencies have one each.

On February 11th of this year, we advised our four executive agents, whose designations were up for renewal in April, of our intention to require that they obtain annual certifications from their contractors regarding small business status. We believe GWACs, like other multiple-award contracts, and GSA's supply schedules may be vulnerable to misrepresentation because they are typically large and long term. Their structure allows a prequalified contractor to receive sizable work orders from agencies over the course of many years, often in millions and occasionally even in hundreds of millions. For this reason, we use the OMB executive agent renewal process to provide temporary protection from possible misrepresentation of small business status.

Under OMB's designations, the executive agents are required to develop schedules identifying when their small business GWAC contractors will begin annual certification of their size status. Our intent is not to disrupt contract performance by requiring termination of contracts with businesses who are small but became large during contract performance. Also, we want to be flexible in considering ways to implement the certification requirement prospectively so that we do not have unintended consequences.

However, we expect our executive agents and their customer agencies to identify this change in business status in the normal course of their reporting to the Federal Procurement Data System. For example, after a change of status from "small" to "other than small" occurs and is reflected in the change in an annual certification, agencies are expected to report that orders under the GWACs were awarded to a large rather than a small business. Departments and agencies can then use this information to more accurately account for their small business contracting activities and make appropriate adjustments to their contracting practices to ensure small businesses have access to contracting opportunities.

Our office will continue to work closely with SBA, this Committee, and major procuring agencies to increase small business access to contracting and subcontracting opportunities and to help guard against instances where small businesses are excluded from federal opportunities by fraud, misrepresentation, or otherwise. By doing so, we are helping to ensure that our citizens reap the full benefit of a robust supplier base.

This concludes my prepared remarks, but I am happy to answer any questions you may have.

[Ms. Styles' statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much. Our next witness, Lloyd Chapman, will be introduced by his member. What we are going to do is I am going to have Congresswoman Woolsey introduce her witness, and then I am going to allow the members of the Committee to ask questions of Angela Styles so she will have time to answer those questions.

Ms. STYLES. Mr. Chairman, it is perfectly all right with me to wait.

Chairman MANZULLO. No. What I would suggest, Lynn, is that you go ahead and introduce Mr. Chapman——

Ms. WOOLSEY. All right.

Chairman MANZULLO [continuing]. And then we will go to Ms. Styles. And then he will be able to testify. Please go ahead.

Ms. WOOLSEY. Thank you for the honor of being able to do this.

Chairman MANZULLO. We welcome you to our Committee. We are glad to see you here.

Ms. WOOLSEY. You are talking about things that don't make sense to me, actually. And thank you, Ranking Member Velazquez, for letting me do this.

It is an honor to join you today to introduce one of my favorite constituents from Novato, California, Lloyd Chapman, and I am confident that Mr. Chapman's testimony will prove insightful. He has been an outspoken advocate for small business people in our North Bay community—we are right across the Golden Gate Bridge from San Francisco—and he has been an advocate for small business people throughout the country for over 17 years.

He founded and is currently president of the Microcomputer Industry Suppliers Association, MISA, which represents the interests of microcomputer and technology suppliers.

Lloyd's tireless efforts have led government purchasing agencies to review their small business-certification processes to ensure that contract set-asides for small businesses truly go to small businesses. There is no doubt that Mr. Chapman shares this Committee's commitment to the mission and goals of the Small Business Act, and I am pleased that he will be able to share his experiences with you today. With that, I am pleased to welcome Lloyd Chapman to Capitol Hill.

Chairman MANZULLO. Thank you very much. Ms. Velazquez, you have questions of Ms. Styles.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Ms. Styles, thank you for your testimony.

In your written testimony, more than half of it is on the President's bundling contract. Here, we are today to discuss and comment on the General Accounting Office report. I don't think you did that. But I would like to pursue your discuss regarding the President's bundling plan.

It seems to me that what is missing in the President's bundling plan is accountability. The report includes the word, "accountability," seven times and the word, "responsibility," 12 times but doesn't include any true measures of accountability.

The first quarterly status report, which barely half of the agencies responded to on time, speaks volumes regarding the commitment to the President's plan. Worse, what you asked for in this status report isn't going to provide one indicator as to whether opportunities for small businesses have increased.

Why didn't you ask agencies to provide you with the number of bundled contracts reviews? How are you going to know if you have reduced the effect of contract bundling on small businesses if you are not even asking agencies to provide you with the impact of their bundled contracts on small businesses. And did you ask agen-

cies to provide you with the number of small businesses that benefited from agencies' action to unbundle.

Ms. STYLES. We actually do recognize that accountability is a key piece of this. I think, when we went to talk to small businesses in this arena, trying to implement what the President wanted, the one thing we heard was what was needed was accountability and leadership. More than changes in the regulation, which we have proposed, and we did propose on time, more than statutory changes is what they were looking for was accountability and leadership.

We came out with the proposed regulations on time. We have gone to the agencies, first, in December with a draft report, quarterly report, which included a great deal of data elements. For the first report, based on our discussions with the agencies, we realized it was almost impossible for them to be able to collect the data for the first report. We will be going out with a very extensive data call in the next report. We are working actively with GAO to make sure that it is a data call that we will be able to measure success or if it is not successful. So we do recognize that we need that data in order to measure where we are, where we are going, and whether the course that we are taking is successful or not.

Ms. VELAZQUEZ. Ms. Styles, can you please answer to me why didn't you ask agencies to provide you with the number of bundled contracts reviews?

Ms. STYLES. We are asking for that information, and the first one we went out to, we believed it was almost impossible, in the two-week period we gave them to get back to us, to actually be able to collect the information.

Ms. VELAZQUEZ. So in the next report, you are going to be asking the question for the agency because the only way we can measure whether or not people are unbundling contracts is if they review those contracts.

Ms. STYLES. Yes, yes. We are asking for detailed information on the number of reviews, the dollar value, et cetera, and we are working with GAO to try and make sure that we are asking the right questions. We don't want to just rely on our ability to ask the right questions. We want to work with you. We want to work with other people. We are very happy to share what we are asking with you, with the Senate, to make sure that we are getting the data and we are getting the information.

So I am very happy to work with you to make sure that we understand what are the right questions, what data you want, what data we want, so we can understand exactly where we are and exactly where we are going.

Ms. VELAZQUEZ. In the proposed bundling rule, small business specialists are required to notify ASDABUs if an agency's contract strategy involves contract bundling that is unnecessary or unjustified. My question to you is, what will the ASDABU be able to do? They have no authority.

Ms. STYLES. They are required to notify both, I believe, the ASDABU and the procurement center representatives, both of whom—certainly the procurement center representatives should have authority to stop the contract, is my understanding, and I think the ASDABUs, in their position with the agencies, should be

able to work with the agency to work through the issues. That is why they are embedded within the agency.

Ms. VELAZQUEZ. Can you explain that to me again? I don't think that they have the authority to stop the contract.

Ms. STYLES. I do not believe they have the authority to stop the contract, but they are within the agencies, and it may be useful to ask some of the ASDABUs here, to help the agency understand the issues in a facilitated environment before you get to a controversial environment, or one that is more like litigation with a procurement center representative.

Ms. VELAZQUEZ. Would you support ASDABU having the authority to stop a contract that did not include adequate small business participation?

Ms. STYLES. I think you have to ask the ASDABUs that. If the ASDABUs say that that authority is required for them to do their job, I would certainly be willing to consider it. I can't say that I know enough about their day-to-day activities to be able to make that determination right now.

Chairman MANZULLO. Let me go to Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman. Let me lock arms with what Mrs. Velazquez said. I know that the subject of contract bundling is a touchy one. I represent the Second Congressional District of Virginia, which includes eight major military bases and 385 military commands, and there is a lot of construction, and there is a lot of business that goes on there, and I have contractors, I have small businesses in that district who could do the job perfectly, but because they bundle it, may go to somebody in another state, and then they subcontract it to the guy that is going to do it anyhow, and that is not right.

I think, you know, if all of us have people in the districts that can do it, it should go to them. I look at contract bundling as just the lazy way out, do one contract and let somebody else do the rest of the work, and I don't agree with that. I think that is wrong, and I think, as Mrs. Velazquez says, that is really sticking it to small business, and that is not a good thing.

And one thing I think that Mrs. Velazquez said, that the administration has said these things that they want to do to support small businesses, but it is only words, it is only rhetoric, and I am getting to the point, I agree with that. You know, you said there is accountability. Who is holding these agencies accountable?

Ms. STYLES. The President's management council and the President himself. The accountability is through the deputy secretaries of each agency. That is why we set it up to go through the leadership of these agencies. I have met with the President's management council at least three times in the past six months to discuss contract bundling, to discuss how important this is to the President, and to make sure people understand that.

I believe our political leadership does understand it, but it takes a while to make cultural changes, and our contracting people don't have a lot of resources at this point. We really have to make some fundamental changes and make sure people from the top down recognize how important this issue is.

Mr. SCHROCK. I know things take a long time, but I am getting old, and I don't have much time, and I want to see some of this

stuff before I leave Congress one of these days, and if it is typical government, they will out-wait me. When I was in the military, they could out-wait me because they knew I would get transferred somewhere. It is the same thing here. We have got to get this thing working because our small businesses are the ones that are suffering, and I agree with Mrs. Velazquez that we just need to hold somebody's feet to the fire to get this done and get it done quickly.

I understand what you are saying, that things move slowly. That is no excuse. Just because it has always been done that way, I, frankly, don't think that is the way it should be done. I didn't come here to do business as usual. If that is the case, my constituents need to send me home. So we just really need to work on this.

Ms. STYLES. I agree with you. I think we all need to work on it. I think our agencies, with the help of this Committee, need to understand how important this issue is, and it is hard to move a bureaucracy, but I certainly am committed to trying to make it move.

Mr. SCHROCK. Great. I appreciate that. Thank you, Mr. Chairman.

Chairman MANZULLO. We are also joined by Mrs. Sanchez. Welcome to our Committee. Glad to have you here.

Ms. SANCHEZ. Thank you.

Chairman MANZULLO. Mr. Miller, do you have any questions?

Mr. MILLER. Just one or two, Mr. Chairman.

I think all of the questioning so far has been about bundling to get above the ceiling of the Small Business Act. There is also evidence, apparently, of unbundling or disaggregating purchases to fall below the floor. What, if anything, is your agency doing about that? How can that be addressed?

Ms. STYLES. We have taken a very hard look at purchase card practices. You are talking about the floor generally being the micro-purchase threshold of $2,500. It certainly has been a concern to us that we don't have proper management controls at the agencies in place, whether that is to prevent fraud and abuse, or whether that is to make sure that there are appropriate opportunities available for small businesses.

We have been pushing both the agencies and the credit card companies to make more data available so we can measure what is going to small businesses below that micro-purchase threshold because I think it hampers our ability to make assessments of whether $2,500 is too high or too low if we don't know how much of that is going to small businesses or not.

Mr. MILLER. One additional question. I understand there are also subcontracting requirements, and either the statute or contracts provide for liquidated damages as an enforcement mechanism. Can you cite instances in which liquidated damages have been used?

Ms. STYLES. I know of no instance where that has been used, although I do think the subcontracting environment is one that has been ignored and is difficult for small businesses as well as prime contractors. We are working on putting together a small, interagency group to assess many of the subcontracting issues, whether it is forms, whether it is understanding whether a company is certified for one procurement but not for another as a small business, to really make the subcontracting environment better and more at-

tractive for companies. I think we recognize that there are a lot of issues that have just been ignored in subcontracting for a while.

Mr. MILLER. Why has the enforcement mechanism of liquidated damages not been used, and do you intend to use that more in the future?

Ms. STYLES. I will have to answer that question for the record for you because I don't know much about liquidated-damages provisions in subcontracting arrangements.

Chairman MANZULLO. Mr. Bartlett?

Mr. BARTLETT. Thank you very much. I am now involved with a constituent in a problem. This is a small business that responded to an RFP that was a set-aside, as I understand it, for small businesses. When the contract award was made, it was made to a business that they say is clearly not a small business. By no measure are they a small business. They have far more than the 500 employees and so forth.

They have taken what they felt was the only course of action available to them. They have filed a protest. So now, with that in adjudication, we can't talk about that. So what I want to talk about is a generic situation. Are there circumstances under which a business which is clearly today not a small business, are there circumstances under which they could compete for a small business contract and be within our regulations, and if that is true, what can we do about that?

Ms. STYLES. I think that is the situation, and I think my office, over the contracts that I have control over, and the Small Business Administration are both taking steps to change that.

Mr. BARTLETT. What are the circumstances under which they could clearly not be a small business and still compete for a small business contract?

Ms. STYLES. We have a system that allows people to prequalify on a contract, whether it is a GSA schedule or another type of multiple-award contract. So you essentially get a hunting license. You are a contractor. You get on to this contract. That doesn't mean you are going to get any business. At the time, Year 1, when you get onto that contract, you are a small business. These can be contracts as long as 20 years. In Year 2, maybe they become a large business. For the next 18 years under our rules, that person will continue to be counted as a small business.

Mr. BARTLETT. Is Bill Gates' Microsoft still a small business? I think he was 20 years ago, wasn't he?

Ms. STYLES. We recognize that there is a problem here. GSA has taken steps, the SBA has taken steps, and my office——.

Mr. BARTLETT. What are you going to do about it?

Ms. STYLES. We have a couple of options here. We have a rule. SBA has a rule out right now that is looking at several of the options. They run the gamut from at option year renewal, which would be about every five years—I, personally, think that is too long to wait—we have an option of recertifying when your size changes. We have an option of annual recertification, or you have an option of every task or delivery order. So you could have a 20-year contract, and once an agency has a need and goes to buy, then the recertification has to take place at that point in time.

The question is, what is the best for our agencies, and what is the best for small business? A lot of small businesses don't want it to be one year. They want a little bit more of a cushion because they can be up and down on that margin of what is small in a several month period, and so on Day 5, you could be small, but the next day you are not. So we do need a little bit of smoothing in there, and the question is, is that a year? Is that two years? Is that three years? Is it every task and delivery order?

Mr. BARTLETT. What will be your proposal?

Ms. STYLES. My office has taken the position that annual recertification is appropriate, but we have heard from a lot of small businesses that think that that might be too frequent for some of the businesses, that they might need a little more leveling from year to year. There are some small businesses that have come in and asked us to look at two or three years or when size status changes, which is why you saw the SBA rule go out with one option identified in the rule but seeking comments on several of the other options, so we understand what the effect on small business is.

We don't want a small business, because they hire one more employee one day and then fir them the next, to be up and down on our scale. I think that could have some unintended consequences.

Mr. BARTLETT. For people who are now caught in this, there is no recourse?

Ms. STYLES. No. An agency can ask, on a task- or delivery-order basis, for a particular business to recertify, is my understanding.

Mr. BARTLETT. Okay. Could that happen under a protest?

Ms. STYLES. I don't know the answer to that question. I don't know, but I can find out for you.

Mr. BARTLETT. I appreciate that. Thank you very much. Thank you, Mr. Chairman.

Chairman MANZULLO. Mrs. Sanchez?

Ms. SANCHEZ. Thank you, Mr. Chairman. I don't have any questions at this time.

Chairman MANZULLO. Let us see. Ms. Majette, do you have any questions?

Ms. MAJETTE. No.

Chairman MANZULLO. Okay. Anybody else? Okay. I would yield the balance of my time to Mrs. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Mr. Mendoza?

Mr. MENDOZA. Yes.

Ms. VELAZQUEZ. Thank you. Ms. Styles said that if ASDABUs wanted the authority to be able to be able to stop a contract that did not have adequate small business protection, she will consider supporting this. Do you think providing that authority is a good idea?

Mr. MENDOZA. I think so, Madam Velazquez. Yes, ma'am, I do.

Ms. VELAZQUEZ. Would you support it?

Ms. STYLES. I would like to talk to all of the ASDABUs. I think the vehicle for that is the new, SBA Small Business Procurement Advisory Council, but I am very happy to follow through with them. I think they are meeting June 1st or second, and I would be very happy to follow through with them and get their ideas on this, particularly since we are in the middle of a rulemaking right now, and we are assessing the comments. We have got a draft rule. We

will be coming out with a final. If this is something that needs to be taken into consideration, we will talk to them and consider it.

Ms. VELAZQUEZ. Thank you. Ms. Styles, in the President's bundling plan, you create significant new requirements for the SBA's procurement center representatives. They will now be required to review contracts not set aside for small businesses and identify alternative strategies to increase small business participation, review a position within 30 days of the agency issuing the solicitation, work with agencies' small business specialists, review agency position strategies and analyses, review agencies' oversight of agency subcontracting programs, review agencies' assessment of contractor compliance with subcontracting plans, and revise agency acquisition strategies to increase small business teaming.

This is in addition to their other duties of working directly with small business to counsel them on the federal marketplace, identifying agency sources for small business products and services, now conducting agency surveillance reviews, acting as part-time commercial marketing representatives. However, no additional resources are provided, either in the form of travel dollars or money to hire additional staff.

This is exactly the same strategy used by the administration for the SEC: tough talk about enforcement but not dollars to address the problem. How do you think that they could do their job? How could you think they could do a good job without the resources that they need?

Ms. STYLES. I think you have fairly identified one of the most difficult parts of the report. I think we recognize the need for procurement center representatives, as well as our ASDABUs, to do more with less in an environment of limited resources. I think we have asked them to do a lot without allocating additional resources.

I do think you have identified a very difficult point. I would certainly ask you to talk to SBA as well on their allocation of resources for PCRs. We certainly try to increase the responsibilities for ASDABUs where we think there is a little bit more capacity to reallocate resources to look at things, but I do agree with you that there is an issue there.

Ms. VELAZQUEZ. And I guess that you are aware that there is not even one PCR per state.

Ms. STYLES. It is less than 50, yes.

Ms. VELAZQUEZ. So would you support doubling that?

Ms. STYLES. Pardon?

Ms. VELAZQUEZ. Would you support doubling the number of PCRs?

Ms. STYLES. I am not from the budget side of the house, but OMB does not support doubling those resources.

Ms. VELAZQUEZ. Ms. Styles, I think that if we are honest and serious about tackling the problem of small businesses through contract bundling, we have to put the numbers and the resources that we need in order for them to do their job; otherwise, it is empty rhetoric.

Thank you, Mr. Chairman.

Chairman MANZULLO. We have got a series of votes. Did somebody hear five votes? Is that what it said? Wonderful.

Ms. Styles, you are excused. We are going to be back. It could be as long as 45 minutes. Does anybody here have an airplane that they have to catch to get back home? Okay.

Ms. VELAZQUEZ. Mr. Chairman, I would like to ask a request for Ms. Styles.

Chairman MANZULLO. Sure.

Ms. VELAZQUEZ. If you could please provide within the next 10 days a list of the top 25 buying activities and of those which have a PCR covering them exclusively and which don't.

Ms. STYLES. Okay. I think I can work with SBA to get that information. They are SBA's people, so I will certainly work with them to get that information.

Ms. VELAZQUEZ. Thank you.

Chairman MANZULLO. Okay. Fine. Well, let us go vote, guys.

[Whereupon, at 2:37 p.m., a brief recess was taken.]

Chairman MANZULLO. Well, we are back at it again, folks, after an exciting series of half-a-dozen votes, including the use of the Capitol grounds for the soap box derby. That was a tough vote, wasn't it, Ms. Velazquez? Okay. You think are they necessary, aren't they?

Ms. VELAZQUEZ. I don't know, but I am not in control.

Chairman MANZULLO. Okay. We look forward to, Mr. Chapman, your testimony. I am glad I encouraged your member of Congress to introduce you way back then. Okay? I look forward to your testimony. You know the story on the lights. When it gets to yellow, you have one minute, and when it gets to red, you should stop. Okay?

Mr. CHAPMAN. All right.

Chairman MANZULLO. The written testimony of all of the witnesses and any members of Congress will be made part of the official record without objection, and anybody else in the audience that wants to submit a written statement, not to exceed two pages, no attachments, of a type that is not less than 12 point, single spaced; you got that? You are welcome to do that. You have 10 days to get that in to Mr. Crouther. Mr. Chapman.

STATEMENT OF LLOYD CHAPMAN, PRESIDENT, MICROCOMPUTER INDUSTRY SUPPLIERS ASSOCIATION (MISA), NOVATO, CALIFORNIA

Mr. CHAPMAN. I want to thank Chairman Manzullo and Ranking Member Velazquez and the distinguished members of the Committee for their attention to this critically important problem to small businesses.

According to information available from the SBA, approximately $85 billion in prime contracts and subcontracts are being shown as awards to small businesses. I believe, during the course of the hearing, you will find that number is dramatically overstated. The billions of dollars in federal small business contracts and subcontracts that are going to large businesses are the direct result of policies, regulations specifically written historically by the SBA, OMB, and GSA.

If we want to find out who is responsible for this problem, we simply have to ask ourselves, who created contract bundling? Who wrote federal policies that allowed large businesses to receive small

business contracts for up to 20 years? Who created small business size standards up to 3,000 percent higher than the average small business?

I am concerned that the SBA and OMB and GSA will attempt to convince this Committee that the staggering deficiencies in small business contracting and subcontracting are mainly the result of bad data and out-of-date information.

In August of 2002, I will begin to compare the information that companies have posted on PRO-Net and CCR against the information on our Web sites. I found dozens of examples where firms had blatantly misrepresented their number of employees, NAICS codes, and their affiliations with large businesses. Subsidiaries of Fortune 1000 companies in international firms were common. Some of the firms had up to 44,000 employees and annual revenues of up to $12 billion. In 2001, a Dutch firm with 26,000 employees received over $60 million in small business contracts through two subsidiaries. Although still listed on PRO-Net, a major government supplier of IT products reported in their 1999 annual report to stockholders that they no longer qualified as a small business after February of 1998.

Based on the information that I began providing the SBA in 2002, the SBA has acknowledged removing over 600 firms from PRO-Net after determining that they were large businesses. Since the SBA has declined MISA's request that the SBA notify agents of these findings, it is my understanding that these 600 firms can continue to receive small business contracts and subcontracts.

Regulation 16(d) of the Small Business Act states that misrepresenting a firm as a small business is punishable by cancellation of contracts, debarment, fines of up to $500,000, and imprisonment up to 10 years. The SBA Office of the Inspector General has indicated no firm has been penalized during the last 15 years for misrepresenting themselves as a small business.

Based upon the magnitude of the discrepancies in small business contracting numbers, I have to question the effectiveness of current protest procedures the SBA has in place. The SBA has acknowledged dismissing hundreds of small business protests in recent years by claiming the acquisitions in question were no small business set-asides. The SBA's apparent policy of dismissing non-set-aside protests is inconsistent with Regulation 16(d) that makes no differentiation between misrepresentations or set-asides, non-set-asides, prime contractor subcontracts. Some of these dismissed protests were filed against the very companies that the SBA has ultimately removed from PRO-Net.

When the Small Business Act was passed more than 50 years ago, it called for a fair portion of government contracts be awarded to small businesses. This is obviously not happening. I believe the Small Business Act was a win/win, economic-stimulus package designed to direct federal contracts and subcontracts to the small businesses that account for 98 percent of U.S. firms and over 50 percent of the American work force.

To achieve this goal, I would like to see a GAO investigation into the accuracy of subcontracting reports. Current policies allowing large businesses to receive small business contracts should be modified or eliminated. In addition, more effective protest proce-

dures are needed, with the strict enforcement of Regulation 16(d) regarding small business misrepresentation. A full and accurate implementation of the Small Business Act will have a powerful impact on our nation's economy and the millions of American small businesses.

This concludes my remarks, and I will be glad to answer any questions that you may have at this time.

[Mr. Chapman's statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much. Our next witness is Fred Armendariz, associate deputy administrator of the SBA. I look forward to your testimony.

STATEMENT OF FRED C. ARMENDARIZ, ASSOCIATE DEPUTY ADMINISTRATOR FOR GOVERNMENT CONTRACTING AND BUSINESS DEVELOPMENT, U.S. SMALL BUSINESS ADMINISTRATION

Mr. ARMENDARIZ. Good afternoon, Chairman Manzullo and Ranking Member Velazquez and distinguished members of this Committee. Thank you for inviting me here today to discuss concerns regarding large businesses obtaining federal contracts intended for small businesses and the accuracy of the small business information contained in databases maintained by the U.S. Small Business Administration (SBA) and the General Services Administration (GSA).

Part of this concern is related to a number of large businesses inappropriately included in the Procurement Marketing and Access Network, or PRO-Net, a small business database administered by the SBA. The SBA developed PRO-Net as a self-certified database of small businesses. Presently, PRO-Net holds records of more than 150,000 small businesses. In December of 2002, the SBA partnered with the Department of Defense to integrate PRO-Net and the Central Contractor Registration, or CCR, systems to create a single point of vendor registration.

PRO-Net is a marketing tool that is designed to assist small businesses with presenting their capabilities to federal agencies and other organizations as a potential source of goods and services. It is not intended or designed to validate the small business eligibility of a registrant, except for firms certified by SBA under the 8(a) Business Development, HUBZone, and small disadvantaged business programs.

For each federal procurement solicitation, a bidder must represent in good faith that it is a small business at the time it submits its initial bid. A contracting officer shall accept a bidder's small business representation unless a size protest is received from other bidders or if other information causes the contracting officer to question the bidder's small business representation. A contracting officer cannot assume, nor is their guidance that suggests, that a business listed on PRO-Net is an eligible small business for a specific procurement.

The SBA has a well-established process for resolving questions concerning the small business eligibility of a bidder on a federal procurement. In most cases, the SBA makes a decision within 10 working days. If a business is determined to be other than small, a contracting officer cannot award the contract to that business. A

business determined to be other than small as a result of a formal size determination is notified that it cannot represent itself as a small business on future procurements which specify a size standard at or below the size standard cited in the determination.

In addition, the business is notified that the Small Business Act prescribes severe penalties for misrepresenting itself as small.

In Fiscal Year 2003, the SBA received 193 size protests. Of these, 68 businesses were determined not to be small. During Fiscal Year 2002, the SBA received 383 size protests. Of these, 110 were dismissed on procedural grounds. Of the cases accepted for review, 85 firms were found to be other than small.

In cases where SBA has evidence that a business knowingly misrepresents itself as a small business, the SBA refers the case to the Office of the Inspector General. Because of the burden of proof required by law in establishing fraudulent intent, a relatively few number of cases have been referred to the OIG.

The SBA takes very seriously its responsibility for ensuring that only small businesses obtain federal contracts and other federal assistance intended for small businesses. Our responsibility is one of providing a sound process to review protests, not to police small business representations. In federal contracting, the SBA must rely on contracting officers and other interested parties to bring these challenges to SBA for resolution.

We are aware that some businesses previously listed on PRO-Net do not meet the SBA criteria for small business status. As described in my written testimony, the SBA is undertaking a number of actions to identify and remove large businesses from PRO-Net. Over the past six months, more than 600 businesses have been removed from PRO-Net because they are other than small.

A major source of complaints involves awards made through GSA Multiple Award Schedule (MAS) program, including Federal Supply Schedule (FSS) or other multiple-award and Government-wide Acquisition Contracts (GWACs). Under the SBA regulations, a business that obtains a contract as a small business remains classified as a small business for the duration of the contract. On MAS and other multiple-award, GWAC contracts, this can last anywhere from five to 20 years.

The SBA, GSA, and the Office of Management and Budget have been working together to develop a new policy which will require recertification of small business status during the term of MAS, FSS, and GWAC contracts. On April 25, 2003, the SBA published a proposed rule to require annual recertification of small business status on these types of contracts. We encourage the Committee and the public to assist us by reviewing the proposed rule and providing us with comments on the feasibility of the proposed and alternative approaches.

The SBA is committed to the President's small business agenda and his proposals to create jobs and growth through the small business sector. We must ensure that small businesses receive their fair share of contract opportunities. Since small businesses are the engine that drives the economy, increased opportunities for these small businesses will result in savings to the taxpayer, a stronger economy, and a stronger America.

This concludes my remarks, and I will be able to answer any questions you may have.

[Mr. Armendariz's statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much. Our next witness is Felipe Mendoza, associate administrator of the General Services Administration. We look forward to your testimony.

STATEMENT OF FELIPE MENDOZA, ASSOCIATE ADMINISTRATOR, OFFICE OF SMALL BUSINESS UTILIZATION, U.S. GENERAL SERVICES ADMINISTRATION

Mr. MENDOZA. Thank you, Mr. Chairman. Good afternoon, Chairman Manzullo and Ranking Member Velazquez, members of the Committee. Thank you for inviting me to appear before you today to discuss a matter of great concern to all of us: businesses classified as "other than small" obtaining federal contracts intended for small businesses and the accuracy of the data contained in the Federal Procurement Data System that specifically identifies or verifies the size status of a business.

Before I begin my testimony, I would like to introduce a distinguished member of the General Services Administration acquisition team who is here with me today, Mr. Dave Drabkin, who is sitting right behind me. He is the deputy associate administrator for acquisition policy and GSA's senior procurement executive.

In GSA, we know that small businesses are the engine of our national economy and that they, more often than not, bring to the market new and innovative solutions to vexing government problems.

Let me begin by stating that GSA is aware of and shares your concern that contracts intended for small businesses are sometimes winding up with larger firms. I will explain what we are doing to address this situation in just a moment.

Increasing procurement opportunities for small businesses is a major initiative of the Bush administration, and it is an issue to which I have devoted a majority of my time and energy since joining GSA last year, seven months ago.

As you are aware, the government-wide goal for contracting with small businesses is 23 percent. GSA's goal for the past several years has been 40 percent. The preliminary figures for Fiscal Year 2002 indicate that GSA spent $13.1 billion in procurement goods and services. Of that amount, a full 40.6 percent, almost $5.3 billion, went to small businesses. Nearly $900 million of that was awarded to small, disadvantaged businesses. In addition, GSA did nearly $650 million in contracting with women-owned, small businesses in 2002. GSA aims high in its goals and achievements because we want everyone in the agency to know that we recognize the statutorily mandated goals to be the floor and not the ceiling.

In addition to our agency-specific procurement opportunities, GSA manages the Federal Supply Schedules program. The schedules program is a simplified procurement process whereby contracts are established with commercial firms for commonly used supplies and services. Of the 11,000 scheduled contracts issued to date, three-quarters have been awarded to small businesses.

I would like to address the issue of small business re-representation; that is, where small businesses are required to reconfirm their

status as small businesses. GSA realizes that a major source of complaints pertaining to large businesses receiving federal contracts intended for small businesses involve awards made through multiple-award-type vehicles such as the schedules program and the Government-wide Acquisition contracts, or GWAC. Under these vehicles, a contract's entire term, including the initial contract, as stated by Mr. Fred Armendariz, periods and subsequent options can range from five to 20 years. Because the SBA regulations state that businesses that obtain contracts as small businesses will remain classified as such for the duration of the contract, some medium-to-large businesses are classified as small businesses for FPDS purposes.

G.S.A. was the first agency to step forward and take aggressive measures to close the loophole regarding this re-representation. We acted as soon as possible once it became apparent that current procurement policy was hindering opportunities for small businesses. We contacted SBA and worked with the Office of Federal Procurement Policy to come up with a solution that made sense and complied with the spirit, as well as the letter, of the Small Business Act.

On March 1, 2003, we implemented a new policy throughout GSA that requires re-representation of business status at contract renewal, i.e., prior to exercise of the contract option period.

Let me make our policy clear. For multiple-award schedule contracts and other multiple-award contracts that contain option periods, GSA contracting officers must require contractors to re-represent their size status prior to exercising an option period.

One final point I would like to make with regard to the General Accounting Office's preliminary report that is at the center of today's hearing and pertains to the FPDS system. The FPDS is not a reliable source for determining a contractor's size. FPDS is a central repository of statistical information on federal contracting opportunities that identifies detailed information on contract actions. Contracting officers should not check FPDS to determine the size status of a contractor. For this reason, FPDS is not used as a source of information as to whether a company is small today, but, rather, it is used to determine whether, at the time of the award, we awarded the contract to a small business.

As this Committee knows, GSA recently ran a competition for a replacement for FPDS. After a full and open competition, a contract was awarded to a small business, Global Computer Enterprises of Maryland. FPDS-Next Generation, "NG" as we call it, will give us more accurate and timely information.

In closing, I would like to state that the General Services Administration is fully committed to the President's small business agenda and his efforts to strengthen the sustainability of the 25 million small businesses in America.

This concludes my remarks, and I will be happy to respond to any questions that you may have. Thank you.

[Mr. Mendoza's statement may be found in the appendix.]

Chairman MANZULLO. Well, thank you very much. Our next witness is Kenneth W. Robinson, president and CEO of KENROB and Associates out of Leesburg, Virginia. I look forward to your testimony, Mr. Robinson.

STATEMENT OF KENNETH W. ROBINSON, OWNER, PRESIDENT, AND CEO, KENROB AND ASSOCIATES, INC.

Mr. ROBINSON. Thank you. Mr. Chairman, Congressman Velazquez, and other honorable members, I wish to first say I view my participation here today as a privilege and an opportunity to share my personal opinion and experience relative to many of the problems and critical issues surrounding small business equity within the federal contract arena.

There is a failure by government program and procurement officials to grasp the magnitude of the problems relative to the plight of small business vying for federal contract dollars. The procurement system, especially relative to small business, is severely "broken" and must be quickly fixed. Accountability, compliance, and enforcement of existing rules, policies, and regulations pertaining to small business utilization are being ignored and, in many instances, carefully circumvented by both government and large business.

In general, the entire concept of small business participation and sharing in federal contract dollars is a well-managed system of omission and deception, which is carefully camouflaged with misinformation and cooked numbers and statistics. This environment thrives only because there exists no viable federal government system of enforcement vested with the appropriate authority and mandated to enforce compliance and accountability by government procurement officials and large business contract management.

Stronger measures are required to force government procurement officials and large, government prime contractors into compliance. Prime contractors and government procurement managers are not committed to compliance or enforcing rules and regulations that currently exist. Particularly, when there is no anticipated consequence of substance or penalty for noncompliance, it is unreasonable to expect that retrofitted rules that are currently being developed will result in significant change in current practice without also inclusion of strict accountability and penalties for noncompliance.

Over the years, I have observed large business and procurement officials, in every way imaginable, undermine small business in the government-contract arena. Loopholes and practices by which small businesses get shortchanged by both large business and government must be eliminated.

I have teamed with large businesses on major contract initiatives as the mandatory, small business participant, only to be denied the work share promised me after the contract was awarded.

Concepts such as contract bundling and evergreen contracts are killing off small business. I wish to repeat: killing off small business. This is a huge problem, with wide-ranging dynamics. Multiple agencies, be it GSA, SBA, and others, are each focused on different aspects of the problem. I implore this Committee to take the leadership and initiative to influence measures that will lead to comprehensive, effective, procurement reform. Again, we need small business contractor utilization enforcement with teeth. We need rules and regulations that are enforceable and cannot be ignored by large business and government procurement managers.

Much attention has been given to bundling and size classification. The issues surrounding bundling and annual size certification are obviously at the top of the list of reform priorities. However, they only represent a tip of the small business iceberg of problems and inequities which prohibit the so-called "level playing field" in the small business government-contracting arena.

Speaking as a small business owner who has fought the equity battle for 20 years, I encourage meaningful procurement reform that effectively addresses the plight of small business and includes mandated rules and enforcement provisions that assure small business participation and equity.

In closing, the following represent areas of concern that I feel must thoroughly be considered with regard to the impact of small business on any significant reform. All future procurement-reform initiatives must be comprehensively and thoroughly thought out and crafted prior to implementation. Part of the existing problems exist because that hasn't been done.

Accountability and compliance regarding small business utilization should be mandated and enforced at all levels of government procurement. Penalties should be leveled for breach of teaming agreements and subcontract terms and conditions by large businesses when subcontracting to small businesses.

Eliminating the practice of large business prime contractors of limiting small business subcontractors to low-tech services and "body shop" providers. Level-of-effort caps should be placed on large businesses performing as a subcontractor to small businesses where procurements is a small business set-aside. Disallowing small business utilization credits achieved through mentor-protege arrangements that are primarily used by large businesses to win contracts but do not result in actual mentorship of the small business.

Mandatory flow-down provisions of contract clauses that mandate utilization of small business subcontractors; and, finally, a revisiting of the size-standard definition for small businesses and mid-sized businesses. Currently there exists much confusion between revenue level versus head-count levels.

I thank you for allowing me to share with you some of the critical small business issues that I feel must be dealt with effectively if any meaningful federal procurement reform is to come about. In closing, I encourage this Committee to vigorously support small business equity in the federal government contracts arena. I thank you. I will entertain any questions, as appropriate.

[Mr. Robinson's statement may be found in the appendix.]

Chairman MANZULLO. Thank you. Our next witness is Professor Steven Schooner from the George Washington University Law School. We look forward to your testimony.

STATEMENT OF STEVEN L. SCHOONER, PROFESSOR, THE GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

Mr. SCHOONER. Chairman Manzullo, Ranking Member Velazquez, and members of the Committee, I appreciate the opportunity to discuss small business participation in the federal procurement process.

I will address four issues. First, small business continues to thrive in the federal government marketplace. Second, as the government turns its attention to management and control of the purchase card program, the small business community must not squander this window of opportunity. Third, while I encourage efforts to better manage small business awards under multiple-award contracts, I urge caution in imposing remedial measures. And, finally, I will attempt to interject a dose of pragmatism into the bundling debate.

First, the outlook for small businesses pursuing federal government contracts is bright. Despite isolated problems, the small business share of federal procurement dollars remains remarkably high. As the chart in my statement demonstrates, Fiscal Year 2001 was a terrific year for small business. Small businesses received an additional $5.3 billion in contract awards, an increase of more than 12 percent. While the rather recent, 23 percent goal has not been met for the last two years, the small business share has remained above the longstanding 20 percent threshold.

Returning to the chart, let me draw your attention to the purchase card statistics, where the picture looks less rosy for small business. Purchase card transactions now exceed five percent of procurement spending. As the government's purchase card use has grown, small businesses have struggled to maintain their ability to sell to the government below the $2,500 micro-purchase threshold.

For nearly 25 million transactions, law, policy, and practice all too often permit purchase card users to ignore normal procurement rules and procedures. To the extent that regulations may require efforts to rotate purchases among vendors or encourage the use of small business, this guidance is routinely ignored. Anecdotal evidence suggests that buyers frequently disaggregate their requirements to take advantage of the streamlined, micro-purchasing regime.

Recent attention, however, from GAO, the Congress, OMB, and the IG community has altered the trend and sparked initiatives to rein in irresponsible purchase card usage, insufficient purchase card management and oversight, and inadequate purchaser training. The small business community can ill afford to relax during this window of opportunity. The time is now to demand insight into purchase card usage trends and appropriate controls on their use.

One of the concerns that animates this hearing derives from reports that certain small business opportunities end up in the hands of large businesses, formerly small businesses that have graduated, or small businesses that, during the course of contract performance, grew out of their previously certified size status.

The worst aspects of this problem are avoidable. Contractors that fraudulently certify their size status should be prosecuted. For multi-year, multiple-award, task order or delivery contracts, where individual tasks or delivery awards are, in effect, new contracting actions, it seems eminently reasonable to require annual recertification of size status, but caution is appropriate. Size standards are, at best, artificial and, at worst, arbitrary. It is disingenuous to bemoan advantages bestowed upon contractors that recently pierced these arbitrary thresholds. Obsessive compliance could elevate form over substance.

In a vibrant marketplace, some small firms will merge or acquire other small firms. They will be acquired by large firms, or they will quickly develop business that will disqualify them from future small business opportunities. None of that is inherently nefarious, nor should it interrupt the government's contractual relationships.

Changing the longstanding policy which treats companies as small for the duration of contract performance would be unnecessarily chaotic. Accordingly, a high degree of precision, coupled with carefully calibrated flexibility, is required in any legislative solution.

Turning to bundling, while I am sympathetic to the antibundling movement, I remain troubled by the disconnect between aspiration and reality. There are costs associated with unbundling, and the current debate fails to acknowledge them. Quite simply, demanding that an overworked, acquisition work force aggressively unbundled its contracts is akin to trying to squeeze blood from a stone. If the government wants its contracts unbundled, we must have a meaningful discussion about how to pay for the additional effort. Any unbundling initiative otherwise is an unfunded mandate, burdening and already strained acquisition process.

More contracts are bundled today because our acquisition personnel must buy more goods and services with ever-decreasing acquisition resources. Let us be frank. There are simply not enough qualified professionals left in the federal government to conduct appropriate market resource, properly plan acquisitions, maximize competition, comply with a plethora of congressionally imposed social policies, administer contracts to assure quality control and guarantee contract compliance, resolve pending protests and disputes, and close out contracts.

Moreover, due to the administration's emphasis on competitive sourcing, we will continue to see growth in service contracting. Service contracts are difficult to draft, and they require significant resources to administer. Asking the current work force, without additional resources, to unbundle requirements is unrealistic and fiscally irresponsible.

Demanding that buyers do more with less is good theater, but it is not responsible leadership. No matter how well intended OFPP's recently proposed, antibundling rules will increase burdens on procurement managers, but no investment will be made to facilitate the efforts.

At the same time, I applaud OFPP's initiative to mitigate the effects of bundling by strengthening compliance with subcontracting plans. In today's environment, it makes sense to shift to the private sector responsibilities and functions that the government is unable or unwilling to support with its own resources. If the government is unwilling to devote resources to identification, nurturing, selection, and management of small businesses through prime contracts, the government can more aggressively enlist its larger prime contractors to help achieve the same ends.

Increasing subcontracting plan compliance will require answers to difficult questions, specifically, what personnel will be deemed responsible for monitoring contract compliance with subcontracting——.

Chairman MANZULLO. How are you doing, Professor? You are over.

Mr. SCHOONER. I am done. That concludes my testimony. Thank you for the opportunity to share this information. I would be pleased to answer any questions.

[Mr. Schooner's statement may be found in the appendix.]

Chairman MANZULLO. I wonder if you were really done.

Mr. SCHOONER. Was I done?

Chairman MANZULLO. Okay. All right. That is fine. Thank you.

Our last witness is David E. Cooper, contracting issues director at the U.S. General Accounting Office. I look forward to your testimony.

STATEMENT OF DAVID E. COOPER, DIRECTOR, ACQUISITION SOURCING MANAGEMENT, GSA; ACCOMPANIED BY DAVID DRABKIN, DEPUTY ASSOCIATE ADMINISTRATOR FOR ACQUISITION POLICY, U.S. GENERAL ACCOUNTING OFFICE

Mr. COOPER. Thank you. Chairman Manzullo, Ranking Member Velazquez, and members of the Committee, it is a pleasure to be here again before your Committee to discuss a very important topic. At your request and a similar request from the Senate Small Business Committee, we reviewed contracts placed with large companies to determine why contracting officers were treating those awards as going to small companies, small businesses, and reported in the Federal Procurement Data System as such.

According to the Federal Procurement Data System, the five companies that we looked at received federal contracts totaling almost $1.1 billion in Fiscal Year 2001. Four hundred and sixty million dollars of that amount was reported as small business awards in the FPDS.

To understand why contracting officers were reporting awards like that, we selected 131 individual contract actions and went to four buying activities, four federal buying activities, where we talked to contracting officials that placed those orders. We found that the primary reason for the misreporting of small business achievements is that the federal regulations currently permit a company to be considered small over the life of the contract they have won, even if the company grows into a large business, mergers with another company, or is acquired by a large company.

Given that the term of a contract in today's federal acquisition environment can extend for many years, and we have heard several witnesses talk about up to 20 years, it is not surprising to see some companies grow from being a small business and, therefore, no longer qualified to enjoy the benefits that a small business enjoys. However, despite changes in their sizes, contracting officials continued to report those contracts as if they were small business contracts. One hundred and fourteen of the contract actions we reviewed were misreported for that reason. The other 17 actions that we looked at were misreported because contracting officials relied on data systems that contain conflicting and incorrect information about the size of the companies.

Page seven of my statement shows what can happen when contracting officials rely on bad data. In the situation that is described on page seven, an order was placed on a NASA, government-wide-

acquisition contract. The company receiving the order had clearly certified itself as a large business. However, when reporting the order to FPDS, the contracting official used information in its own agency's database that showed the company was a small business. Therefore, it was reported incorrectly and inflates the achievements reported annually by the FPDS.

While our results cannot be projected to all contract actions reported in FPDS, they raise serious questions about relying on the systems data to measure federal agency efforts to meet the government's 23 percent annual goal. The General Services Administration, the Office of Federal Procurement Policy, and the Small Business Administration, as you have heard already, have undertaken a number of actions or proposed actions to address this problem.

Generally, the actions would require small businesses holding long-term government contracts to recertify annually that they are, in fact, small businesses. When the proposed changes are implemented, companies will no longer be permitted to retain their small business status. Considering the duration of current federal contracts, we believe it is reasonable to require a recertification.

On April 25th, the Small Business Administration published proposed rules in the Federal Register for comment. Comments are due to SBA by June 24th. In addition to the recertification issue, we believe further efforts are needed to ensure federal databases contain accurate and reliable information so that contracting officials know the size of the company they are doing business with.

That concludes my statement. I will be glad to answer any questions.

[Mr. Cooper's statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much. With regard to these databases, I am a little bit confused. On page two of Mr. Armendariz's statement, it says: "PRO-Net is not designed or intended to validate the small business eligibility of a registrant." And then on page five of Mr. Mendoza's statement, it says: "Contracting officers do not check FPDS to determine the size status of a contractor." But in the last testimony of Mr. Cooper, even though a company had self-certified itself as a large corporation on one database, that agency checked its internal database and found out that it was small. And then on page four of Mr. Chapman's testimony—you guys didn't think I was listening, did you?

[Laughter.]

Chairman MANZULLO. It states that he had sent a letter to the SBA. MISA attorneys—what is "MISA"?

Mr. SCHOONER. The Microcomputer Industry Suppliers Association.

Chairman MANZULLO. Your association, okay, sent a letter to the SBA asking that they notify all federal agencies and prime contractors of the firms that have been removed from PRO-Net CCR. In the SBA's March 21, 2000 response to MISA's attorneys, the SBA refused to notify agencies and prime contractors that the firms had been removed.

My first question is, does the SBA have any obligation to notify any agencies or prime contractors that the firms have been removed as a small business?

Mr. ARMENDARIZ. The SBA conducts informal size determinations and, therefore, doesn't report that data to the agencies.

Chairman MANZULLO. Well, why not?

Mr. ARMENDARIZ. There are no grounds for it because it is an informal review. Only if there is a protest, and the protest determines that that company is and, in fact, through a formal size determination, other than small we report that back to the agency.

Chairman MANZULLO. Well, then this is former Congresswoman Helen Bentley's problem, where a company that she is trying to help out, Rayloid—this is what is involved in a protest. You have to hire a law firm to file these formal court documents.

I would think this is pretty simple, to determine whether or not somebody is large or small, and I don't understand the complexity—before the Office of Appeals of the U.S. Small Business Administration. These little guys are literally thrown into court against these big guys, and this stuff goes on and on. Your answer probably is that Congress is the one that mandated this appeals process. Would that be correct, Mr. Armendariz? Is this part of a federal review process?

Mr. ARMENDARIZ. The initial size determination is done at the staff level, and then from there, what you are discussing here is an appeal of that determination.

Chairman MANZULLO. There is an appeal level on it?

Mr. ARMENDARIZ. Yes.

Chairman MANZULLO. Okay. Then how long does the appeal level take? Any clue? Is it three months? six months? a year? Does anybody——.

Mr. ARMENDARIZ. They are relatively quick. We do the initial ones typically within 10 to 15 days.

Chairman MANZULLO. You mean the in-house.

Mr. ARMENDARIZ. Correct.

Chairman MANZULLO. And then the appeals?

Mr. ARMENDARIZ. It depends on the complexity of the issue.

To back up even further, I think one of the main problems in regards to why there is so much confusion is the size-standard system itself. You know, currently, we have 32 different size standards. Some of them are employee based, some of them are revenue based.

Chairman MANZULLO. Well, we are going to address all of those. This thing is getting to the point where, in the reauthorization of the SBA, we might just make a determination ourselves and say that is it. You have three people on staff that do size determinations, and I know they wrestle with it on a continuous basis.

Mr. ARMENDARIZ. And I wrestle with it personally. People ask me, "I do X for a living. Am I small?" and I literally have to go to the NAISC codes and figure out exactly what they do to understand if they are small. I go back to my own personal business experience when I was a small business person in California, and I found out afterwards, I was not a small business because I had one too many employees.

Chairman MANZULLO. What I would like, if there is anything that you think can be done in the reauthorization that would simplify this, and I would address this to all interested parties, too, let Mr. Crouther know, again, not to exceed two pages, single spaced,

12-point type, sufficient margins to make notes on each side. But we are really interested in trying to make that an easier standard on that. I would appreciate that.

Mr. ARMENDARIZ. We currently have a task force that has met now three times in the past month that is working on this issue exclusively, and the contributing parties are DoD, OMB, and SBA. So we, too, would love to gather information and input from the general public as well as the Committee.

Chairman MANZULLO. The related question on there is, an agency, a federal agency, would go to PRO-Net or would go to—Mr. Mendoza, what is the name of your——.

Mr. MENDOZA. The Federal Procurement Data System.

Chairman MANZULLO. Okay. Both of you state that what is stated in there is not to be a statement of the agency as to the verification of the size. Is that correct? Is that correct?

Mr. ARMENDARIZ. Well, FPDS is not a database that the SBA manages. We manage the PRO-Net database, and the PRO-Net database was established primarily with a focus of a tool that small business could utilize to market themselves to agencies. The only aspects of that that are filtered through our processing in our office for approval in regards to which certifications they hold are the 8(a) certification, the HUBZone certification, and the SDB certification.

Chairman MANZULLO. Those are the ones that you monitor before they go up on the PRO-Net.

Mr. ARMENDARIZ. We trigger those ourselves. All of the certifications are self-certified, and we also make sure that the agencies understand that. We go over that time and time again, that the agencies must do the verification at the time of the award.

Chairman MANZULLO. Mr. Mendoza, your answer would be the same. Is that correct?

Mr. MENDOZA. That is correct.

Chairman MANZULLO. Well, then where does the agency go to determine the size? Mr. Cooper, could you help?

Mr. COOPER. Yes. Can I elaborate on that? First, I want to make one thing clear. When we talk about databases, we are not talking about the FPDS. The FPDS is a collection system. It is not a system you go to to check a small business size. The systems I am talking about are PRO-Net, the Central Contractor Registration System that is now being expanded to include not just Department of Defense contractors but all federal contractors, and I am talking about the individual agency systems that have grown up over time and are being used by the people placing these orders.

And the problem that we identified, again, going back to that page seven, when that contracting official went and placed that order on that NASA GWAC, clearly the company they placed the order with had self-certified when they got the GWAC that it was a large company. It wasn't trying to misrepresent itself or anything else. But when the contracting official entered the information into the form that goes to FPDS, its agency system is set up and had recognized that company as a small business.

Chairman MANZULLO. That didn't raise a red flag with that bureaucrat?

Mr. COOPER. Not a bit.

Chairman MANZULLO. Wonderful.

Mr. COOPER. And that is the problem of a lot of different databases being used. Sometimes contracting officers just using their knowledge of the size of the company——.

Chairman MANZULLO. One of the things that I am going to suggest—in fact, we might put it into the reauthorization—is that any company that certifies itself as a small business and gets a contract and gets money from that will result in a forfeiture of every dime that they have received as a result of misstating the size——.

Mr. COOPER. I think that is the way the regulations are written today, Mr. Chairman.

Chairman MANZULLO. Has that ever happened?

Mr. COOPER. Yes.

Chairman MANZULLO. It has?

Mr. COOPER. Yes.

Chairman MANZULLO. Does anyone want to elaborate on that?

Mr. COOPER. We did a protest on the size of a company probably in the last four months, and we sustained the protest because the company was a large company and should not have gotten the award, and they didn't get the award.

Chairman MANZULLO. But that was before the award was given.

Mr. COOPER. During the process of the award.

Chairman MANZULLO. Professor?

Mr. SCHOONER. Historically, if you factor in the False Claims Act and the fact that the small business certifies its size status, once they receive the contract, if they submit invoices, which they do in order to become paid, they have falsely certified, and so every invoice, for purposes of the False Claims Act, is counted against them. There are monetary penalties and, ultimately, criminal penalties.

One reported decision that would be an interesting one to look at historically is the Jets case, where you had a small business that had falsely certified its size status. There were criminal prosecutions, staggering penalties. It is a very, very risky approach for a large business to take, and the government's arsenal to fight that, if it is identified, is a powerful one.

Chairman MANZULLO. Yes, but they are doing it all the time.

Mr. SCHOONER. But if I could respond, Mr. Chairman.

Chairman MANZULLO. Yes.

Mr. SCHOONER. The problem still comes down to resources and enforcement. As I suggested in my written testimony, this is a classic case where there aren't enough government employees——.

Chairman MANZULLO. There are 28,000 procurement officers in the Department of Defense. How many more do we need?

Mr. SCHOONER. You need significantly more, Mr. Chairman, because they were cut dramatically during the 1990's. There was no empirical evidence whatsoever to justify the cuts. There is a terrific report out by the General Accounting Office, just in the last couple of weeks, talking about the dramatic cuts that were made for purposes of just literally arbitrary downsizing. And so the problem still comes down to who is going to enforce.

This is a classic situation where third-party oversight is appropriate, the key TAM provisions that empower competitors. The competitor is in the best situation to know when an other than

small business gets a small business contract. So let us empower these people and have the enforcement mechanisms work.

Chairman MANZULLO. So that would allow somebody who had been bumped the right to sue in court.

Mr. SCHOONER. Indeed.

Chairman MANZULLO. Ms. Velazquez?

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Mr. Armendariz, you said in your testimony that over the past six months more than 600 businesses have been removed from PRO-Net because they are not small businesses, according to the SBA size standards. Are you now convinced that there are no large businesses in PRO-Net?

Mr. ARMENDARIZ. Absolutely not. I believe that, at any given time, that we can identify businesses that either are erroneously or mistakenly placed on PRO-Net or purposely placed on PRO-Net.

Ms. VELAZQUEZ. Well, as far as I can tell you, the PRO-Net still lacks integrity. You also state in your testimony that the SBA will request a registrant in PRO-Net to verify the accuracy of the submitted business-size information and acknowledge that it understand the penalties associated with falsely certifying as a small business on government contracts and subcontracts.

What about false statements, as far as PRO-Net regulation? Will you be including certifications in PRO-Net to ensure information submitted for regulation in PRO-Net is true and accurate?

Mr. ARMENDARIZ. I am not sure if I understand the question, ma'am.

Ms. VELAZQUEZ. Don't you recall that there was a recommendation from your inspector general to include false statement, as far as PRO-Net regulation?

Mr. ARMENDARIZ. Yes, ma'am.

Ms. VELAZQUEZ. Why you didn't include it?

Mr. ARMENDARIZ. We are working on that as we speak. We are fully implementing all of the IG's recommendations in regards to PRO-Net.

Ms. VELAZQUEZ. Will you be including regulations on penalties in making false statements in all PRO-Net certifications?

Mr. ARMENDARIZ. We refer all irregularities to the IG.

Ms. VELAZQUEZ. Will you please answer me, yes or not? I am asking you if you are going to be including regulations on penalties in making false statements in all PRO-Net.

Okay. So let us make it short and sweet. For the record, are you going to implement your inspector general's recommendations?

Mr. ARMENDARIZ. Yes.

Ms. VELAZQUEZ. Okay. Let us move to the next question.

Mr. Cooper, shortly, the administration will come out with data that is supposed to tell us what the small business share of federal contracting is. Will the contract awards to large businesses coded as small business awards cause an inflation in the numbers reported for small business awards?

Mr. COOPER. As I stated in my testimony, we have serious concerns about relying on any of that data to measure small business achievements.

Ms. VELAZQUEZ. In your opinion, does this bring the credibility of these numbers into question?

Mr. COOPER. Yes. Based on the work we have done and the reporting that we have seen, it is not right.

Ms. VELAZQUEZ. Are there adequate measures of accountability in the President's bundling plan?

Mr. COOPER. I testified on March 18th over on the Senate side, and I raised questions at that point about whether there would be good data to measure whether, in fact, the strategy will achieve the outcomes, that is, more opportunities for small businesses.

Ms. Styles mentioned today, we are going to be working with them to try to come up with some real, statistical measures so that we can see. There are a number of provisions like actions taken to mitigate the consequences of bundling, teaming of small businesses, and we are going to be trying to come up with some measures in order to be able to measure whether those things are, in fact, happening or not.

Ms. VELAZQUEZ. In your opinion, will the President's bundling plan cause a significant change in the current federal procurement environment for small businesses?

Mr. COOPER. I think that remains to be seen.

Ms. VELAZQUEZ. Thank you. Mr. Schooner, would you agree with Mr. Cooper that the administration's bundling plan includes no accountability measurements?

Mr. SCHOONER. Yes.

Ms. VELAZQUEZ. Would you agree that without resources and accountability—I think that you answered the question before, but I just want to be on record asking you the question—would you agree that without resources and accountability, the President's plan will not succeed?

Mr. SCHOONER. Yes. I think the only real target of opportunity in the President's plan as stated is with regard to the subcontracting plans and basically shifting the responsibility for identifying subcontractors to the large, prime contractors.

Ms. VELAZQUEZ. Mr. Cooper, in regulations proposed on April 25th, the SBA suggests that an annual certification of all small businesses seems to be the answer. That seems to be very burdensome on small companies. In fact, the SBA's own analysis suggests that only six to 12 businesses will be impacted. Doesn't it make sense to have only those small businesses whose business changed from small to other than small provide notice to relevant agencies that their size has changed?

Mr. COOPER. I think the SBA, when it sits down and looks at all of the comments it is going to receive, I would be highly surprised if it doesn't get that issue. And I think instead of burdening 6,000 small businesses—I think that was the number they had in that regulation—maybe we need to deal with the exceptions, and if it is only six to 12, that is a lot of burden that you are not going to place on a lot of companies, so that could be a very reasonable approach to take.

Ms. VELAZQUEZ. Thank you. Mr. Armendariz, we do not expect Ms. Styles' office, the GSA, or any other agency to ensure that small businesses are treated fairly. That is the job of the SBA.

What concerns me is when small businesses' own advocate sells them out. Time and time again, rather than assuming your role, which can, in some cases, be adversarial because you are supposed

to be holding people accountable, the SBA caves in, to the detriment of small businesses. You have yet to break up any big contracts, and I would like to bring up a case in point that highlights SBA's outrageous actions.

On the GSA FPDS–NG contract, small businesses objected and went to the SBA to let you know that they had been shut out. Your own PCR said the same thing. At that time, you told this Committee that GSA said there were not small businesses to perform this contract, and you believed GSA over the concerns of small businesses and your own employee. Those two factors should have caused you to support an appeal action to the agency on this contract, but you didn't. Instead, you took the easy way out and did exactly what the agency wanted.

It turns out that the small businesses and your PCR were right. Out of 27 bidders, 20 were small, far more than the two required to restrict this project to only small businesses, as Congress intended. With all of this, do you think you pursued the correct course of action?

Mr. ARMENDARIZ. Well, in retrospect, there obviously was a small business that was able to handle this procurement. At the time, we consulted with GSA quite extensively, over a course of many meetings, and it was our opinion at the time, and we stand by that opinion, that it was the prudent thing to do, to allow GSA to offer that full and open.

I will applaud the small business community, though, and the specific contractor that was awarded this contract. It just proves to us and proves to the balance of the agencies that small business can compete full and open when it has to, but we would have liked to have seen it gone as a small business set-aside, and at the time——.

Ms. VELAZQUEZ. I can tell you that your actions on this specific contract really impacted the credibility of SBA regarding increasing opportunities for small businesses. You know, a small business got the contract in spite of what you did, in spite of your actions.

Chairman MANZULLO. Mrs. Napolitano?

Ms. NAPOLITANO. Thank you, Mr. Chairman. There are a number of questions, and I am not quite sure where to start.

The SBA office in my area has been very helpful to some of my businesses, but there still, nonetheless, remains the fact that a lot of the small businesses that I have have contacted me, and I visit one at least every weekend that I get home, and have made it quite clear to me that they are not able to crack the SBA nut, so to speak. And it kind of bothers me because we have been on contract bundling for how long now? At least, I have been here four years, four and a half, whatever. But there seems to be an issue with you stating you have 33 definitions for small business.

Mr. ARMENDARIZ. Yes, ma'am.

Ms. NAPOLITANO. How do we put it in balance so that we are able to identify the truly small businesses and the ones that are really giving our economy the boost it needs and not the major contractors that can afford to be able to do the major contracting? That is a very, very troubling question for me.

Mr. Mendoza, does the GSA keep track of the awards made to schedule contract holders, and, if so, would you please provide this

Committee, within the next 10 days, if possible, of the awards made to schedule holders for the past five years, separated out by small, small disadvantaged business, women-owned business, and the 8(a) firms, including both number and dollar of task orders?

The reason for that, for me, is to individually determine whether or not we are really getting small businesses, the disadvantaged, the women-owned, if they are being successful and how successful the 8(a) firms are in being able to get there.

The second question would be, does the GSA get small business gold credit for the schedule contract holders, or do individual agencies, or both of them, get credit for this? It is my understanding that GSA codes all of its schedule holders into the FPDS. Part of the problem for the DEERs is that when an award is made to one of these companies, the system defaults to the size that the firm was for purposes of the GSA schedule, thereby showing an award to a small business when the award was actually to a larger business. Will the FPDS–NG correct this error? Would you reply?

Mr. MENDOZA. Yes, ma'am. Let me refer that question, the answer, to Mr. Dave Drabkin, who is my senior procurement analyst at GSA. He has been there the longest, and he is the senior procurement specialist. He can answer that question for you.

Chairman MANZULLO. Do you want to scoot up to the table, please? Why don't you come over to the end over here, and if you could state your name into the record and spell the last, please. Thank you.

Mr. DRABKIN. My name is David Drabkin, D-R-A-B-K-I-N. I am the senior procurement executive at GSA.

Chairman MANZULLO. You have to talk into the mike. Thank you.

Mr. DRABKIN. All contract awards above $25,000 are reported individually into the Federal Procurement Data Center, regardless of where they are made, by whom they are made, or against what vehicle they are made. So every time a schedule order with a value of $25,000 or more is placed, it is recorded in the database. The database gives credit for the small business category to the agency that places the award. We have that for small businesses generally. We have that now for women-owned businesses, I believe, and we are working on 8(a) and HUBZone businesses as well. So the agency that actually is buying the work gets the credit for their contract dollars.

It is true that the schedules are placed into the FPDS database, and at the time of the award, their size status is determined. That is based upon a rule from the Small Business Administration, which, at the time the rule was made, it kind of made sense. At the time the rule was made, many years ago, the average government contract was for one year and had four one-year options, and it really didn't make sense to interrupt that relationship, particularly since small businesses have a habit of growing and sometimes contracting.

Of course, we like them to grow; that is the whole purpose of the program. And it wouldn't make sense that a small business that might grow one year because it gets a little extra business and then contract the next year would go into a category one year of other than small and the next year as small again.

However, our rules changed on the schedules in the mid–1990's, and we created something called the Evergreen program, which essentially created a 20-year contract: a five-year base period with three five-year options for the schedule contracts themselves. At the time we changed our rules, we did go talk to SBA because we realized that that didn't make sense anymore. Five years might make sense for keeping a small business small for reporting purposes, but going to 20 years just didn't make any sense, and it took us a number of years to work that out.

We had to make a decision because we were about to award two new GWAC contracts, one for 8(a)'s and one for HUBZones, and we wanted to make sure that at the time we awarded those contracts that the rules were clear that we would, at least at the end of the option period, require a re-representation of the size status of the company.

I didn't write down your whole question. Have I answered it all?

Ms. NAPOLITANO. You answered part of it, I believe. What about the 8(a) firms?

Mr. DRABKIN. We keep all of the statistics. I don't believe we give 8(a) credit for schedule awards to the agency that placed the order. I believe, right now, that is reported as a GSA credit, but I can clear that up when we submit the written answers to your questions.

Ms. NAPOLITANO. Well, okay, then. How do you determine if that business that you had—I am sorry, Mr. Manzullo, if I may finish the trend—if the company, as you say, has started off small business has gone and become a large business because of the order and then comes back down, if that company goes out of that small business slot, how do you determine it? Do they have to reapply? Do you make the determination based on what?

Mr. DRABKIN. Under the current SBA rule, the rule in effect, the rule says that you remain whatever size you are on the day we award you the contract for the length of the contract. Like I said, at the time the rule was made, it was a great rule, but times have changed, and how we manage procurements has changed.

So the answer to your question is, under our rules, except for in GSA, where I issued a deviation to the SBA rule so I could change that rule for our GWACs, under the other rules that exist in the government, the size you are on the day you sign the contract until the day that the contract closes, no matter how long the contract is, and no matter what happens to your size status or your other small business status, but that is a rule. I mean, that is not a factor of anybody doing anything nefarious. That is a rule that is in place.

Ms. NAPOLITANO. One more question. How many GSA employees are charged with marketing the schedules program?

Mr. DRABKIN. We will have to send you the number. I don't know.

Ms. NAPOLITANO. Okay.

Mr. DRABKIN. I am in charge of the procurement people. I can tell you how many there are.

Ms. NAPOLITANO. Okay, because apparently small businesses have experienced consolidation of the contracts into schedule pro-

grams, and it would be nice to know, and, if so, does GSA encourage this?

Mr. DRABKIN. I am sorry. Encourage what, ma'am?

Ms. NAPOLITANO. Well, the experienced consolidation of the contracts into schedule programs, and is GSA encouraging this consolidation?

Mr. DRABKIN. There is something called the Corporate Contracting Initiative, which is an effort to get companies that are on multiple schedules into a single contract to reduce the cost of administration to the company and the cost of administration to the government. The program is in its infancy. It began about two years ago. It is not receiving a lot of support from the private sector. There are small and large businesses who are participating in that program, mostly large because they tend to have multiple contracts in multiple, different areas because they tend to have different types of work.

Ms. NAPOLITANO. Thank you, Mr. Chair.

Chairman MANZULLO. Mr. Case?

Mr. CASE. Thank you, Mr. Chair. I am trying to sort this through myself, and listening to the panel, it strikes me that there is one person on the panel that has been in the field, and that is you, Mr. Robinson. You have a nice poker face, but a lot has to be going through your head.

I want to give you kind of the floor here. I want to listen to what you think about the other testimony because I am sure that is what is running through your mind is, well, that is true, and that is not true, and that is not really how it works when you are out in the field, and it is nice to talk about it in principle, but that is not really what is going on, and maybe they don't know what is really going on.

Tell me what you thought about what you heard. Where are the problems in the field, on the front lines, where you live?

Mr. ROBINSON. Well, I think that the problem is far greater than it has been represented here, generally. A lot of the focus here has been on the process of small business evolving into big business. That is only the tip of the iceberg, as I said earlier. A lot of this whole concern with respect to small business equity deals with big business that unwillingly share and, in many instances, mistreat small business, and I don't think that is being addressed to a great extent here. We are concerned with those instances that have gotten a lot of press recently where small business has received awards, and, in fact, they have grown into big business.

So I think the breadth of the problems that exist here is far greater than bundling and size classification. There are many, many other issues that need to be addressed across the global terrain here.

Mr. CHASE. Mr. Chapman gave us a list of 10—I think there were 10—areas, fairly specific. You heard his testimony.

Mr. ROBINSON. Yes.

Mr. CHASE. Do you agree with his testimony?

Mr. ROBINSON. Absolutely.

Mr. CHASE. How much of the tip of the iceberg is that? Are we down to half of the iceberg yet?

Mr. ROBINSON. It is a big chunk. It is a big chunk of it.

Mr. CHASE. Were there any things that were left off of his list that you thought, oh, you should have put that on the list?

Mr. ROBINSON. Well, I am sure he did not cover all of the concerns that not only I have but many other of my fellow small businesses have. I think there has to be greater dialogue. Earlier today—I can't recall now—maybe it was Administrator Styles indicated that there had been an effort to open dialogue with small businesses. I really wish I had been included.

I am not certain how that group of small businesses were identified or who participated, but I don't think that the full breadth of the problem was conveyed, and I think that there needs to be more of that sort of thing, more dialogue with small businesses, with companies such as myself, who are down there in the trenches and who experience the kinds of misrepresentation of the fact.

I have had tremendously bad experiences with teaming with big businesses, for instance. We participate very eagerly and energetically in assisting big businesses to win huge contracts. They usually come to us because we represent a slice of the technology or a small area of expertise that they cannot support out of their own arenas. However, there seems to be a systematic way that, when it is all said and done, we, the small business, end up being shortchanged, either with work or promises of work that eventually is kept in house for the large business or sent offshore or whatever. This is a growing, growing problem that no one seems to be addressing, at least, in my opinion.

Mr. CASE. Mr. Chapman, any observations as well from the testimony you have heard? Are we getting to the bottom of anything here?

Mr. CHAPMAN. I don't think so. I would like to make a couple of points.

When the gentlemen here that work for the government talk about small businesses, here is one of them, AT&T Wireless—it is on PRO-Net, updated about four or five days ago—with 20,000 employees and $5 billion in sales. That is on PRO-Net right now while we are sitting here.

Mr. Cooper talked about the survey that they did, and I am assuming that their survey was fairly representative, and based on my calculations here, it sounds like it was about 45 percent of the awards that they showed that were going to small business that were actually large businesses. If you look at the SBA's number of $85 billion and apply Mr. Cooper's numbers, that is $35 billion a year, and these guys are talking like it is a little, minor, bookkeeping problem. That is $35 million a year.

I saw on the news the other day that 1.9 million Americans have been out of work for six months or more, and 40,000 people lost their jobs in April. That is a big deal. Thirty-five billion dollars a year is amazing. I don't know this gentleman, but he said something that just blew me away. He said, at one point in time, we realized that letting people keep small business contracts for 20 years wasn't a good idea.

When was that a good idea? When was that ever a good idea, to let someone keep a small business contract for 20 years? And what concerns me is those are the people that we are looking to for solu-

tions, the people who thought that was a good idea to let some small business keep that for 20 years.

One gentleman said small businesses are thriving. Remember, they are talking about, you know, billion-dollar companies. They are talking about the biggest companies in the world. Today, as we sit here, you know, some of the biggest companies that are household names that any 10-year-old kid would understand are on PRO-Net, and I am just completely floored, you know, that they don't think that is a problem.

But, again, I would like to ask one thing of the Committee. Can we get rid of the term, "other than small"? When they abbreviate it, it shows "OTHR small business," and people think it means "other small business." That is like calling people that are dead "other than alive." There is large, and there is small, and I personally think that the concept, "other than small," is indicative of the type of terminology that you see——.

Chairman MANZULLO. Mr. Case, would you yield on that?

Mr. CASE. Yes.

Chairman MANZULLO. Would anybody here like to answer that question as to why "other than small" appears?

Mr. ARMENDARIZ. Well, I would like to answer several of the statements that Mr. Chapman made, and I think he misheard what you said earlier, if I may. I believe what GSA said was that when the regulation was in place, we never envisioned having 20-year contracts. At that time, the regulation made sense. Times have changed. We need to change regulations, and we have got a proposed regulation right now out to the public. So that is issue number one.

Issue number two is that companies like AT&T—I fully agree that AT&T should not be listed in PRO-Net, but there is a reason. We researched how AT&T got placed on PRO-Net. When we merged CCR and PRO-Net several months ago, about six months ago, there were several large companies that leaked on. I guarantee you that there is not an executive over at AT&T that went on and put themselves on PRO-Net. It happened via the merger.

So we are concerned. This is a huge issue for us. We live and breathe this issue every single day. The small business community is the reason we came to the SBA. We believe it, deep down in our soul, and we are coming up with creative and innovative solutions to address the problems. We commend Mr. Chapman. We need more Mr. Chapmans out there because he is helping us solve the problem, but we can do it together, not unilaterally.

Mr. CASE. Thank you.

Chairman MANZULLO. You know, there is something wrong here, and we are going to get to the bottom of this thing, if I have to spend an entire day issuing subpoenas to bring large companies before this Committee, and I will examine them personally to see if they are large or small, and I will raise so much Cain doing that, that they will pull themselves out of the system.

Let me tell you what happened in Los Alamos. We were invited to go down there by Congressman Tom Udall, who is a member of our Committee, and he said, You would not believe what is happening down there to the local Indian tribes and others, the Los Alamoses, you know. What a mess down there. And we went down

there, and almost had to issue subpoenas to bring in officials from the lab, and held a field hearing down there.

This is some of the crap that was taking place. I guess I did say that word. An Hispanic was given a contract as a minority, and Los Alamos put out a press release that said that so-and-so was given an award of up to $100,000 for computer repair. And that young man—do you remember that nonsense?—he said he had gotten not one nickel of work from Los Alamos. Now, some clown down there was taking credit for engaging a minority firm that did absolutely nothing.

Then I asked the classic question: Where do you buy your pens and pencils? And the answer was, Well, we have just entered into a five-year contract with a ma-and-pa small business store to fulfill all of the—Mr. Cooper knows what happened, and somebody should go to prison over that—to fulfill all of the stationery requirements, an office supplier for Los Alamos. Now, Los Alamos has what, two to 3,000 employees down there, something like that?

That was the answer that came from the official there. Right after the hearing, someone came up to me and said, Did you know that just after that contract was signed that Boise-Cascade bought that store? Now, that is the type of stuff that Mr. Robinson and Mr. Chapman have been living in that environment.

And I am going to serve notice right here. If any of those big companies think they are going to get away with this stuff, they are going to have to come before this Committee, and I will put them under oath, and if they take the Fifth Amendment, I am going to request the SBA to remove them and the GSA, and those companies will have no further set-asides. I want to deal with them, one on one, if necessary, because somebody has to set an example. But the first thing we have got to do is get rid of the lobbying efforts that go into determine the size of these companies.

Let me give you an example. If you are regular manufacturing, you are 500 employees. If you are aerospace, you are 1,500. Now, nobody can defend, nobody can defend, that discrepancy in sizes of companies except maybe somebody wanted to come in and say, Well, aerospace should be treated differently. Is it Mr. Williams who is in charge, the gentleman at SBA? Fred, what is his name, the fellow that has the terrible task of determining size at SBA?

Mr. ARMENDARIZ. Gary Jackson.

Chairman MANZULLO. Mr. Jackson. That is correct. Sorry. Mr. Jackson, and we had him testify, and, I mean, you just pulled your hair out when you had to go through this thing. But here is the fallacy in the size standards, and this is what Mrs. Velazquez and I found out and why we had to have a horrible hearing where we almost had to lock the doors to get something done when it came the time for those emergency loans for the travel agencies. I think it is irrelevant of the issue to determine market penetration as to whether or not a company is large or small. Okay? This is where you get into the problem with it.

As it turned out, all of the travel agencies mostly were excluded. You have got things where if you are a law firm, it is $5 million in gross sales, if you are an accounting firm, I think it is $6 million, and I think what has happened is that the system of classi-

fication has become so complicated that the big boys are conning the system. That is exactly what is going to happen.

So I am going to put into the reauthorization one size standard for manufacturing, and no one knows manufacturing more than I do in this Congress. We are going to put it at 500. It is going to be an arbitrary thing. We are going to put it at 500. We are going to try to go through some other things. Congress is going to take that decision away and make life a little bit easier for Mr. Jackson. Some of these areas that are causing a lot of heartburn, and I think manufacturing—Mr. Chapman, Mr. Robinson, is that a big area in there where the size standards are being tossed all over the place?

Mr. ROBINSON. Well, I think one of the recommendations that I made at the closing of my statement involved the need to review this whole concept of size standards.

Chairman MANZULLO. They are doing that. The SBA and the GSA are doing that.

Mr. ROBINSON. A case in point: My organization is an information and technology support services company. Typically, the size standard that determines large and small is $21 million for three consecutive years of revenue. I have recently participated in procurements where so-called "small business," with up to 1,500 employee head count, has been allowed to effectively bid on opportunities that——.

Chairman MANZULLO. In IT?

Mr. ROBINSON. Absolutely.

Chairman MANZULLO. Okay, okay. Well, that is the whole problem, and the market-penetration approach does not work in all cases because in the travel agency no one qualified. They had a $1 million size standard on that, and it took eight months in order to increase that size standard to be eligible for the loans on it. But the size standards; these are also used for getting the 7(a) and the 504's. Is that correct?

Mr. ROBINSON. Yes, sir.

Chairman MANZULLO. Maybe we shouldn't have a one-size-fits-all. Maybe there should be a different standard for a small business loan as opposed to qualifying for a set-aside. We are willing to take a look at all of this stuff. We are going to try to reauthorize this bill at the end of June, and I really want to see a tremendous amount of input and would like Mr. Armendariz to continue working with our staff on it.

We need to come to a solution on this thing, and perhaps it might not be done by the time we go into the House, and perhaps it will have to done in time for a conference on it. But I think this is what is causing all of the angst, and there are only three people in that size department. Is that correct? There are four people in that size department——

Mr. ARMENDARIZ. Including myself.

Chairman MANZULLO [continuing]. Including yourself, and you continue to wrestle with that all of the time.

Well, listen, this has been good. Every witness has been exquisitely prepared. I really appreciate that.

Ms. VELAZQUEZ. Mr. Chairman.

Chairman MANZULLO. Yes, Mrs. Velazquez?

Ms. VELAZQUEZ. I have one last question.

Chairman MANZULLO. Yes.

Ms. VELAZQUEZ. I just want to take the opportunity that Mr. Armendariz is here. When are you going to get the women's procurement program up and running?

Mr. ARMENDARIZ. Well, the women's procurement program is up and running. We have our CAWBO (Office of Federal Contract Assistance for Women Business Owners) office. It has been in place for about 18, 24 months now.

Ms. VELAZQUEZ. Is that the Restrictive Competition program?

Mr. ARMENDARIZ. Are you talking about the set-aside program?

Ms. VELAZQUEZ. Yes.

Mr. ARMENDARIZ. Currently, we have commissioned a company to look at the study we had done so it will stand up to judicial muster.

Ms. VELAZQUEZ. But I have been hearing the same excuse for the last year. Can you give me, like, a more concrete answer? Is it going to take 30 days, 60 days, or never?

Mr. ARMENDARIZ. Well, we didn't have a budget until just recently. Once we received our budget, we let the contract out for competition. We have a company that now has the contract—it just was recently awarded—and they have told us it will take 90 to 180 days to review the study and tell us where we are deficient and where we need to shore up.

Ms. VELAZQUEZ. It shows our commitment to women-owned businesses.

Chairman MANZULLO. Thank you very much. This hearing is adjourned.

[Whereupon, at 5:08 p.m., the Committee was adjourned.]

House Committee on Small Business

"Are Big Businesses Being Awarded Contracts Intended for Small Businesses?"

May 7, 2003

Opening Statement of Committee Chairman Don Manzullo

Good morning and welcome to this hearing of the Committee on Small Business. A special welcome to those who have come some distance to participate and to attend this hearing.

Is there a scandal going on in the Federal procurement arena? Are big businesses being awarded contracts that were intended to be awarded to small businesses?

A recent article in the Los Angeles Times would indicate that this is the case. The article states that: "Large companies are improperly getting billions of dollars in government contracts meant for small businesses."

It is imperative that this Committee look into what is going on and to investigate the truth of these allegations. We have asked GAO to investigate this matter and they will testify here today.

To answer these allegations, we have invited as witnesses – the highest official of the Administration responsible for Federal procurement policy, the investigative arm of Congress, the United States General Accounting Office, persons in the private sector, and members of the Executive branch responsible for seeing that small businesses are fairly treated in the Federal procurement process.

At the end of this hearing, it is my hope that we will have an answer to the question: Are big businesses receiving contracts intended for small businesses? It is my understanding the some agencies are already taking steps to correct this situation. We will find out today.

One recommendation is that small businesses be required to certify their size annually. The committee is willing to work with the Small Business Administration on proposed regulations, and changes to statutory law if necessary. We welcome the SBA's input on that.

The bottom line is that this Committee is very much concerned with faulty information that results in an agency awarding to a big business a contract intended for a small business. And this Committee is equally concerned with the accuracy of the data by which the Congress evaluates agencies' performance against established small business procurement goals.

This Committee intends that the benefits of small business laws go to real-life small business owners and employees - not to large companies.

Sometime in the fall this Committee intends to revisit this issue to evaluate the conclusions raised in the GAO's final report.

I now yield for an opening statement by my good friend and colleague, the Ranking Member, Ms. Velazquez of New York.

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House Small Business Committee Democrats

STATEMENT
of the
Honorable Nydia M. Velázquez
Are Big Businesses Being Awarded Small Business Contracts?
House Committee on Small Business
May 7, 2003

Thank you, Mr. Chairman.

With the economy in a slump, small businesses need all the help they can get. A good way for small businesses to grow is to have the federal government as a customer. What small businesses may not realize is their biggest marketplace is not overseas, but right in their own backyard. The federal government spends approximately $220 billion on goods and services each year - from food and uniforms to airplanes and artillery.

Yet this billion-dollar marketplace remains largely closed to small businesses. Even though the United States government is the largest customer in the world, small businesses find they have no luck when making sales calls to federal agencies. In fact, for the last two years, our government has failed to meet its small business goals, costing small firms an estimated $12.4 billion in lost opportunities.

To make matters worse, today we find yet another reason why federal agencies are unable to meet their small business goals. As if contract bundling, poor oversight and lack of accountability weren't big enough obstacles, now small businesses are losing out on even more contracts intended for them because they are going to large businesses instead. This is yet another example of how the federal procurement system is fraught with inequities.

Shortly after these allegations were brought to our attention, this Committee directed the GAO to investigate the situation. During this hearing, we will learn the findings of the GAO report and what actions federal agencies with oversight responsibilities are doing to address the issue.

Not only is it wrong and unfair that large businesses win small business contracts, but it also inflates the federal government's track record for achieving its small business goals. In 2001 - the most recent year data was available on contracts awarded - the federal government missed its small business goal of 23 percent. Now with the latest GAO findings, we will learn that the government didn't just miss the small business mark, but it missed it by more than we had originally thought since the large business contracts were miscounted - and misrepresented - as small ones.

The truth is large businesses receiving contracts intended for small businesses is just part of a larger, more prevalent problem. What we have here is a federal procurement system that is fatally flawed. It is riddled with practices of contract bundling, weak oversight, no real appeals process, and little commitment to small businesses from top agency heads and other officials. Small businesses lose out - but so do the American taxpayers because, in effect, what the government buys may not be the best quality at the best price.

Even the president acknowledges there is a problem. More than a year ago, President Bush unveiled his five-point small business agenda. Along with health care, tax incentives, and regulatory relief, opening opportunities in federal contracting for small business topped his list. The rhetoric coming out of the White House is definitely pro-small business, but the reality is that little action has been taken to deliver on the promises made to help this nation's entrepreneurs.

The administration did outline its contracting strategy last fall, but it was just like the rhetoric - empty. Unfortunately, it will become clear today that it will take more than the minor regulatory changes and increased reporting requirements contained in the administration's proposal to bring about any real change.

I can tell you what we need to bring about some real change - a complete and comprehensive overhaul of the entire federal procurement system. We need to start with strengthening the appeals process and empowering small businesses to fight and actually win when they are treated unfairly. We need to put in place a regulatory body that can truly police federal agencies. We need to hold these agencies accountable. It is only then that we will see small businesses get their fair shake - and their fair piece - of the $220 billion procurement pie.

The GAO report is yet another symptom of our ailing federal procurement process. Small businesses all over this nation can provide the federal government with quality goods and services at competitive prices - agencies need to understand and embrace this. If they refuse to - which is usually the case - then safeguards will have to be put in place to protect small businesses and more power will have to be given to those responsible for enforcing the law - which mandates the federal government work with small businesses. It's the American way. And small businesses are the backbone of this economy - they deserve fairness and equity - especially from their own government.

Thank you.

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STATEMENT OF ANGELA B. STYLES

ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY

BEFORE THE COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

MAY 7, 2003

Chairman Manzullo, Congresswoman Velazquez, and Members of the Committee, I am pleased to be here today to discuss an issue of concern to us all - - whether larger businesses are improperly receiving contracting opportunities intended for small businesses. At the outset, I would like to briefly discuss the Administration's efforts to increase contracting opportunities for small businesses and then discuss efforts to make sure that small businesses do in fact have access to these opportunities.

Expanding the small business supplier base

The Administration is working hard to create an environment where small businesses can flourish and apply their talents to the many pressing needs facing our government. For small businesses, the primary issue is access to the federal marketplace and the opportunity to compete. And, for us, as policymakers, the issue is a dramatically reduced contractor base, and the mounting lost opportunity cost of choosing among fewer firms with fewer ideas and innovations to deliver products and services at lower prices.

On March 19, 2002, the President unveiled a Small Business Agenda that made several proposals to increase the access of small business to federal contracting opportunities. The Agenda called upon the Office of Management and Budget to develop a strategy for unbundling federal contracts. Contract bundling is defined in the Small Business Act as "consolidating 2 or more procurement requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small business concern." The law further defines a separate smaller contract as a "contract that has been performed by 1 or more small business concerns or was suitable for award to 1 or more small business concerns." While statutory and regulatory provisions recognize that contract bundling can have some benefits these provisions address the detrimental effects that this contracting practice can have on small business opportunities.

My office formed and chaired an interagency working group to develop the strategy requested by the President. In June we held a public meeting to give interested parties - - especially small businesses - - an opportunity to express their views on this important subject. Taking these views into consideration, I submitted a report to the President in October 2002 entitled "Contract Bundling: A Strategy for Increasing Federal Contracting Opportunities for Small Business." In our report, we found that, although contract bundling can serve a useful purpose, the negative effects of contract bundling over the past 10 years cannot be underestimated. Not only are substantially fewer small businesses receiving federal contracts,

but the federal government is suffering from a smaller supplier base. As we have broadened the scope of contract requirements into fewer and fewer contract vehicles over the past decade, the pool of small business contractors receiving new contract awards declined from 26,000 in 1991 to about 11,600 in 2000.

Our report to the President found that "multiple award contracts" and orders placed against such contracts are not uniformly reviewed for contract bundling issues. Multiple award contracts allow agencies to award identical contracts to multiple qualified contract holders who engage in streamlined competition amongst each other for task and delivery orders. This lack of uniform review is a problem because, while there has been a sharp decline in other contract actions, there has been a significant increase in orders. Our data showed that department and agency expenditures for orders under existing contracts increased from $21 billion in fiscal year 1990 to a high of $72 billion in fiscal year 2001. Also, as you know, federal contractors that receive contracts of $500,000 or more for products or services or $1 million or more for construction are required to prepare plans for subcontracting with small businesses. Our report to the President found that compliance with these subcontracting plans and agency oversight of contractor compliance with the plans has been inconsistent.

The strategy outlined in our report to the President identified nine specific actions the Administration is taking to eliminate unnecessary contract bundling and mitigate the effects of bundling that agencies find to be necessary and justified. To help implement the strategy, my

office is heading an interagency task force to develop regulations to amend both the Federal Acquisition Regulation (FAR) and Small Business Administration (SBA) bundling regulations. We published proposed regulations in the *Federal Register* on January 31, 2003.

Several actions in the strategy and our proposed regulations address findings in our report to the President. For example, to close a loophole that might allow agencies to avoid justification and mitigation procedures that would otherwise guard against unwarranted bundling, we intend to clarify that contract bundling rules apply to various types of multiple award contracts and task and delivery orders placed against such contracts. Also, we are asking agencies to assess prime contractor compliance with goals identified in their small business subcontracting plans, as part of the agencies' overall evaluation of the prime contractor's performance. Since this "past performance" information is often used as a significant factor in agency decisions to award contracts, this requirement should provide strong incentive for prime contractors to increase subcontracting opportunities for small businesses.

We believe that, when fully implemented, the actions identified in the Administration's strategy will significantly increase small business access to federal opportunities for contracting and subcontracting. However, we share your interest in making sure that small businesses do in fact have access to these opportunities. When small businesses are excluded from federal opportunities, our agencies, small businesses, and the taxpayers lose. With this in mind, the Administration is taking steps to ensure that large businesses are not improperly receiving contracting opportunities intended for small businesses.

Small business size status

We have heard of instances where large businesses are taking advantage of contracting opportunities intended for small businesses. Our office does not have "hard evidence" that this is happening. But, of course, we want to make sure that the various actions the Administration is taking do in fact increase small business access to contracting opportunities. We are particularly concerned about larger contractors masquerading as small businesses in large, long-term contracts, thus depriving small businesses of significant opportunities to compete against their peers. We understand the General Accounting Office (GAO) is investigating this matter and we look forward to reviewing their findings.

We also welcome SBA's recent issuance of a proposed rule to amend its regulations on small business size status. SBA, which determines eligibility for programs that require status as a small business, has proposed amendments to make sure that large businesses do not take advantage of benefits intended for small businesses. This action should help protect against misrepresentation of small business status.

In the meantime, there are other protective measures we can and should take. I understand that GAO is finding that, in some cases, agencies are relying on inaccurate or misleading data to make decisions about small business contract awards. If that is the case, we need to take corrective action. We want to make sure that small businesses do in fact have access to contracting opportunities intended for their benefit. In particular, my office is taking steps to prevent misrepresentations under "government-wide acquisition contracts" for information

technology, known by their acronym, "GWACs." GWACs are awarded by executive agents designated by OMB under the Clinger-Cohen Act. Typically structured as multiple award contracts, GWACs are popular vehicles for satisfying agency needs, in large part because they provide quick access to the marketplace and can save customers the cost and burden of establishing their own separate contracts. Today four agencies serve as executive agents: (1) the General Services Administration (GSA), (2) the Department of Commerce, (3) the National Aeronautics and Space Administration, and (4) the National Institutes of Health (NIH). These agencies maintain a total of 15 GWACs. GSA has ten GWACs, NIH has three, and the other two agencies have one each.

On February 11, 2003, we advised our four executive agents, whose designations were up for renewal in April, of our intention to require that they obtain annual certifications from their contractors regarding small businesses status. We did not target these agencies because of perceived wrongdoing. As I mentioned earlier, our office does not have hard evidence of larger businesses improperly taking advantage of contracting opportunities intended for small businesses. However, we believe GWACs, like other multiple award contracts and GSA's Federal Supply Schedules, may be vulnerable to misrepresentation because they are typically large and long term. Their structure allows a pre-qualified contractor to receive sizable work orders from agencies over the course of many years, often in the millions and occasionally even in the hundreds of millions. For this reason, we used the renewal process to provide temporary protection from possible misrepresentation of small business status.

Under OMB's designations, the executive agents are required to develop schedules identifying when their small business GWAC contractors will begin annual certification of their size status. Our intent is not to disrupt contract performance by, for example, requiring termination of contracts with businesses who were small but became large during contract performance. Also, we remain flexible in considering ways to implement the certification requirement prospectively, so that we do not have unintended consequences. However, we expect our executive agents and their customer agencies as appropriate to identify this change in business status in the normal course of their reporting in the Federal Procurement Data System. For example, after a change of status from small to "other than small" occurs and is reflected in a change in the annual certification, agencies are expected to report that orders under the GWAC were awarded to a large rather than a small business. Departments and agencies can then use this information to more accurately account for their small business contracting activities and make appropriate adjustments to their contracting practices to ensure small business access to contracting opportunities. Of course, we expect all agencies to report suspected fraud and misrepresentation regarding business status to SBA and appropriate investigatory offices.

Conclusion

Our office will continue to work closely with SBA and major procuring agencies to increase small business access to contracting and subcontracting opportunities and to help guard against instances where small businesses are excluded from federal opportunities by fraud,

misrepresentation, or otherwise. By doing so, we are helping to ensure that our citizens reap the full benefit of a robust supplier base and the talents of our many competitive small businesses who stand ready to help agencies carry out their missions. This concludes my prepared remarks. I am happy to answer any questions that you might have.

Written Testimony

Submitted by Lloyd Chapman
President of M.I.S.A.
(Microcomputer Industry Suppliers Association)

May 5, 2003

WRITTEN TESTIMONY OF MISA

This testimony is submitted by Lloyd Chapman. I am the president and founder of the Microcomputer Industry Suppliers Association. Our association focuses on issues affecting small businesses in the IT industry.

I have serious concerns that small businesses are unfairly losing small business contracts to large businesses. This is negatively impacting the ability of small businesses to survive in the federal procurement arena. Contract bundling, unrealistic size standards and a variety of other federal procurement policies that make it easier for larger and larger firms to qualify as small businesses have adversely affected legitimate small businesses across the country. As a result, legitimate small businesses, minority-owned firms and woman-owned firms are receiving dramatically fewer contracts than the minimum goals established by Congress and a far cry from the "fair proportion" Congress intended them to receive when the Small Business Act was passed fifty years ago.

In August of 2002, I began providing information on possible small business misrepresentation to the GAO, SBA Office of Inspector General and the U.S. Attorney's Office in Washington D.C. I continued to work with the GAO as they conducted an investigation into abuses and misrepresentation in small business contracting.

MISA research of federal procurement data indicates an alarming percentage of government small business contracts and subcontracts is awarded to large businesses in the United States and several large firms in Europe. I believe that the GAO report will confirm this startling but unfortunately true fact. This problem is particularly true in the information technology industry. In our industry, the majority of GSA schedule holders that are listed as small businesses are divisions of Fortune 1000 firms or other large businesses.

Misrepresentation of a firm's small business size standard in small business contracting is a widespread problem for the small business community. I have heard individuals at the SBA and other agencies attempt to explain, using a variety of explanations, why large businesses are the recipients of our small business contracting program. Their favorite defense defines the problem as "bad data" or "out-of-date" information. When a large business is discovered misrepresenting itself as a small business, the blame is always

placed on out-of-date information, not on the large business. When a buyer places an order with a large business and reports it as a small business award, it is again blamed on bad data, not the buyer or agency. I have been told that the consolidation of vendor databases, confusion over NAICS codes and just a general misunderstanding of the FAR causes the problem. No company, no individual and no agency is ever responsible for these failings.

However, I believe one agency, the SBA, is the major source of this problem. Fortunately, I also believe the SBA can be the solution to this problem.

I have identified ten specific problems and corresponding solutions. I believe that the SBA, OFPP, GAO and the OMB can achieve these solutions through policy changes. No new legislation is needed.

1. PRO-NET/CCR SMALL BUSINESS DATABASE CONTAINS THE NAMES OF HUNDREDS OF LARGE BUSINESSES

In 2002 I began reviewing information on the federal government's vendor database, Pro-Net/CCR. During my review, I found that Pro-Net/CCR contains hundreds of large businesses. Some appear to be misrepresenting themselves as small businesses. Pro-Net, the SBA's small business database, is littered with the names of many of the largest firms in the world. In addition to the names of large companies in the United States, I have identified large businesses from Holland, Finland, Germany and Switzerland on Pro-Net/CCR. Some of the firms had up to 44,000 employees and annual revenues of up to $12 billion dollars. One Dutch firm with 26,000 employees received over $60 million dollars in small business contracts in 2001. A major government supplier of IT products had reported in their 1999 Annual Stockholder's Report that they no longer qualified as a small business after February 1998. This information is readily available by comparing a company's information posted on PRO-Net/CCR against the information posted on the company's website.

I received a letter from the SBA on February 4, 2003, notifying me that the SBA had removed 19 firms from Pro-Net/CCR based on information provided by MISA. I have continued to provide similar information to the SBA and they have continued to remove more firms from PRO-Net/CCR. It

has been reported in the media that the SBA recently removed approximately 540 firms from Pro-Net/CCR after determining that these firms were large businesses. Under Section 16 (d) of the Small Business Act, misrepresenting a firm as a small business is a serious crime with severe penalties such as cancellation of contracts, debarment, fines of up to $500,000 and imprisonment of up to 10 years. In direct contradiction to the statutes, the SBA appears to be treating hundreds of cases of federal small business misrepresentation as a minor infraction. The SBA has described this situation as a simple misunderstanding. To date, not a single company out of the 600 cases has been penalized. I have to wonder why some of the most successful companies in the world with some of the best lawyers always seem to misunderstand federal contracting law in a manner that allows them to receive millions of dollars in federal funding.

It is unrealistic to believe that I was able to easily find information indicating small business misrepresentation on so many firms, yet the SBA, GSA and other agencies were completely unaware of even the most blatant examples.

On January 31, 2003, MISA attorneys sent a letter to the SBA asking that they notify all federal agencies and prime contractors of the firms that had been removed from Pro-Net/CCR. In the SBA's March 21, 2003 response to MISA's attorney, the SBA refused to notify agencies and prime contractors that the firms have been removed. The SBA indicated they would only consider publishing the names of these firms on their website at some point in the future. The approximately 600 firms the SBA did remove from Pro-Net/CCR will continue to receive small business contracts and subcontracts since the SBA has declined to notify federal agencies and prime contractors of the change in their small business status.

It is unlikely that firms removed from Pro-Net have made any effort to notify their government customers of this fact. The large businesses that have been removed are most likely still accepting small business contracts and subcontracts and making no change in any of their company materials to reflect any changes to their size status.

THE SOLUTION: The SBA and the federal agencies should immediately re-certify all of their small business vendors. Each small business should be required to re-certify their small business size and acknowledge a warning of the penalties for misrepresentation. Based upon the new certifications, each

agency should re-certify their small business reporting. In addition, the Secretary for each agency should be required to sign off on the reports.

The SBA database, PRO-Net, and the Department of Defense database, CCR, have been combined. The Pro-Net/CCR database should have a warning that clearly states the penalties for misrepresentation. Each company registering their size standard on the database should have to acknowledge the warning statement as part of the registration process. The responsibility including the registration procedure and the enforcement of the small business compliance for the federal small business database should remain with the SBA and not be transferred to the Department of Defense. Currently, registration is only available through the Department of Defense database, CCR.

2. LACK OF COMPLIANCE WITH SMALL BUSINESS PROTEST POLICY

The SBA has acknowledged dismissing hundreds of small business size standard protests in recent years by claiming the protesting firms had no standing to file a protest because the acquisition in question was not a small business set-aside. Section 16(d) of the Small Business Act makes no differentiation between misrepresentations for set-asides, non-set-asides, prime contacts or subcontracts. In many cases, the agency represented the acquisition to the protesting firm as a small business set aside and represented that the award was made to a small business. The SBA's policy of dismissing non-set-aside protests is in direct contradiction to the statutes and regulation governing misrepresentation and protests.

Contracting officers are reluctant to work with protests. Federal Acquisition Regulations require contracting officers to forward a copy of all size standard protests to the SBA. This is not happening. I believe the SBA is well aware of this situation. Stories of contracting officers threatening to penalize small businesses for filing size standard protests are common. It is my understanding the SBA has received a number of complaints of this. Minority and small business groups are very aware of this pattern of behavior.

Contracting officers will also withdraw an acquisition if a protest is filed. If the acquisition is withdrawn, there is nothing to protest. I have received

examples of this from our association members. Is this happening to possibly shield firms with questionable small business standing from proper review?

THE SOLUTION: Section 16(d) of the Small Business Act governing misrepresentation does not differentiate between misrepresentations for set aside or non set-asides acquisitions. The SBA's position on dismissing small business protests because they were not small business set asides is not supported by the law. Each size standard protest that is filed according to the protest procedure should result in a size standard determination by the SBA regardless of whether or not the acquisition was a set aside.

Furthermore, the SBA should send a letter to each Agency reiterating the protest process, the obligation of the agency and the rights of the small business in filing a protest.

3. SIZE STANDARDS

When the SBA is reviewing size standards, I think it is reasonable to base the size standard definition on information provided by the U.S. Census Bureau. In the IT industry, the average firm has 15 employees. Prior to 1986, the small business size standard under the non-manufacturer rule which incorporates the vast majority of commonly purchased products by federal agencies and prime contractors was 100 employees. This seemed to be a very appropriate size standard since it encapsulated 98% of the firms in America. In 1986, the SBA increased that size standard to 500 employees which is over 3300% higher than the average company and was a five-fold increase from where it had been. The SBA did not increase it from 100 to 120 or 150 or even 200, but from 100 to 500 employees. By raising the size standard to 500 employees, only an additional 1% of firms were included. However, for the benefit of that 1% of firms, the average American firm that has less than 15 employees is now forced to compete head-to-head with many of the largest firms in their industry. This essentially repeals the Small Business Act for small businesses selling to the federal government.

This also resulted in the creation of what I call "super companies". The average company with 10-20 employees is now being competed by the agencies directly against the 500 employee companies who have easily gained dominance in the field. This super company dominance has brought

us to the current situation we have today. Most of the GSA scheduled contract holders in the industry claiming small business status are large businesses.

An additional problem under size standards is the misuse of NAICS codes. When a firm becomes too large to qualify as a small business under the correct size code, they will adopt another size code with a larger small business size standard. A prime example is a computer reseller that exceeds the 500 employee standard. The company will begin to represent itself as a manufacturer using the 1500 employee size standard. In reality, they simply continue selling the same product line as before without any real manufacturing functions.

THE SOLUTION: The size standard for the non-manufacturer should be returned to the 100 employee size standard. The 100 employee size standard can be justified based upon information from the US Census Bureau.

4. NO ENFORCEMENT OF REGULATIONS REGARDING SMALL BUSINESS MISREPRESENTATION.

Without enforcing existing legislation, problems that are negatively impacting small businesses will continue to increase. Large businesses in America and Europe will continue to misrepresent themselves as small businesses to unfairly compete for federal small business contracts until there is some reasonable enforcement of Section 16 (d) of the Small Business Act. The penalties for misrepresentation under 16(d) include cancellation of contracts, debarment, fines of up to $500,000 and up to 10 years in prison. The SBA Office of Inspector General has been unable to provide any information documenting that a single firm has been penalized for misrepresentation during the last fifteen years. The complete absence of any penalties or negative consequences for misrepresentation has obviously encouraged the widespread abuse in small business contracting.

THE SOLUTION: The penalties for small business misrepresentation already exist. No new legislation needs to be passed. There must be enforcement of the penalties. Companies that are providing false information to misrepresent their status as a small business should be prosecuted to the full extent of the law. This includes having contracts cancelled and being debarred from doing business with the government. The enforcement of

these penalties will be a major step in reduction of abuse in small business contracting and will dramatically increase contracts for legitimate small businesses.

5. CONTRACTS AWARDS VS THE OPPORTUNITY TO BID

The small business program is degenerating into an "opportunity to bid" program. As opposed to actually awarding a percentage of business to small businesses and achieving their goals, federal agencies and prime contractors are giving small businesses "an opportunity to bid". They have redefined "trying to work with small businesses" to mean allowing a small business to compete head-to-head with some of the largest companies in America. This is particularly true with defense contractors that are trying to project the image of a good faith effort as stated in 48 CFR Ch.1 19.705-7 to avoid being subject to liquidated damages. When the large dominant company wins the bid, the small business will be told that they did "have the opportunity to bid". This is not an opportunity to bid. It is an opportunity to fail. This misdirects the efforts of the small businesses as they work on bids and try to compete for proposals that they have no real chance of winning. It is damaging to the small business community as a whole since it creates the untrue image that small businesses are not competitive.

THE SOLUTION: The solution can be a two step process. Number one – identify the goods and services that can be provided by small business to the federal government and prime contractors. Number two – Restrict the bidding and acquisition of those goods and services to small business until the federal government and prime contractors have reached their small business goals.

6. COMPREHENSIVE TEST PROGRAM

Under this program, certain large prime contractors were exempted from the statute on liquidated damages for failure to make a "good faith effort" to meet their small business subcontracting goals. These contractors are also exempted from having to report the status of small business goals on a federal contract-by-contract basis (SF 294). Instead, the contractors report only on their overall company performance (SF 295). Although it is considered a test program, it is ten years old. The justification for the

program was that, by exempting these contractors from small business reporting on a federal contract-by-contract basis, their overall performance with small business would increase. In reality, small businesses can no longer request a SF 294 under the FOIA to track the small business or small disadvantaged business performance on a specific government contract.

THE SOLUTION: The comprehensive test program should be eliminated. Prime contractors should be required to file small business contract performance reports by individual contract (SF294) and by company wide reporting (SF 295). A program that eliminates, both, small business reports for individual federal contracts and penalties for non-compliance with small business goals will not increase opportunities for small businesses.

7. LIQUIDATED DAMAGES

The lack of enforcement of liquidated damages has reduced opportunities with prime contractors for small business. There is a statute in place with penalties for contractors failing to make a good faith effort. And yet, to the best of my knowledge, no one has ever paid liquidated damages. This further reduces the compliance with small business subcontracting programs.

THE SOLUTION: The enforcement of the liquidated damages clause for failure to make a good faith effort. Clearly, a pattern of contractors being charged liquidated damages for failure to make a good faith effort in reaching contracting goals will increase contracting with small businesses.

8. ANNUAL RECERTIFICATION

It is increasingly difficult for legitimate small businesses to succeed in the federal procurement space with the exemptions, exceptions and broad interpretations allowed for large businesses. Currently, a large business can buy a small business with long-term contracts and continue using the small business status for the term of the contract including options. A small business can receive a contract making it a large business and continue using its small business status for the term of the contract including options. These contracts can last as long as 20 years.

SOLUTION:
MISA supports the position of the OFPP that firms should have to re-certify annually for their contracts. MISA also supports the position that the size determination is made at the time of bidding on the task order and not at the time of the original contract award.

9. NON-MANUFACTURER RULE

The abuse of the non-manufacturer rule is resulting in a reduction of opportunities for small businesses. The vast majority of the goods ordered by the federal government are manufactured by large business. The vast majority of small businesses are not manufacturers. The $100,000 small business threshold does not benefit the majority of small businesses because they are not selling a product manufactured by a small business. However, some contracting officers continue to report these non-manufacturer procurements as small business purchases. The non-manufacturer rule precludes most of the office products and computer hardware and software products used by the federal government from being considered a small business purchase without a specific exemption.

THE SOLUTION: Modify the non-manufacturer rule so that it does not have a negative impact on small business opportunities or eliminate the non-manufacturer rule. Based upon the goods that the federal government procures, the majority of small businesses will not qualify for a small business set aside because of the non-manufacturer rule.

10. ORDER OF PRIORITY FOR SUPPLIES AND SERVICES

In view of the current dismal levels of small business contracting by agencies, there should be a strong push to work with small businesses as much as possible. Contracting officers are quick to reference Subpart 8.001 Priorities for use of Government supply sources that lists the descending order of priority for supply and services requirements. In the order of priorities, the last priority is Commercial sources. The vast majority of small businesses trying to work with the federal government are in this category.

SOLUTION: Until the federal government has reached or exceeded the established small business goal, the source priority for small business should be higher.

In closing, I ask this committee to ensure that cases of federal small business misrepresentation be properly investigated and handled according to the appropriate statute, Section 16 (d) of the Small Business Act. I also ask this committee to repeal federal policies that have allowed Fortune 1000 firms and large business to dominate the small business contracting programs in America. It should be the goal of all federal agencies and, in particular, the SBA to increase small business contracting to the level that was intended by Congress when the Small Business Act was passed 50 years ago.

It was reported in the news recently that the national unemployment rate has reached 6%. 48,000 Americans lost their jobs in April and 1.9 million Americans have been out of work for six months or longer. I believe the Small Business Act was a win-win economic stimulus package designed to direct federal contracts and subcontracts to the small businesses that account for 98% of U.S. firms and over 50% of the American workforce.

A full and immediate implementation of the Small Business Act would have a powerful impact on our nation's economy and America's 5.5 million small businesses.

I sincerely appreciate the committee's attention to this very important issue that is adversely affecting small businesses in America. My thanks to Chairman Manzullo, Ranking Member Velasquez and the committee members for your time.

Lloyd Chapman
President
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Novato, CA

Legal Position Statement

Submitted by Lloyd Chapman
President of M.I.S.A.
(Microcomputer Industry Suppliers Association)

May 5, 2003

LEGAL POSITION STATEMENT

The Small Business Administration ("SBA") openly acknowledges that it is aware that numerous businesses have in the past and continue today to misrepresent themselves as qualified small businesses for the purpose of obtaining small business contracts and subcontracts. The SBA is fully aware that cases of misrepresentation, fraud, and abuse of PRO-Net and the regulations governing small business contract qualifications are widespread.

The SBA's Office of Inspector General has been provided with substantial, irrefutable evidence that dozens of major federal suppliers claiming status as small businesses were in fact Fortune 1000 firms, major European conglomerates, or otherwise not qualified as small businesses. As one example, the SBA was provided with compelling information that GTSI, which continues to represent itself as a small business, stated in its annual report to the stockholders: "As a result of the acquisition of the BTG Division in February 1998, GTSI no longer qualifies as small business for contract award after February 1998."

As is apparent, this is not a situation where the SBA was required to launch an extensive investigation to reach its determination that misrepresentation of business size was widespread. Instead, it is glaringly apparent to all concerned that hundreds of contracts which are, according to law, required to be awarded to qualified small businesses continue to be awarded to other than small businesses as a result of misrepresentations of the businesses' size.

Much of the misrepresentation by unqualified business takes place on the SBA's own website, PRO-Net. The SBA represents that "PRO-Net is an electronic gateway of procurement information – for and about small businesses ... PRO-Net is an internet-based database of information on more than 195,000 small, disadvantaged, 8(a), HUBZone and women-owned businesses ..." The foregoing representation is, in hundreds of cases, inaccurate. Many of the businesses which continue to be listed on PRO-Net are not small businesses. Unfortunately, this is not simply a situation where the SBA has sat idly by and permitted unqualified businesses to obtain contracts legally set aside for small businesses. Rather, this is a case in which the SBA has, under the imprimatur of its authority, transmitted affirmative representations to persons using PRO-Net that the firms listed thereon are, in fact, "small businesses." It is more the SBA simply turning a "blind eye" to illegal activity; the SBA is affirmatively acting through publication on its own website to perpetuate the award of contracts intended for small businesses to unqualified businesses in direct violation of its mandate as set forth in the Small Business Act.

When confronted by the ongoing use of PRO-Net by other than small businesses to misrepresent that such businesses were qualified small businesses, the SBA's response was far from adequate. Rather than seek the prosecution of large businesses who use the SBA's resources to perpetuate fraud, the SBA merely began to remove the unqualified businesses from its website. Frequently, the removed firms simply put their company back on PRO-Net, notwithstanding the SBA's action. The SBA refused to inform government procurement officers of the size misstatements, offering the justification that it would "confuse" the purchasing officers.

Given the fact that the SBA is responsible for actually contributing to the misinformation published on its own website, the SBA's response to the concerns raised by genuine small businesses fall far short of adequate. The limited and ineffective means by which the SBA has thus far chosen to address this situation will do no more than perpetuate the ongoing fraud. The SBA has made an affirmative contribution to this ongoing fraud, and it is incumbent upon the SBA to take affirmative and aggressive steps to correct the misrepresentations made on its website.

The mere removal of unqualified entities from PRO-Net, as proposed by the SBA, has not and will not alleviate the problem. Contracting officers are not required by law to constantly monitor PRO-Net for changes, and cannot reasonably be expected to do so. Instead, a contracting officer will rely on its previous experience in dealing with a company that has represented itself as a small business on PRO-Net. In addition, federal contracting officers and procurement personnel for prime contractors will continue to rely on incorrect information previously published on PRO-Net. If the SBA's efforts to address the past misrepresentation and ongoing fraud consist merely of removing unqualified businesses from PRO-Net, the flood of federal contracts which are illegally being awarded to unqualified businesses will continue unabated. This occurs in large part because the removed businesses just replace their company name back on PRO-Net.

In January 2003, MISA requested that the SBA notify all of the contracting officers of the identity and removal of unqualified businesses from PRO-Net. The SBA's response is that such notice was not appropriate because removal from PRO-Net was based on its "informal" review. That response, itself, shows that it took very little effort for the SBA to conclude that the subject businesses were misrepresenting their status. Moreover, as the SBA concedes, any business which is wrongfully removed from PRO-Net has two remedies available to it: requesting a certification of qualification by the SBA or re-registering on PRO-Net by providing the appropriate size information. It is our position that given the fact that the SBA has in the past and continues today to misrepresent these businesses as qualified small businesses, it is incumbent upon the SBA to take affirmative steps to correct the misidentification by, at the very least, notifying the contracting officers responsible for awarding contracts of the unqualified status of large businesses formerly listed on PRO-Net. In the interim, the burden should be on the removed business to demonstrate that its status supports its return to PRO-Net.

As stated above, the SBA further justifies its refusal to take affirmative steps to correct the misinformation it has disseminated by stating that the publication of the names of removed unqualified businesses will cause "confusion" among contracting officers. This argument is hardly novel. Governments historically have attempted to justify withholding accurate information under the guise of "avoiding confusion." In this context, however, the proffered justification is not only disingenuous, but also specious. The release of accurate information will not "cause confusion" to the contracting officers. The contracting officers are already confused, because the SBA has affirmatively represented that unqualified concerns are small businesses by

allowing such statements to be published under the auspices of a government agency on its own website—even after the unqualified business has been previously removed from PRO-Net by the SBA itself. The SBA has caused the confusion, and that confusion must be rectified by providing accurate information to the public and contracting officers rather than acquiescing to the ongoing fraud which has resulted from the publication of misinformation.

MISA is equally disappointed in the SBA's reaction to its demand that unqualified businesses which make fraudulent misrepresentations in the course of unlawfully seeking small business contracts and subcontracts be prosecuted. In response to this demand, the SBA writes: "When the SBA finds that a registrant exceeds the small business size standards, it removes that registrant from PRO-Net. The SBA believes that this is the appropriate remedy." In fact, "an appropriate remedy" has been provided by Congress. Section 16 of the Small Business Act (15 U.S.C. §645) provides:

> Offenses and Penalties
>
> (a) False statements; overvaluation of securities
>
> Whoever makes any statement knowing it to be false, or whoever willfully overvalues any security, for the purpose of obtaining for himself or for any applicant any loan, or extension thereof by renewal, deferment of action, or otherwise, or the acceptance, release, or substitution of security therefore, or for the purpose of influencing in any way the action of the Administration, or for the purpose of obtaining money, property, or anything of value, under this chapter, shall be punished by a fine of not more than $5,000 or by imprisonment for not more than two years, or both.

. . .

(d)(1) Whoever misrepresents the status of any concern or person as a "small business concern," a "qualified HUBZone small business concern," a "small business concern owned and controlled by socially and economically disadvantaged individuals," or a " small business concern owned and controlled by women," in order to obtain for oneself or another any –

(A) prime contract to be awarded pursuant to section 638 or 634 of this title;

. . .

(D)… shall be subject to the penalties and remedies described in paragraph (2).

15 U.S.C. §645(2) provides:

Any person who violates paragraph (1) shall –

(A) be punished by a fine of not more than $500,000 or by imprisonment for not more than 10 years, or both;

(B) be subject to the administrative remedies prescribed by the Program Fraud Civil Remedies Act of 1986 (31 U.S.C. 3801-3812);

(C) be subject to suspension and debarment as specified in subpart 9.4 of title 48, Code of Federal Regulations (or any successor regulation) on the basis that such misrepresentation indicates a lack of business integrity that seriously and directly affects the present responsibility to perform any contract awarded by the Federal Government or a subcontract under such a contract; and

(D) be ineligible for participation in any program or activity conducted under the authority of this chapter or the Small Business Investment Act of 1958 (15 U.S.C. 661 et seq.) for a period not to exceed 3 years.

. . .

(e) Any representation of the status of any concern or person as a "small business concern," a "small business concern owned and controlled by socially and economically disadvantaged individuals," or a "small business concern owned and controlled by women" in order to obtain any prime contract or subcontract enumerated in subsection (d) of this section shall be in writing.

Given the unambiguous language of the above-quoted statute, it is clear that the SBA has legal authority to pursue prosecution and penalties for misrepresenting small business status on PRO-Net. We note that 15 U.S.C. §645(d)(2) provides mandatory fines and mandatory removal from eligibility for participation in any program conducted under the auspices of the Small Business Administration whenever such misrepresentations are established. See 15 U.S.C. §645(2)(a-d).

In submitting written information to PRO-Net in electronic form, the registrant is making a written representation that it is a small business concern. Nothing in Section 645 requires that the misrepresentation be in the form of a request for certification, or be made directly to an SBA office. Instead, the statute provides severe penalties for anyone misrepresenting the status of the concern for the purpose of obtaining contracts which are to be awarded pursuant to any Small Business program set forth in Title 15. The statute does not require that the misrepresenting unqualified individual or business actually be awarded a set-aside contract. It is the misrepresentation itself which is a violation of the Act. Moreover, given PRO-Net's stated purpose – as a "gateway of procurement information for and about small businesses," there is no purpose for a firm to list itself on PRO-Net unless its purpose is to obtain contracts which are to be awarded to a qualified small business. Thus, a firm listing itself on PRO-Net's website is making an affirmative representation of its small business status for the purpose of obtaining contracts which should be awarded to small businesses. It follows that such a listing by an unqualified large business is a violation of Section 645.

When the SBA finally began investigating the misrepresentation on PRO-Net, the Agency, rather than identify the abusing businesses for prosecution and/or administrative

sanctions, instead came to the conclusion that the cause of the misrepresentation was a lack of information on the part of large firms who "mistakenly" represented themselves as small. The SBA determined that two factors contributed to these "errors" by large firms: First, the large firms "do no receive sufficient information regarding the requirement that the firm be small in accordance with SBA size standards, and, second, the large firms "receive no advisement of the criminal statutes, penalties and/or regulations that apply to the submission of false information to the U.S. Government" U.S. Small Business Administration Program Vulnerability Memorandum 3-09, February 7, 2003. Thus, the fraud and misrepresentation by large concerns has been excused by the SBA. In the SBA's analysis, a large business cannot understand the regulations defining small businesses in the Code of Federal Regulations, and doesn't know that lying for the purpose of receiving government program benefits is illegal. Accordingly, the solution proposed by the SBA is not prosecution for fraud, but publishing a warning that such misrepresentation may result in criminal penalties.

The Inspector General Act of 1978, as amended, authorizes the SBA's Inspector General to conduct, supervise and coordinate audits, investigations and inspections relating to the programs and operations of the SBA. 13 C.F.R. Ch. 1, §101.300. The Inspector General Act provides:

> "It shall be the duty and responsibility of each inspector general with respect to the establishment within which his office is established... to conduct, supervise and coordinate audits and investigations relating to the programs and operations of such establishments;" Title 5, Appendix 3, Section 4(a)(1).

The Inspector General Act also provides:

> "In carrying out the duties and responsibilities established under this Act, each Inspector General shall report expeditiously to the Attorney General whenever the Inspector General has reasonable grounds to believe there has been violation of criminal law." Title 5, Appendix 3, Section 4(d).

Moreover, the SBA's own regulations, at 13 C.F.R. Ch.1 Sections 101.302, grant broad investigatory powers to the SBA'S Inspector General. In addition, the Administrator of the Small Business Administration is specifically granted the power to make investigations to determine whether a person has engaged in acts or practices which violate the Small Business Act. *See* 15 U.S.C. §634(b)(11). The SBA thus has the duty, means and directive to investigate such violations and turn its findings over to the Attorney General for prosecution "whenever the Inspector General has reasonable grounds to believe there has been a violation of Federal criminal law." Title 5, Appendix 3, Section 4(d). However, notwithstanding overwhelming evidence and the SBA's concession that fraudulent misrepresentation by unqualified businesses is widespread, we have been unable to locate a single case in which an entity has been prosecuted for misrepresenting its size qualification.

MISA has provided the SBA with information regarding several unqualified businesses which exceed the size standards which successfully bid for small business contracts and subcontracts. Moreover, we have observed a custom and practice developing within the SBA in

which the protests of qualified small business to the awards of such contracts are summarily dismissed with a groundless determination by the SBA that the contract in question was not a small business set-aside. Regardless of whether the contract was correctly classified as a small business "set-aside", the misrepresentation of the successful bidders' size should, under the mandatory provisions of 15 U.S.C §645(d)(2), subject the principals to fines and/or imprisonment along with rendering them ineligible to participate in SBA programs, regardless of whether the misrepresentation was necessary to obtain the award of the contract. See U.S. v. Condon, 132 F.3rd 653 (11th Dis. 1998), cert. denied 523 U.S. 1008 (statute proscribing making a false statement to Small Business Administration does not include element of materiality; statute fails to mention materiality and expressly prohibits any false statements.).

Given the foregoing, the SBA's position that the removal of an unqualified registrant from PRO-Net "is the appropriate remedy," along with the SBA's self-determination that it lacks the legal authority to pursue penalties for misrepresentations on PRO-Net are contrary to the intent and clear language of the Small Business Act. Instead, it is clear that the SBA must immediately begin steps to enforce 15 U.S.C. §645(d)(2) by imposing the disqualification sanction mandated under that section, and providing the Attorney General with the results of any investigation it has pursued which has revealed evidence of misrepresentations of size status.

To reiterate, the act of making misrepresentations in an effort to obtain the benefits of the Small Business Act call for mandatory penalties. MISA has provided the SBA with undisputed evidence of misrepresentation and fraud by numerous unqualified businesses that have made the

misrepresentations in order to obtain the benefits provided by the Act. Accordingly the SBA is required by law to impose the penalties required under 15 U.S.C. §645(d)(2).

As we have also pointed out above, the Office of Inspector General of the SBA has a mandatory duty to investigate allegations of misrepresentation and fraud in violation of Section 645(d)(2). When that investigation discloses evidence of such fraud or misrepresentation, the disqualification of the individual or business making such misrepresentations is also mandatory. 15 U.S.C. §645(d)(2).

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Statement of Fred C. Armendariz
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U.S. Small Business Administration
Small Business Status
House Committee on Small Business
May 7, 2003

Good afternoon, Chairman Manzullo, Ranking Member Velazquez, and distinguished Members of this Committee. Thank you for inviting me to discuss concerns regarding large businesses obtaining Federal contracts intended for small businesses and the accuracy of small business information contained in databases maintained by the U.S. Small Business Administration (SBA) and the General Services Administration (GSA).

The Small Business Act defines a small business as one that is independently owned and operated, not dominant in its field of operation, and meets the detailed definitions or size standards established by the Administrator of the SBA. To be eligible as a small business for a Federal procurement, a business must not exceed the size standard designated for the procurement. The applicable size standard is determined by identifying the North American Industry Classification System (NAICS) industry that best describes the principle purpose of the goods or services being acquired. The SBA has established a size standard for each private sector NAICS industry.

Each year, the Federal Government awards over $200 billion in contracts. In fiscal year 2001, small businesses received about $50 billion dollars, or 22.81 percent. In addition, large businesses subcontracted approximately $35.5 billion in Federal work to small businesses. However, small businesses have complained that large businesses are receiving Federal contracts

intended for small businesses. Part of this concern is related to a number of large businesses inappropriately included in the Procurement Marketing and Access Network (PRO-Net), a small business database administered by the SBA.

The SBA developed PRO-Net as a self-certified database of small businesses. Business profiles in PRO-Net include business and marketing information. Businesses can also link their PRO-Net profiles to their home pages. Presently, PRO-Net holds records of more than 150,000 small businesses. In December 2002, the SBA partnered with the Department of Defense to integrate PRO-Net and the Central Contractor Registration (CCR) systems to create a single point of vendor registration.

The Federal acquisition community, state and local governments, and prime contractors use PRO-Net for preliminary identification of qualified small business vendors. Contracting officers can search businesses profiled in PRO-Net based on NAICS codes; key words; location; certifications; business type; ownership demographics; electronic data interchange capability, etc.

PRO-Net is a marketing tool that is designed to assist small businesses with presenting their capabilities to Federal agencies and other organizations as potential sources of goods and services. While PRO-Net continues to function as a marketing tool, the SBA will rely on the CCR infrastructure, as the single point of registration, to collect information on small businesses. This new integration will enable the SBA to better focus PRO-Net on its primary function. PRO-Net is not designed or intended to validate the small business eligibility of a registrant.

PRO-Net, however, does serve as the authoritative source of eligibility information on firms certified by the SBA under the 8(a) Business Development and HUBZone Programs, and small disadvantaged businesses.

For each Federal procurement solicitation, an offeror must represent in good faith that it is a small business at the time it submits its initial bid. Except for 8(a) BD and HUBZone program participants, and certified Small Disadvantaged Businesses, a contracting officer cannot assume nor is there guidance that suggests that a business listed on PRO-Net is an eligible small business for a specific procurement. Because size standards vary by NAICS industry, a business can be small under some NAICS industries but not under others. A contracting officer shall accept an offeror's small business representation unless a size protest is received from other offerors or if other information causes the contracting officer to question the offeror's small business representation.

The SBA has a well established process for resolving questions concerning the small business eligibility of an offeror on a Federal procurement. The small business representation of an offeror may be protested by the contracting officer, another offeror, or by the SBA. These size protests are submitted to one of the SBA's Government Contracting Area Offices for a formal size determination. In most cases, the SBA makes a decision within ten working days. If a business is determined to be other than small, the contracting officer cannot award the contract to that business if the procurement is set aside exclusively for small businesses. The parties to a size protest may appeal a formal size determination to the SBA's Office of Hearings and

Appeals. However, a contracting officer has the discretion to continue with an award of a contract to another offeror or to wait for the outcome of a size appeal.

A business determined to be "other than small" as a result of a formal size determination is notified that it cannot represent itself as a small business on future procurements which specify a size standard at or below the size standard it had been found other than small. In addition, the business is notified that the Small Business Act prescribes severe penalties for misrepresenting itself as small. If the business' size status changes, it must request that the SBA conduct a new size determination and be certified as a small business before representing itself as small on Federal procurement opportunities.

In fiscal year 2003, the SBA has received 193 size protests. Of these, 68 businesses were determined not to be small. During fiscal year 2002, the SBA received 383 size protests. Of these, 110 were dismissed on procedural grounds. Of the cases accepted for review, 85 firms were found to be other than small.

In cases where SBA has evidence that a business knowingly misrepresents itself as a small business, the SBA refers the case to the Office of the Inspector General (OIG). A relatively few number of cases have been referred to the OIG.

The SBA takes very seriously its responsibility for ensuring that only small businesses obtain Federal contracts and other Federal assistance intended for small businesses. The SBA views its responsibility in this area as one of providing a sound process to review protests; not to

police small business representations. In Federal contracting, the SBA must rely on contracting officers and other interested parties to bring these challenges to the SBA for resolution. There is no mechanism for advising the SBA of which businesses are bidding on procurements or to receiving notification of the successful offeror. The procedures to file a size protest are not complicated. It only requires that a protestor provide specific information suggesting why an offeror may not be small. The size protest must also be filed within 5 business days after award. However, size protests filed by the contracting officer or the SBA may be filed at any time.

We are aware that some businesses previously listed on PRO-Net do not meet the SBA's criteria for small business status. The SBA conducts periodic searches of businesses on PRO-Net to find large businesses. In addition, we examine a business' PRO-Net profile in response to information provided to us from the public that questions the small business status of a particular business. Over the past six months, more than 600 businesses have been removed from PRO-Net because they are not small businesses according to the SBA's size standards. Thousands of others businesses have been removed because they did not update their PRO-Net profile within past 18 months.

While these efforts have led to the removal of many large businesses from PRO-Net, the SBA is pursuing other actions that will more effectively address this problem. The SBA is developing an automated check of size information of new PRO-Net registrants. If the submitted information shows that a business exceeds the applicable SBA size standards, it will not be listed in PRO-Net. The SBA will also be adding information on the criteria for determining small business status to ensure that a registrant is fully aware of size standards and other eligibility

criteria, such as including the size of all affiliates in calculating business size. The SBA will request a registrant to verify the accuracy of the submitted business size information and acknowledge that it understands the penalties associated with falsely certifying as a small business on Government contracts and subcontracts. The SBA believes these actions will significantly reduce the number of large businesses on PRO-Net.

The SBA is also providing a letter to Federal agencies concerning the proper use of PRO-Net and advising them to be more conscientious in reviewing the small business representations of an offeror. As described above, an offeror must make a representation that it is a small business as part of its bid proposal. A business listed on PRO-Net may or may not be small for that particular procurement. However, PRO-Net may assist contracting officers in deciding whether to accept the small business representation or file a size protest with SBA by reviewing the information contained in the offeror's PRO-Net profile. To further assist Federal agencies with questions regarding the small business status of an offeror, the SBA is listing on its web site (www.sba.gov) information on the businesses that have been determined to be other than small through a formal size determination.

One of the major sources of complaints that large businesses are receiving Federal contracts intended for small businesses involves awards made though the GSA Multiple Award Schedule (MAS) Program (including the Federal Supply Schedule (FSS)), and other multiple award and Governmentwide Acquisition contracts (GWAC). Under the SBA's regulations, a business that obtains a contract as a small business remains classified as a small business for the duration of the contract. On MAS and other multiple award GWAC contracts, the initial contract

period and subsequent options can last anywhere from 5 to 20 years. Consequently, successful small businesses that outgrow the size standards, or who merge or are acquired by large businesses, are still considered small for the purposes of that contract until it expires or is otherwise terminated. This policy has resulted in small businesses competing against, and sometimes losing opportunities to, businesses that exceed the SBA's small business criteria. In addition, Federal agencies have been able to take small business credit for awards to other than small businesses.

The SBA, the GSA, and the Office of Management and Budget have been working together to develop a new policy which will require recertification of small business status during the term of a MAS, FSS, multiple award, and GWAC contract. The GSA, for example, is attempting to remedy the situation until a Government-wide regulation, provides a remedy. The GSA implemented a Federal Acquisition Regulation deviation requiring contractors operating under the MAS Program or any other multiple award contract (such as the FAST program in the GSA's Federal Technology Service), to re-represent that the concern qualifies as a small business each time their contract is up for renewal, i.e., prior to exercise of the contract option. In addition, on April 25, 2003, the SBA published a proposed rule to require an annual recertification of small business status on these types of contracts. The proposed rule also presents alternative approaches on recertifying small business status. The SBA encourages the Committee and the public to assist us in developing a new small business certification policy on MAS and other multiple award contracts by reviewing the proposed rule and providing us comments on the feasibility of the proposed and alternative approaches.

The SBA is committed to the President's Small Business Agenda and his proposals to create jobs and growth through the small business sector. Small businesses, indeed all businesses, must receive fair access to contract opportunities. Small businesses are an important driver of growth in our economy, and increased opportunities for these businesses based on their competitive advantages will result in savings to the taxpayers, a stronger economy, and a stronger America. This concludes my remarks, and I will be able to respond to any questions that you may have.

STATEMENT OF

FELIPE MENDOZA

ASSOCIATE ADMINISTRATOR

OFFICE OF SMALL BUSINESS UTILIZATION

U.S. GENERAL SERVICES ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

MAY 7, 2003

Good afternoon Chairman Manzullo, Ranking Member Velazquez, and Members of the committee.

Thank you for inviting me to appear before you today to discuss a matter of grave concern to all of us – businesses classified as "other than small" obtaining Federal contracts intended for small businesses, and the accuracy of the data contained in the Federal Procurement Data System (FPDS) that specifically identifies or verifies the size status of a business.

Before I begin my testimony, I'd like to introduce a distinguished member of the General Services Administration's (GSA) acquisition team who's here with me today. Mr. David Drabkin is the Deputy Associate Administrator for Acquisition Policy, and GSA's Senior Procurement Executive. In GSA, my office and David's, work closely together to ensure that small businesses have ample opportunity to compete in GSA procurements, viewing small businesses as solutions for many of our acquisition requirements. In GSA we know that small businesses are the engine of our national economy and that they more often than not bring to the market new and innovative solutions to vexing government problems.

Let me begin by stating that GSA is aware of and shares your concern that contracts intended for small businesses are sometimes winding up with larger firms. I will explain what we are doing to address the situation – and what we think needs to be done outside GSA – in just a moment.

Increasing procurement opportunities for small businesses is a major initiative of the Bush administration, and it is an issue to which I have devoted a majority of my time and energy since joining GSA last year.

As mandated by Federal law, GSA works hard to ensure that small, minority-, women-, Hub zone-, veteran-, and service disabled veteran-owned small businesses have every opportunity possible to participate in the federal procurement process. As an agency, we actually exceed what Congress expects.

As you are aware, the government-wide goal for contracting with small businesses is 23 percent. GSA's goal for the past several years has been 40 percent. GSA recently exceeded that internal agency goal, and based on preliminary FY 2002 data, this trend will continue.

The preliminary figures for FY 2002 indicate that GSA spent $13.1 billion in procuring goods and services. Of that amount, a full 40.6 percent – almost $5.3 billion – went to small businesses, nearly $900 million of that was awarded to "small, disadvantaged businesses." In addition, GSA did nearly $650 million in contracting with small, women-owned businesses in 2001. GSA aims high in its goals and achievements, because we want everyone in the agency to know that we recognize the statutorily mandated goals to be the floor --- not the ceiling.

In addition to our agency specific procurement opportunities, GSA manages the Federal Supply Service's Multiple Award Schedules (MAS) Program. The Schedules Program is a simplified procurement process whereby contracts are established with commercial firms for commonly used supplies and services. The Schedules Program offers a broad range of products and services at prices that have been negotiated by GSA and meet accepted levels of expertise, performance and value.

Federal agencies turn to these schedules contracts to fulfill agency requirements, knowing that they can depend on the quality of the products

or services these companies provide. The Schedules, in short, offer small businesses a whole new avenue of potential work with the federal government. Of the over 11,000 schedule contracts issued to date, three quarters (8,250) have been awarded to small businesses. We have several aggressive initiatives in place under this program that target small businesses and we are constantly working with the Small Business Administration (SBA) to improve the opportunities for all categories of small businesses through our program.

I'd like to address the issue of small business re-representation; that is, where small businesses are required to reconfirm their status as small businesses.

GSA realizes that a major source of complaints pertaining to large businesses receiving Federal contracts intended for small businesses involves awards made through multiple award type vehicles such as the MAS Schedules Program and Government-wide Acquisition contracts (GWAC). Under these vehicles, a contract's entire term, including the initial contract periods and subsequent options can range from five to 20 years.

Because the SBA's regulations state businesses that obtain contracts as small business will remain classified as such for the duration of the contract, some medium to large businesses are classified as small businesses for FPDS purposes.

GSA was the first agency to step forward and take aggressive measures to close the loophole regarding this re-representation. We acted as expeditiously as possible once it became apparent that current procurement policy was hindering opportunities for small businesses. We contacted SBA and worked with the Office of Federal Procurement Policy

to come up with a solution that made sense and complied with the spirit, as well as the letter of, the Small Business Act.

On March 1, 2003, we implemented a new policy throughout GSA that requires re-representation of business status at contract renewal, i.e., prior to exercise of the contract option period.

Let me make our policy clear: For Multiple Award Schedule contracts and other multiple award contracts that contain option periods, GSA contracting officers must require contractors to re-represent their size status prior to exercising an option period. For existing contract periods, implementation is effective with the next exercise of any option for these contracts. We believe we have now got the policy right and the interests of small businesses protected.

One final point I'd like to make with regard to the General Accounting Office's preliminary report that is at the center of today's hearing pertains to the Federal Procurement Data System (FPDS). The FPDS is not a reliable source for determining a contractors size.

FPDS is a central repository of statistical information on Federal contracting that identifies detailed information on contract actions over $25,000, and offers summary data on procurements less than $25,000. The System can identify who bought what, from whom, for how much, when and where.

Contracting officers manually load award data into FPDS in most cases through agency feeder systems as awards are made. Since business size status is self-represented by the contractor (except SDB, 8(a) and HUBZone), contracting officers are not required to seek verification of size status (absent a reason to suspect otherwise). Accordingly, contracting

officers rely on the information contained in the "Representations and Certifications" section of the proposal. Contracting officers do not check FPDS to determine the size status of a contractor.

A firm's size status may change over the course of months or years. FPDS is designed to capture pertinent data (including size status) that exist at the time of contract award. Under SBA's size standard designation, a firm could be determined small for a particular industry, and "other than small" for another industry. SBA establishes a size standard for each private sector North American Industry Classification System (NAICS) industry.

FPDS captures information, assuming it is properly entered, at the time of award – a specific moment in time.

That information may, and we hope it does, change over time. We want small businesses to grow and graduate from the small business program. For this reason, FPDS is not used as a source of information as to whether a company is small today, rather it is used to determine whether at the time of award, we awarded the contract to a small business.

As this Committee knows, GSA recently ran a competition for a replacement for FPDS. After a full and open competition, a contract was awarded to a small business, Global Computer Enterprises (GCE) of Gaithersburg, MD. GCE will deliver a new service for FPDS, allowing data to be entered directly over the web either by the contracting officer or through a machine-to-machine interface. *FPDS-Next Generation*, "NG" as we call it, will give us more accurate and timely information on the Government's contract awards. The result of this competition proves yet again that small businesses can compete and win government contracts because they bring innovative solutions and a commitment to success in the government marketplace.

As an aside, I am also proud to report to you that we completed a competitive out-sourcing of the Federal Acquisition Institute in which we awarded a contract to SRA who's partner, Bowie State University, is a Historically Black University.

In closing, I would like to state that the General Services Administration is fully committed to the President's Small Business Agenda and his efforts to strengthen the sustainability of the 25 million small businesses in America. To this end, GSA will continue to monitor our contracting programs and implement initiatives that result in increased opportunities for small, minority, women, HUBZone, Veteran and Service-Disabled Veteran-owned businesses.

This concludes my remarks, and I will be happy to respond to any questions that you may have.

Thank You.

KENNETH W. ROBINSON
Owner, President and CEO
KENROB and Associates, Inc.

KENROB and Associates, Inc. (KENROB) is a nationally recognized and award winning professional services organization established to provide advanced business applications and information technology services to government and industry. Established in December 1982, KENROB is a SBA Certified Small Disadvantaged business (SDB) with annual revenues exceeding $10 million. KENROB has over 100 employees and its corporate headquarters is in Leesburg, Virginia.

Mr. Robinson has over 39 years of management and technical experience, with 20 years as President and CEO of KENROB and Associates, Inc. Mr. Robinson's key to success in business is quite simple: a strong work ethic, impeccable integrity, and quality service.

Mr. Robinson spent his early years in a rural community in the Virginia Tidewater area. His formative years were spent in Philadelphia, Pennsylvania where he received his secondary education. Mr. Robinson attended Howard University in Washington, D.C., where he pursued a BS degree in Business Administration (1959). Mr. Robinson continued post-graduate studies in Computer Science, Operations Research, and Information Technology Management at American University in Washington, D.C. (1963).

In 1991, Mr. Robinson was nominated by the U.S. Small Business Administration as the Small Businessman of the Year. Also in 1991, under his leadership, KENROB was nominated for the U.S. Department of Transportation Minority Business of the Year Award.

He is a past President of the Loudoun County Virginia Chamber of Commerce, Town of Leesburg (Virginia) Parks and Recreation Commission, an active member of St. James Episcopal Church, (Leesburg, Virginia), and member of numerous local and community organizations. Mr. Robinson currently resides in Leesburg, Virginia.

Mr. Robinson's wife, Sylvia Robinson, is the Senior Vice President of Administration at KENROB. They have two sons, who both work in the family business. In his free time, Mr. Robinson enjoys spending time with his family, gardening, traveling, and playing golf.

Mr. Chairman and Other Honorable Members of this Committee:

My name is Kenneth W. Robinson, President and CEO of KENROB and Associates, Inc. KENROB is a small disadvantaged business government contractor and provider of innovative technology solutions and technical services. The client base is 90% federal government. KENROB is a graduate of the 8(a) program and has recently completed its 20th year of business.

I view my participation here today as a tremendous privilege and opportunity to share my opinion and experiences relative to many critical issues surrounding small business equity within the current federal procurement arena.

I wish to first state for the record that it is my belief that the federal procurement process, as currently structured and administrated, has serious flaws regarding equity and the well being of small business government contractors. These flaws must be addressed and eliminated. The implied problems are universal and span the entire federal government contracting activity. There is a failure by government procurement officials to grasp the magnitude of problems relative to the plight of small business vying for federal contract dollars.

The procurement system, relative to small business, is severely "broken" and must be fixed. Accountability, compliance, and enforcement of the existing rules, policies, and regulations pertaining to small business utilization are being ignored and, in many instances, carefully circumvented by both government and large business contractors.

In general, the entire concept of small business participation and sharing in federal government contracting dollars is a well-managed system of omission and deception carefully camouflaged with misinformation and cooked numbers and statistics.

This environment thrives only because there exist no viable system of enforcement vested with appropriate power, authority and mandate to enforce compliance and accountability by government procurement officials and large business contract management.

I salute Administrator Styles, of the OFPP, who recently stated "there is a need to put teeth into old rules by making subcontracting compliance a major part of companies past performance evaluation."

Certainly, this would be a step in the right direction. However, much stronger measures are needed to force government procurement officials and large government prime contractors into compliance. Prim contractors and government procurement managers are not committed to complying with or enforcing rules and regulations that currently exist. Particularly, when there is no anticipated consequence or penalty for non-compliance. It is beyond reason to expect that new rules that are currently being developed will result in significant change in practice without strict accountability and severe consequences for non-compliance.

Why am I capable of making such allegations? The answer is quite simple, experience. For the past 20 years I have been in the information technology services business, primarily as a government contractor. Over the years, I have observed large business and procurement officials in every way imaginable undermine small business in the government procurement arena. Loopholes and practices by which small businesses get short-changed by both large business and the government must be eliminated.

I have teamed with large business on major contract initiatives as the mandatory small business participant, only to be denied the work share promised to me after the contract was awarded.

Assuring small business participation in all federal government contracting opportunities must be an integral part of meaningful procurement reform initiatives. The well-being of the small business must be preserved and considered a vital component of the federal procurement community

Concepts such as "bundling" and "evergreen contracts" are killing off small business. This is a huge problem with wide ranging dynamics. Multiple agencies, be it DoD, GSA, NASA, SBA, and others, are focused on different aspects of the problem. I implore this committee to take the leadership and initiative to influence measures that will lead to effective procurement reform. We need small business utilization enforcement with teeth. Rules and regulations that are enforceable and enforced and cannot be ignored by large business and government procurement managers.

The Office of Management and Budget (OMB) are on record as supporting increased competition among government contractors. In so doing, greater emphasis will be placed on accountability and small business participation. We are being told that accountability is a constant theme throughout this administration and that initiatives designed to encourage competition are being worked on.

The attention being paid to accountability, competition and bundling by the OMB is applauded and welcomed by small business. However, proposed changes in policy alone will not get the job done. Consistent with the Bush Administration's small business agenda, which champions greater small business participation in government contracting, the universal government procurement arena must be committed and driven as well. In particular, the OMB and the Small Business Administration must take the lead in appropriate reform of Federal Acquisition Regulation (FAR) and SBA regulations.

Much attention has been focused on bundling and size classification. Issues surrounding bundling and size certification are obviously at the top of the list of reform priorities, but only represent a tip of the small business iceberg of problems and inequities, which prohibit the so-called "level playing field in the small business procurement arena".

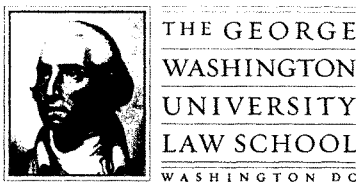
Speaking as a small business owner who has fought the procurement equity battle for 20 years, I encourage meaningful procurement reform that effectively addresses the plight of small business and includes mandated rules and enforcement provisions that assure small

business participation and equity. The following represent areas of concern that must be thoroughly examined with regard to their impact on small business government contractors:

- Future reform initiatives must be comprehensively thought-out and crafted prior to implementation;
- Accountability regarding small business utilization should be mandated and enforced at all levels of government procurement;
- Breach of teaming agreements and subcontract terms and conditions by large business when subcontracting to small business;
- Large business prime contractors limiting small business subcontractors to low-tech services and "body shop" providers;
- The existence of Mentor protégé arrangements that are primarily used by large business to win contracts, but do not result in mentorship the small business partner;
- Mandatory flow down provisions of contract clauses that mandate utilization of small business subcontractors; and
- Revisiting of size standard definition for small and mid-sized businesses. Currently there exists much confusion between revenue levels versus headcount levels.

I thank you for allowing me to share with this Committee some of the critical small business issues that I feel must be dealt with through effective procurement reform. In closing, I encourage this Committee to vigorously support small business equity in the federal government procurement arena.

Statement of
Professor Steven L. Schooner
before the
U.S. House of Representatives
Committee on Small Business



Wednesday, May 7, 2003

Small Business and Public Procurement

Chairman Manzullo, Congresswoman Velazquez, and members of the Committee, I appreciate the opportunity to appear before you today. The issues raised by the Committee offer a unique opportunity to consider the role and efficacy of Congressionally mandated policies regarding small business participation in the federal procurement process.

I will address four issues today. First, although federal agencies are not meeting the legislative goal for small business participation in procurement, small businesses continue to thrive in the federal government marketplace. Second, to the extent that the government's attention has turned to management and control of its purchase card program, the small business community must not squander this window of opportunity. Now is the moment for small business to begin to recapture a larger share of this market, worth nearly $14 billion per year. Third, while I encourage efforts to better manage small business awards under multiple award contracts, I urge caution in imposing remedial measures. The unintended consequences of otherwise facially attractive solutions may adversely impact small business participation in government contracts. Finally, I attempt to interject a dose of pragmaticism into the ongoing bundling debate.

An Optimistic Assessment

First, putting anecdotal evidence aside, the outlook for small businesses pursuing the federal government's contracts is bright. Despite isolated problems, the small business share of federal procurement dollars remains remarkably high. Accordingly, I strongly discourage the Committee from fixating on short- or long-term failures to meet the rather-recently increased 23 percent small business participation goal. It seems wrong to ignore the surprising ability of the federal government to sustain high small business participation – above the long-standing 20 percent benchmark – in light of numerous changes and developments that could far more adversely impact small business.

The Small Business Administration (SBA) Reauthorization Act of 1997 raised the

government-wide goal for small business participation from 20 percent to 23 percent.[1] At the time, this incremental increase was a bartered result – no serious empirical research justified the increase. During the mid-1990's, agencies, on a government-wide or aggregate basis, had exceeded the 20 percent goal, but not by three percent (and not consistently). Those who followed the issue closely recognized, at the time, that increasing the government-wide goal would prove a formidable challenge. Many predicted failure to achieve and sustain the increased rate. We should not be surprised by any such difficulties currently being experienced.

As the chart below demonstrates, Fiscal Year 2001 was a terrific year for small businesses in federal procurement. Small businesses received an additional $5.3 billion in contract awards – an increase of more than twelve percent. Moreover, while the 23 percent goal has not been met for the last two years, the small business share has remained above the 20 percent threshold.

SMALL BUSINESS PARTICIPATION IN FEDERAL PROCUREMENT (Federal Procurement Data Center)		
	FY 2000	**FY 2001**
Small Business Actions (government-wide)	4,943,770	5,035,668
Small Business Dollars	$44.7 billion	$50.1 billion
small business increase: FY 00 to FY 01: $5.3 billion (12 percent)		
Government-wide Actions (total)	9,847,967	11,410,869
Government-wide Dollars	$218.8 billion	$234.8 billion
Small Business Share of Dollars Awarded	**22.26**	**22.81**
Small Business share of dollars: adjusted percentage (independent calculation using FPDC data)	*20.4*	*21.3*
Purchase Card Transactions	23,457,456	24,443,850
Purchase Card Dollars (total)	$12.28 billion	$13.78 billion
Purchase Card activity as a percentage of procurement dollars (total)	*5.3*	*5.5*

[1] Pub. L. No. 105-135 (1997); 15 U.S.C. § 644(g).

Purchase Cards: Procurement Opportunities Below the Radar

Returning to the chart above, let me draw your attention to the purchase card statistics. Here, the picture looks less rosy for small businesses. Purchase card transactions now exceed five percent of procurement spending. It seems axiomatic that, as the government's purchase card use has grown, small businesses have struggled to maintain their ability to sell to the government below the micro-purchase threshold (currently $2,500 per transaction). Insufficient data continues to impede efforts to quantify these impacts, but anecdotal evidence suggests that large-scale retailers, such as Office Depot, Staples, Best Buy, and Circuit City, have benefitted at small businesses' expense.[2]

For this huge number of transactions, law, policy, and practice all too often permit purchase card users to ignore the Government's normal procurement rules and procedures. The current regime requires virtually *nothing* of the government employees who buy using a government purchase card. Their average training in procurement is less than four hours. To the extent that regulations may require efforts to rotate purchases among vendors or encourage the use of small businesses, this guidance is routinely ignored.[3] Moreover, anecdotal evidence suggests that buyers frequently dis-aggregate their requirements (the opposite of bundling, discussed below) to take advantage of the streamlined micro-purchasing regime.

Until recently, with few exceptions (notably the General Accounting Office (GAO) and agency inspectors general), the government adopted an ostrich-like approach to oversight concerns while trumpeting the efficiencies associated with purchase card use.[4] Even as disclosure of purchase card abuse became more widespread,[5] few attempted to rein in purchase

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[2] Anecdotal evidence suggests this is an over-simplification, because: (1) the growth of these companies derived, at least in part, from absorbing or rolling-up smaller, regional competitors; and (2) far fewer small, independent firms currently compete in these markets.

[3] Summary Report of the DoD Inspector General, *DoD Purchase Card Audit Coverage*, D-2002-029 (December 27, 2001).

[4] Steven L. Schooner & Neil S. Whiteman, *Purchase Cards and Micro-Purchases: Sacrificing Traditional United States Procurement Policies At the Altar of Efficiency*, 9 PUBLIC PROCUREMENT LAW REVIEW 148 (2000); Neil S. Whiteman, *Charging Ahead: Has the Government Purchase Card Exceeded Its Limit?*, 30 PUBLIC CONTRACT LAW JOURNAL 403 (2000).

[5] See, generally, General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-01-995T (July 30, 2001); and the

(continued...)

card use. Recent attention, however, from Congress, the GAO, the Office of Management and Budget, and the inspector general community, has altered the trend and sparked initiatives to reign in irresponsible purchase card usage, insufficient purchase card management and oversight, and inadequate purchaser training.[6] But the small business community can ill afford to relax during this window of opportunity. The time is now to demand insight into purchase card usage trends and appropriate controls on their use.

It is easy to disregard the purchase card market as an unwieldy concatenation of high volume, low dollar value transactions. Granted, the nearly 25 million transactions average only $560 apiece. But $13.78 billion dollars is nothing to sneeze at. Moreover, through their numbers and the geographical dispersion, small businesses are uniquely well positioned to serve the government's seemingly insatiable needs in the form of small transactions. But, if the government intends for purchase card usage to entail a high degree of reliance on small business, a significant behavioral change is required. As the government works to reform its purchase card practices and controls, small business should demand a seat at the table

Bad Apples, Bad Policy?

One of the concerns that animates this hearing derives from reports that certain small business opportunities end up in the hands of large businesses, formerly small businesses that have "graduated" or grown into other-than-small businesses (either by hiring additional employees or generating additional revenue, depending upon the industry), or small business that, during the course of contract performance, grew out of their previously certified size status.[7]

Clearly, the worst aspects of this problem are avoidable. Contractors that fraudulently certify their size status should be prosecuted.[8] For multi-year, multiple-award task order or

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[5](...continued)
subsequent report, GAO-02-32 (November 30, 2001).

[6] Conversely, Congress granted the nascent Department of Homeland Security, now the third largest federal agency, micro-purchase authority up to $7,500 – triple that currently available in other agencies. Pub. L. 107-296, § 833.

[7] See, e.g., Karen Robinson-Jacobs, *U.S. Is Examining Government Contracts Meant for Small Firms*, LOS ANGELES TIMES (November 4, 2002).

[8] As I discuss below, however, in the current environment (in which the government lacks sufficient resources to properly award and administer its contracts), it is difficult to justify using the government's scarce acquisition resources for this purpose. This is a classic example
(continued...)

delivery order contracts – where individual task or delivery awards are, in effect, new contracting actions – it seems perfectly reasonable to require annual re-certification of size status. OFPP's recent efforts (in a series of letters dated February 11, and April 1, 2003) to focus its executive agents on this problem seems like an appropriate response. Be forewarned, however, that one short-term result of this initiative may be a marked decrease in the small business participation rates.

A word of caution is appropriate here. The nature of size standards – tethered to industries arranged according to the North American Industry Classification System (NAICS) – causes some firms to be small (and eligible) for certain contracts, yet large (and ineligible) for other work. Further, the size standards are, at best, artificial and, at worst, arbitrary. Outside of the procurement community, reasonable business people would be hard-pressed to distinguish a pharmacy grossing an average of $6.05 million over a three-year period from the neighboring drug store that took in an average of $5.95 million during the same period. Of course, the same could be said for two construction companies: there is no meaningful difference between a small business (grossing $24.4 million per year) and its large competitor (grossing $24.6 million per year). It seems disingenuous to bemoan advantages bestowed upon contractors that recently pierced these arbitrary thresholds. In this context, obsessive compliance seems to elevate form over substance.[9]

Moreover, the procurement community is well versed in the gamesmanship attendant in operating within the constraints inherent in these policies. For example, few procurement professionals are surprised (or concerned) by creative small business contractor "size management" practices. A textile manufacturer, highly dependent upon government contracts, has every reason to avoid hiring its 501st employee (and, might instead, subcontract out certain tasks or utilize an employee augmentation subcontractor to avoid crossing the size threshold).

Nonetheless, we should discourage and, where appropriate, punish truly large firms that

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[8](...continued)
where third-party oversight – deputizing competing contractors as private attorneys general – is particularly appropriate. SBA's size protest procedures, as well as the *qui tam* provisions of the False Claims Act, permit and encourage both small and large businesses to assist the government in maintaining integrity of its small business programs.

[9] Moreover, it seems Draconian to promptly spurn recent "graduates," rather than wean them of the government contracting preferences that may have accounted for much, if not all, of their recent growth. This is particularly true to the extent that many of these firms fail to sustain and build upon their successes, thus promptly "regaining" their small business size status. For similar reasons, it seems inefficient to devote more than the minimum resources to aggressively policing and purging Pro-Net (or the Central Contractor Registration system).

falsely certify their size status.[10] At the same time, in legislating and regulating, we must recognize that, in a vibrant marketplace, some small firms will merge with or acquire other small firms, be acquired by large firms, or quickly develop business that will disqualify them from future small business opportunities. None of these growth-related activities are inherently nefarious. Nor should they lead to the interruption of the government's contractual relationships.[11] Changing the government's longstanding policy, which treats companies as "small" for the duration of contract performance, would prove unnecessarily chaotic. Accordingly, a high degree of precision coupled with carefully calibrated flexibility are required in any legislative or regulatory solution.

Bundling Issues:
Resources, Cheerleaders, Ostriches, and Responsible Leadership

While I am sympathetic to the anti-bundling movement, I remain troubled by the disconnect between aspiration and the realities of implementation in this sphere. There are costs associated with unbundling, yet much of the current debate fails to acknowledge them. Quite simply, demanding that an over-worked acquisition workforce aggressively unbundle its contracts is akin to trying to squeeze blood from a stone. If the government wants its contracts unbundled, I recommend that we initiate a meaningful discussion about how to pay for this additional effort. Otherwise, any unbundling initiative becomes an unfunded mandate burdening an already strained acquisition process.

Contract bundling or aggregation refers to a consolidation of contract requirements that makes the scope of work so large or diverse that it limits small business participation. Statutory requirements limit the government's ability to leverage its buying power through consolidation of its procurement requirements or "bundling." These statutory provisions seem inconsistent with the federal government's general policy of buying in quantities that generate economies of scale

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[10] Unfortunately, as discussed at greater length below, I remain concerned that a host of economic and non-economic factors have conspired to reduce the oversight required to maintain integrity in our public procurement system. See, e.g., Steven L. Schooner, *Fear of Oversight: The Fundamental Failure of Businesslike Government,* 50 AMERICAN UNIVERSITY LAW REVIEW 627 (2001).

[11] Consider the following example. Assume that the government properly awards a set aside construction contract, expected to require 18 months to complete, to a small business. Six months later, the firm no longer qualifies as a small business. Six months later, the government modifies the contract, requiring additional work within the scope of the contract. Although a large business received this work, no impropriety has occurred

to maximize savings.[12] Before bundling requirements, agencies must determine if anticipated consolidations are necessary and justified (i.e., because the consolidation would result in measurably substantial benefits in terms of cost savings, quality improvements, reduction in acquisition cycle times, better terms and conditions, or any other benefits). Historically, the battle lines formed around whether the benefits (such as cost savings) *projected* by the procuring agency were *substantial enough* to justify the *de facto* exclusion of small business competitors.

But the battlefield has shifted, and it is important to understand why more contracts are bundled today. There are obvious administrative efficiencies associated with avoiding smaller, more numerous purchases, and the need to pursue these efficiencies has increased, rather than decreased, over the last decade. Increasing sophistication in government systems also, on occasion, means that agencies can purchase only from large firms. Moreover, the demands upon our acquisition personnel to buy more goods and services with ever-decreasing acquisition resources drive our buyers to use the most efficient (but often the least transparent or competitive) vehicles to accomplish their mission.[13] OFPP Administrator Angela Styles succinctly articulated these points:

> Increased demands to make the acquisition process quicker and less complex coupled with reductions in the overall acquisition workforce have driven acquisition managers to bundle requirements. To meet these demands and increase customer satisfaction, agencies have increasingly consolidated contractual requirements into larger contracts and used limited and simplified competition procedures for acquiring products and services.
>
> . . .
>
> This decline in small business participation has been exacerbated by the use of contract vehicles that are not uniformly reviewed for contract bundling. Orders under agency multiple award contracts (MACs), multi-agency contracts, Government-Wide Acquisition

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[12] See 10 U.S.C. § 2384(a), 41 U.S.C. § 253f, and FAR 7.202, which generally require agencies to procure supplies in quantities that will result in the total cost and unit cost most advantageous to the government. Solicitations for supplies invite offerors to indicate whether the quantity proposed to be acquired is economically advantageous or recommend a quantity which would be more economically advantageous.

[13] But herein lies the rub. "The *reduction of administrative or personnel costs alone shall not be a justification* for bundling of contract requirements unless the cost savings are expected to be substantial in relation to the dollar value of the procurement requirements to be consolidated." 15 U.S.C. § 644(e)(2)(C)(emphasis added).

> Contracts (GWACs), and GSA's Multiple Award Schedule Program are not subject to uniform reviews for contract bundling issues. This lack of uniform review is a problem because, while there has been a sharp decline in other contract actions, there has been a significant increase in orders under these contracts.[14]

Let's be frank. There simply are not enough qualified acquisition professionals left in the federal government to conduct appropriate market research, properly plan acquisitions, maximize competition, comply with a plethora of Congressionally-imposed social policies, administer contracts to assure quality control and guarantee contract compliance, resolve pending protests and disputes, and close out contracts.[15] The most recent GAO report finds that the acquisition workforce has declined dramatically,[16] while "all agencies face the prospect of losing many of their skilled acquisition personnel over the next 5 years – with a significant portion of the government's acquisition workforce becoming eligible to retire by fiscal year 2008." Yet, GAO concludes that "[f]urther growth in contract spending . . . is likely given the President's request for additional funds for defense and homeland security, agencies' plans to upgrade their information technology systems, and other factors. . . . Further, the administration's emphasis on competitive sourcing could increase agencies' reliance on services provided by the private sector."

This point bears emphasis for two reasons. First, as GAO succinctly explains: "Our prior work has shown that when workforce reductions do not consider future needs – such as the staff reduction at DOD during the 1990's – the result is a workforce that is not balanced with regard to experience and skill sets."[17] Moreover, there is no doubt that the most rapidly growing area of procurement activity lies in service contracting. Successful service contracts are difficult to draft and, more importantly, require significant resources to administer or manage. Currently, there are inadequate personnel resources, and insufficient investment has been made to train existing

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[14] October 2002 Office of Federal Procurement Policy (OFPP) paper: *Contract Bundling: A Strategy for Increasing Federal Opportunities for Small Business.*

[15] See, generally, *Federal Procurement: Spending and Workforce Trends*, GAO-03-443 (April 2003); Office of the Inspector General, Department of Defense, *DoD Acquisition Workforce Reduction Trends and Impacts*, Report D-2000-088 (February 29, 2000).

[16] The two reports, *supra*, differ as to the specific quantities of the cuts (with estimates of the reductions ranging from approximately one-quarter to one-half during the 1990's), but both acknowledge that the cumulative impact has been devastating.

[17] GAO-03-443, citing, *inter alia, Contract Management: Trends and Challenges in Acquiring Services*, GAO-01-753T (May 22, 2001).

personnel in required skills (such as drafting performance-based statements of work). In other words, the critical acquisition workforce problems will get worse before they get better. Asking this workforce, without the promise of additional resources, to unbundle its requirements, is unrealistic and, arguably, fiscally irresponsible.

The problems associated with inadequate acquisition personnel resources will not quickly evaporate. Nor is there any reason, at this point, to expect Congress to provide sufficient resources for agencies to achieve their missions and goals. Here, Congress has done the opposite. After a decade of arbitrary procurement workforce reductions, Congress demands that its buyers do more with less. That makes for good theater, but it's not responsible leadership. Against that backdrop, few no-cost alternatives offer a solution. OFPP's recently proposed anti-bundling rules, however well intended, will increase burdens on procurement managers.[18] But nothing suggests that any investment will be made to facilitate these additional efforts.

At the same time, I applaud OFPP's initiative to mitigate the effects of contract bundling by strengthening compliance with subcontracting plans. OFPP suggests that, "in acquisitions where contract bundling is determined to be necessary and justified, actions will be taken to mitigate the effects of bundling by increasing subcontracting opportunities for small businesses." In today's procurement environment, it makes sense to shift, to the private sector, responsibilities and functions that the government is unable or unwilling to support with its own resources.

The time is ripe for the government to demand more of its contractors through their subcontracting plans. If the government is unwilling to devote sufficient resources to the identification, nurturing, selection, and management of small businesses through prime contracts, the government can more aggressively enlist its larger prime contractors to help achieve the same ends. Of course, agencies could increase – incrementally or even arbitrarily – subcontracting goals on large contracts. This may prove the proper trade-off where bundling is unavoidable. In addition, Congress or agencies could incentivize – either through evaluation criteria or through award fees – higher small business participation.

This Committee recognizes that, historically, compliance with these subcontracting plans and agency oversight of contractor compliance with the plans has been unfortunately

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[18] The proposed rule would require that periodic reviews be prepared and provided to agency heads and the Small Business Administration (FAR 19.201(d)(11)); that additional information be included in the preparation of a mind-boggling number of contractor performance assessments (FAR 42.1502(a)); and that additional justifications, descriptions of anticipated benefits, and discussions of alternatives be generated where bundling occurs (FAR 7.107). 65 Federal Register 5138 (January 31, 2003).

inconsistent.[19] Moreover, it is unclear what resources are available to assist agencies in strengthening oversight of contractor efforts to comply with subcontracting plans. This is an area hit particularly hard by acquisition workforce reductions. The reality of the workforce cuts has led to a triage-type focus on buying, which has severely limited the resources available for contract administration. (Think about it: when the acquisition corps shrinks, the buyers who remain must keep buying to fill agencies' stated needs. The first responsibility jettisoned often is contract administration or management.) Of course, this recipe for disaster hides significant downstream costs. But reduced contract administration resources also render impractical any efforts to increase attention to subcontracting plan compliance. Increasing subcontracting plan compliance will require difficult answers to questions that, to date, have been studiously avoided. Specifically, what personnel will be deemed responsible for monitoring contractor compliance with subcontracting plans? (Or, more importantly, which of their current responsibilities can be sacrificed to handle this additional responsibility?)

Conclusion

United States procurement policy aspires to obtain quality supplies, services, and construction economically, efficiently, and in a timely manner. Federal procurement law, regulation, and policy seek to procure the best value for the taxpayer in a system that is transparent, maximizes competition, and ensures integrity. At the same time, our government utilizes its purchasing power as a means of promoting numerous social policies. Government contracts further goals such as fostering small businesses, overcoming regional unemployment, assisting minority workers, ensuring fair treatment of employees, protecting the environment, and, where appropriate, providing preferences to domestic and other special sources of supply, such as the blind and severely handicapped. These policies, and the requirements that implement them, impose certain burdens upon the procurement process, most noticeably by adding complexity to our statutes, regulations, and policy guidance.[20] The tensions inherent in small business procurement participation are long-standing and thorny. At the end of the day, we can only hope that Congress makes a good faith effort to balance these competing concerns.

That concludes my testimony. Thank you for the opportunity to share this information and these thoughts with you. I would be pleased to answer any questions.

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[19] *Small Business Subcontracting Report Validation Can Be Improved*, GAO-02-166R (December 13, 2001).

[20] "These goals are often regarded as illegitimate by people inside the system because they have no direct bearing on national security or on acquisition. Indeed, they look like the workings of powerful special interests trying to bend society's rules in their favor." Mark Cancian, *Acquisition Reform: It's Not as Easy as it Seems*, ACQUISITION REV. Q. 189, 191 (Summer 1995).

United States General Accounting Office

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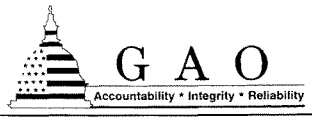
Testimony
Before the Committee on Small Business, House of Representatives

For Release on Delivery
Expected at 2:00 p.m. EDT
Wednesday, May 7, 2003

CONTRACT MANAGEMENT

Reporting of Small Business Contract Awards Does Not Reflect Current Business Size

Statement of David E. Cooper
Director
Acquisition and Sourcing Management



GAO-03-704T

May 7, 2003

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Highlights

Highlights of GAO-03-704T, testimony before the Committee on Small Business, House of Representatives

CONTRACT MANAGEMENT

Reporting of Small Business Contract Awards Does Not Reflect Current Business Size

Why GAO Did This Study

According to information in the Federal Procurement Data System (FPDS), in fiscal year 2001, small businesses received approximately 23 percent of federal contract dollars awarded. However, concerns have been raised that large companies are receiving federal contracts intended for small businesses.

What GAO Recommends

We have not made recommendations in this testimony. However, we note the need for accurate and consistent data on companies' business size in order to reliably report small business contract awards. Accordingly, we believe a coordinated effort between agencies is necessary to ensure that accurate and reliable small business data is reported.

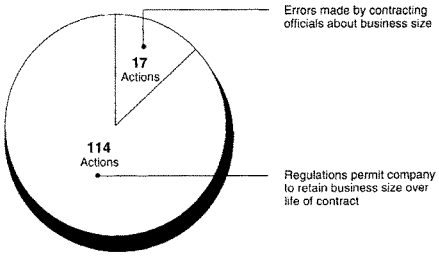
What GAO Found

According to FPDS, five large companies that we reviewed received contracts totaling $1.1 billion in fiscal year 2001, including $460 million as small business awards. To understand why awards to these large companies were listed in FPDS as small business awards, we focused our review on 131 individual contract actions awarded to these companies by four federal buying activities.

The predominant cause for the misreporting of small business achievements is that federal regulations generally permit a company to be considered as a small business over the life of the contract—even if they have grown into a large business, merged with another company, or been acquired by a large business. In today's federal contracting environment, contracts can extend up to 20 years. In addition, agencies relied on various databases containing inaccurate information on current business size.

The General Services Administration, the Office of Federal Procurement Policy, and the Small Business Administration have taken or proposed a number of actions aimed at requiring small businesses to re-certify and not retain their small business status for the life of the contract. While these proposals do not directly address the database problems we identified at the four federal buying activities, there are a number of initiatives under way designed to improve federal contract databases.

Large Companies' Contracts Reported as Small Business Awards



Source: GAO.

www.gao.gov/cgi-bin/getrpt?GAO-03-704T.

To view the full report, including the scope and methodology, click on the link above. For more information, contact David Cooper at (617) 788-0555 or cooperd@gao.gov.

Mr. Chairman and Members of the Committee:

Thank you for inviting me to participate in today's hearing on whether large companies[1] are receiving federal contracts intended for small businesses. According to the Federal Procurement Data System (FPDS),[2] small businesses received approximately $50 billion, or almost 23 percent of federal prime contract dollars awarded in fiscal year 2001. In response to your request, we reviewed awards to five large companies to determine

- how contracts awarded to the companies were reported in FPDS,
- why federal contract officials reported the contracts as small business awards, and
- what actions are being taken to address any identified problems.

A detailed discussion of our scope and methodology can be found in appendix I.

According to FPDS, the five large companies received contracts totaling over $1.1 billion in fiscal year 2001, including $460 million reported as small business awards. To understand why awards to these large companies were listed in FPDS as small business awards, we focused our review on 131 individual contract actions awarded to these companies by four federal buying activities.

The primary reason these contract actions were reported as small business awards is because federal regulations generally permit companies to be considered small over the life of a contract—even if the company grows into a large business, merges with another company, or is acquired by a large business. We also found that contracting officials reported some contract actions as small business awards because they relied on databases containing conflicting and incorrect information about the current size of some of the companies we reviewed. While these results cannot be projected to all contract actions reported, they raise serious questions about relying on FPDS data to measure federal agencies' efforts to meet the government's 23 percent small business goal.

[1] The Small Business Administration (SBA) uses the terms small and other than small to define those concerns that meet their size standards and those that do not. For purposes of this statement, we use the term large to identify those concerns that are other than small.

[2] FPDS is the government's central repository of statistical information on federal contracting. The system contains detailed information on contract actions over $25,000 and summary data on procurements of less than $25,000.

The Office of Federal Procurement Policy (OFPP), the General Services Administration (GSA), and the Small Business Administration (SBA) have all recognized the need to address issues regarding changes in the size of businesses, particularly in the context of today's long-term federal contracts. Each has proposed actions designed to protect small business interests and ensure small business achievements are reported accurately.

Background

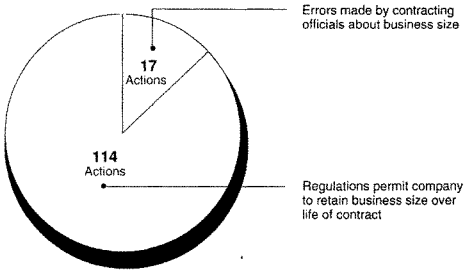
The Small Business Act defines a "small business concern" as one that is independently owned and operated and that is not dominant in its field of operation. The act allows SBA to further define a small business. In its regulations, SBA has established size standards for different types of economic activities, or industries, generally under North American Industry Classification System (NAICS) codes. Size standards define the maximum size that a business, including all of its affiliates, can be to be eligible as a small business for all SBA and federal programs that require small business status. Most size standards are based on either number of employees or average gross revenues.

The Federal Acquisition Streamlining Act of 1994 (FASA) codified the authority of agencies to enter into task or delivery order contracts with multiple firms for the same or similar products, known as multiple award contracts (MAC). Also, the Clinger-Cohen Act of 1996 provided for the use of multiagency contracts and what have become known as governmentwide acquisition contracts (GWAC). Agencies have increasingly used these types of contracts, which can extend up to 20 years, to quickly meet their acquisition needs rather than issuing new contracts. For these types of contracts, the size of a business is determined as of the date the business submits a self-certification in its initial offer. If a business is small as of that date, agencies may place orders pursuant to the original contract and consider these orders as awards to a "small business" for the length of the contract, even if the company outgrows the original contract's size standard.

Reporting of Small Business Contract Awards in FPDS Does Not Reflect Current Business Size

Our work at the four federal buying activities showed that contracting officials reported 131 contract actions made to the five large companies in fiscal year 2001 as small business awards. (See fig. 1.)

Figure 1: Large Companies' Contracts Reported as Small Business Awards



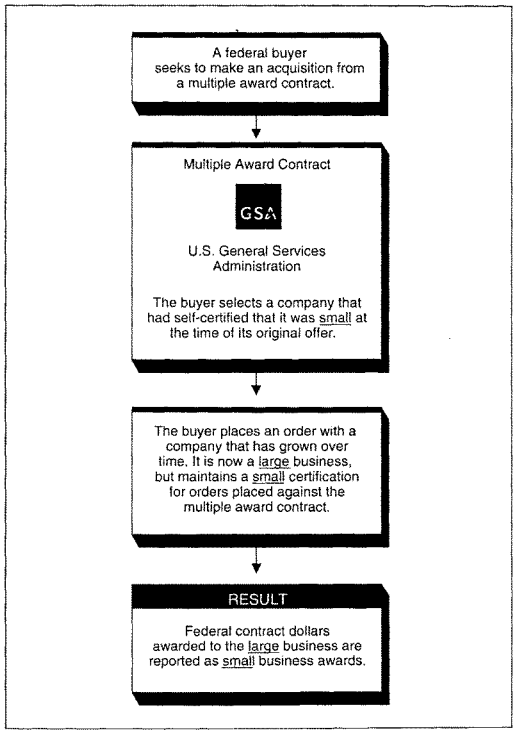
Source: GAO.

SBA conducted an analysis of FPDS data concerning four companies in fiscal years 2000 and 2001 under GSA's Multiple Award Schedules Program and concluded that the small business award information in FPDS is misleading. According to SBA, the four companies were initially certified as small businesses and awards to these companies continued to be reported as small business contracts even though they became large businesses. In fiscal year 2000, the four companies received 1,313 contract actions valued at over $190 million that were reported as small business awards. In fiscal year 2001, these companies received 1,271 contract actions amounting to over $200 million reported as going to small businesses.

Reasons Why Information In FPDS Does Not Reflect Current Business Size

The primary reason why contracts awarded to large companies are reported in FPDS as small business awards is that federal regulations permit companies to be considered small over the life of a contract—even if they have grown into a large business, merged with another company, or been acquired by a large business. Given that the term of a contract can extend for up to 20 years in the current federal acquisition environment, there is often ample time for a company's size to change. We found this to be the case in several of the companies we reviewed. For example, one company was initially certified as a small business but subsequently grew in size and no longer qualified as a "small business" for federal contracting purposes. However, the company continued to receive awards that were reported in FPDS as small business awards in accordance with current regulations. In fiscal year 2001, this company received small business contract awards totaling nearly $330 million. (See fig. 2.)

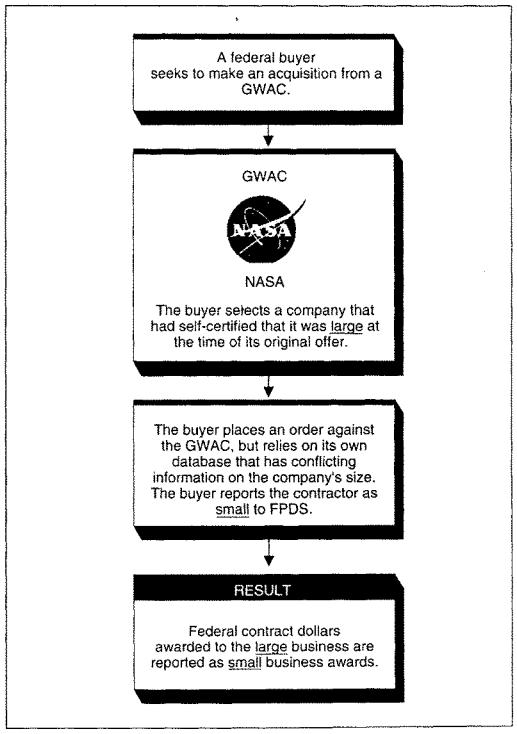
Figure 2: An Example of How FPDS Small Business Information Is Affected by Federal Regulations



Source: GAO.

We also found several cases where contracting officials relied on conflicting and inaccurate information in federal databases to report business size information. Specifically, at the four federal buying activities we visited, contracting officials were using databases that contained outdated and inaccurate information about the size of the companies we reviewed. For example, a company certified it was a large business under a GWAC, but contracting officials placing an order off of this GWAC relied on outdated information contained in databases and reported these orders as going to a small business. (See fig. 3.)

Figure 3: An Example of How FPDS Small Business Information Is Affected by Contracting Officials Using Databases That Contain Outdated or Inaccurate Information



Source: GAO.

Proposals to Address Reporting of Small Business Size

GSA, OFPP, and SBA have taken or proposed a number of actions to improve the accuracy of reporting small business size. All of the proposed actions are aimed at requiring small businesses to re-certify and not retain their small business status for the life of the contract. For example:

- In October 2002, GSA changed its policy to require companies receiving Federal Supply Service (FSS) Multiple Award Schedule Program contracts and all other multiple award-type contracts to re-certify their business size when the government exercises options to extend such contracts—which for the FSS contracts generally occurs at 5-year intervals.
- In February 2003, OFPP required agencies with GWACs to have their contractors annually re-certify their status as small businesses.
- In April 2003, SBA proposed several changes to its regulations governing small business size. Specifically, SBA proposed that companies receiving Multiple Award Schedule Program contracts and other multiple award contracts must re-certify their small business status annually. SBA's proposed changes also included procedures for publishing a list of re-certifications and allowing interested parties to challenge the re-certifications. SBA also reserved the right to review or request a formal size determination of any re-certification. Public comments on SBA's proposed regulatory changes are due by June 24, 2003.

While these proposals address the primary cause of large companies being reported as receiving small business awards, they do not directly address the database problems we identified at the four federal buying activities. It is imperative that federal contracting officials have accurate and consistent data on companies' business size in order to reliably report small business contract awards. There are a number of initiatives underway designed to improve federal contract databases. Accordingly, we believe a coordinated effort between agencies is necessary to ensure that accurate and reliable small business data is reported.

Conclusion

A purpose of the Small Business Act is to ensure that a fair proportion of all federal contracts be placed with small business concerns. Implicit in this is the notion that the work under the contract will actually be performed by a small business.

Small business contracting information reported in FPDS is misleading because regulations permit companies to retain their small business status over the life of contracts—which in today's federal contracting environment could last as many as 20 years. Federal databases containing outdated and incorrect information add to the problem.

Considering the duration of current federal contracts, it is reasonable to require contractors to update their small business status more frequently to reflect their actual size. We believe the proposals by GSA, OFPP, and SBA are preliminary steps to achieve this purpose.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

Contact and Acknowledgments

For further information regarding this testimony, please contact David E. Cooper at (617) 788-0500. Individuals making key contributions to this testimony include Robert Ackley, Penny Berrier, Chris Galvin, Julia Kennon, Judy Lasley, John Needham, Russ Reiter, Sylvia Schatz, and Karen Sloan.

Appendix I: Scope and Methodology

Using FPDS, we identified 49,366 companies receiving contract awards reported as going to small businesses in fiscal year 2001. Of these companies, 5,341 also received contract awards as a large business. These companies were reported receiving over $13.8 billion as a small business and almost $60.6 billion as a large business. To conduct our work, we reviewed a judgmental sample of contract actions awarded by four federal buying activities to five large companies.

To ensure that we had a good selection of contract actions and federal buying activities to review, we identified companies that received at least 50 contract actions that were recorded as going to a small business and at least 50 contract actions recorded as going to a large business. Nineteen companies met these parameters. We selected five of these companies based on a number of factors including the type, value, and number of contract actions, and location of the buying activity. The five large companies in our sample received both large and small business contracts totaling about $645 million and $460 million, respectively, in fiscal year 2001. We then selected contract actions awarded to determine how the companies had, in these cases, been classified as a small business. We reviewed 131 contract actions totaling $17.4 million. Our work was performed at the Office of Personnel Management, GSA's Federal Systems and Integration Management Center, the Department of Air Force's Hanscom Air Force Base, and the Department of Army's Defense Contracting Command-Washington.

In addition, we reviewed the contracts awarded by GSA's Federal Supply Service, National Institutes of Health's Information Technology Acquisition and Assessment Center, National Aeronautic Space Administration's Scientific and Engineering Workstation Procurement, and the Department of Army's Small Army Computer Program.

Finally, we held discussions with officials at GSA, OFPP, and SBA. To obtain the small business perspective, we spoke with small business association representatives. We conducted our review between November 2002 and May 2003 in accordance with generally accepted auditing standards.

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May 15, 2003

via: Federal Express and email

Mr. Nelson Crowther, General Counsel
Committee On Small Business
U.S. House of Representatives
2361 Rayburn Building
Washington, D.C. 20515

Re: Comments to Committee Meeting of May 7, 2003

Dear Mr. Crowther:

We listened to the U.S. House of Representatives Committee On Small Business hearing entitled "Are Big Businesses Being Awarded Contracts Intended for Small Business?" on May 7, 2003 via the live webcast. We would like to take the opportunity offered by Chairman Manzullo and submit our observations on this matter. Chairman Manzullo allowed for ten (10) days to submit this statement and therefore it is timely. We appreciate this opportunity and will make our statements brief and succinct.

We agree with many of the problems illustrated by the testimony presented at the hearing. We too have witnessed problems with the misclassification of many large businesses. Due to the breadth of testimony given at the hearing, we need not elaborate further about these concerns. However, we have witnessed possible abuses which, in our opinion, were not adequately conveyed during the hearing. These concerns involve cases where a small or disadvantaged business is awarded a contract as a set-aside and subsequently subcontracts most, if not all, of the work directly to a large business. We have witnessed these possible abuses in two (2) separate instances.

First, through the Patriot Partners Program, a sub-program of the Service Disabled Veterans Group, Inc. (SDVG), we have reason to believe that contracts awarded to service disabled veterans are actually being performed by a large publicly traded company. According to its website (www.asdv.org), the SDVG is a for-profit corporation, established as a means of initiating opportunity for increased participation by service disabled veterans in the economic system. Service disabled veterans are engaged in joint venture, teaming, co-operating agreements and other partnering operations with larger corporation entities known as "PATRIOT PARTNERS." Our attempts to learn more about the Patriot Partners program have been met with resistance and the program's workings are veiled in secrecy.

If this program truly mentors and provides economic opportunity for service disabled veterans we fully support the program and would welcome the opportunity to participate. If this program does not truly assist and provide economic opportunity to service disabled

veterans, it is wrongfully taking business away from otherwise qualified small business. Unfortunately, due to the secrecy of the program, we have not been able to ascertain the true beneficiaries of the program. Therefore, we respectfully request the assistance of the Committee in determining the structure of the Patriot Partner's program.

In addition to taking contracts away from small business, an abuse of this program may cost the taxpayers additional funds. In early December, 2002, the contract to provide medical transcription services for the Bronx VAMC was awarded to the SDVG. SDVG was awarded the contract at a price of $0.195 per line while we placed a bid $0.125 per line. It is important to note that three (3) small businesses bid less than SDVG. The Bronx VAMC will dictate approximately 1,620,000 lines per year resulting in a bidding discrepancy between InfoPro's bid and SDVG's bid of approximately $113,400 per year or an aggregate expense of $340,200 over the life of the contract if renewed for its maximum 3-year term. We have also witnessed other instances where federal contracts are awarded to small disadvantaged businesses which, in our opinion, are not capable of performing to the specifications. Therefore, we assume some type of subcontract arrangement is in place with a large company.

Our second concern involves contracts awarded to small disadvantaged companies where the actual work under the contract is being performed by a large company. We have heard allegations of at least one (1) small disadvantaged company which obtains federal contracts on the basis of an 8(a) set-aside and subsequently contracts out most, if not all of the work, to a large corporation. While we believe that such action is not appropriate, we are unsure of the regulations in place to monitor such behavior. Again, we respectfully ask the Committee for it's guidance on this matter.

All of the situations illustrated herein threaten the integrity of the small business set-aside program. We understand that joint ventures and teaming arrangements are encouraged to mentor and assist small and disadvantaged businesses. However, our concern is that no mentoring actually takes place in some of these joint venture and teaming arrangements. We have reason to believe that, in some instances, all of the work is being performed by the large company and the small or disadvantaged business only serves as a conduit to allow the big business to obtain a contract it would not have otherwise been able to obtain.

Thank you for the opportunity to present these observations. If we may be of any further assistance, or additional information is needed, please feel free to contact us at your convenience.

Sincerely,

InfoPro Group, Inc.

Christopher M. Clements
Legal Counsel

cc: Richard L. Collins
Tom Boyd

The Honorable Donald Mazullo
Chairman
House Small Business Committee
2361 Rayburn House Office Building
Washington, DC 20515

May 15, 2003

Dear Mr. Chairman:

Thank you for holding the May 7th hearings on "Are Big Businesses Being Awarded Contracts Intended For Small Businesses?" I also appreciate the opportunity to provide my comments to the Committee concerning the issue of ensuring America's small businesses are treated fairly under the federal government's acquisition system and have fair and open access to the federal government's procurement processes. The enclosed two pages include a general observation and five specific suggestions for consideration to address this issue.

If I can provide any additional information, I would be pleased to do so. My home contact information follows:

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Sincerely,

Joseph A. Capuano, Jr

Enclosure

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Public Comments Provided by Joseph A. Capuano, Jr.

General Observation: America's small businesses are essential to the economic vitality of our Nation and inspire hope and opportunity in the communities and families they touch. This is a very unique time in our history when we have the opportunity to strategically change how the federal government provides access to small businesses within its acquisition system and the procurement processes that drive the system. The complexity and number of programs that have implemented by SBA and the federal agencies to assist small businesses since the passage of the Small Business act of 1958 (including women-owned, small disadvantaged, 8(a),veteran-owned, service-disabled veteran-owned, HUBZone and very small business programs) may be actually reducing the ability of small businesses to understand and access federal contracting opportunities and be entrepreneurial in growing their business. These programs may also be hampering the ability of federal procurement and program personnel to use small businesses as part of the federal government procurement processes and, in reality, may have increased the level of government regulatory intrusion on the operations of small businesses. To reverse this trend and get the government's acquisition system moving in the direction of awarding 50 % of federal procurement dollars to America's small businesses, we need to simplify the federal procurement processes that impact small businesses and provide a framework where small business can be accessed by federal procurement and program personnel in a direct (as small business set-asides) yet competitive manner. Hopefully, the five recommendations outlined below will help to achieve this goal.

1. Certification of the Size of a Small Business as a Small Business. Currently, a small business must self-certify that it is a small business at the time of the contract award. This same policy should be applied to task or delivery order contract, known as multiple award contracts (MAC), government-wide acquisition contracts (GWAC) and GSA's Multiple Award Schedules Program. Every time a new acquisition is awarded under any of the above procurement vehicles, the small business would have to self-certify it is a small business. If it is not, it would not be entitled to the award. The argument has been made that over the course of any given year and even from award to award under the above procurement vehicles, a small business' size (number of employees and annual revenues) can exceed its small business size standard. The question is, how is this issue any different for other small businesses that are not under MAC, GWAC or GSA Schedules? If however, Congress chooses to legislate a different authority for small businesses that are under MAC, GWAC or GSA Schedules, then maybe it should consider allowing the small businesses to exceed their size standard by a set percentage to allow for fluctuation over the size standard during the life of the procurement vehicle being used (i.e. MAC, GWAC or GSA Schedule). Also, the life of the procurement vehicle should not exceed five years for both large and small businesses, the same general standard used for contract awards under the SBA's 8(a) Business Development Program. The challenge will be establishing a high enough percentage to allow for the level of growth intended by Congress. In my opinion, a 50 percent to 100 percent fluctuation would appear reasonable with the stipulation that for contract dollars awarded between the 50 percent and 100 percent level , the small business should follow the same subcontract requirements as large businesses.

2. OSDBUs Having the Authority to Stop the Procurement Award Process.
If the procurement is not appropriately being set aside for small business, in my opinion this additional authority should be needed or necessary. Currently, in accordance with FAR Subpart 19.5, the Agency assigned SBA PCR has the authority to execute a SBA Form 70 actions to stop the procurement action for the above-stated reason. Providing another level of authority in the OSDBUs is both redundant and

could cause further confusion in an already complicated federal procurement process. However, Congress should consider providing the same authority provided SBA's PCR, in accordance with FAR Subpart 19.5, to the OSDBU Directors in Agencies that Congress have exempted from the FAR, i.e. the Federal Aviation Administration, the Transportation Security Agency and the Smithsonian Institution. The Committee should also ensure all OSDBU Directors report directly to the head of their Agencies. This will further their ability and accountability to act independently as advocates on behalf of their small businesses customers and, if appropriate, advise their Agencies' SBA PCR of the need to execute a Form 70. This should also further the OSDBU Directors' proactive involvement in their Agencies' procurement planning process.

3. Using the FPDS and PRO-Net Systems to Verify a Small Business Size Status.

It would appear reasonable to place the informational and accountability responsibility for small business size standards status with the Central Contracting Registration (CCR) system. A proposed rule (*Federal Register* 4/3/03 pp16366-71) will require all federal contractors to be on the CCR by September 30, 2003. Recently, the SBA and the Department of Defense integrated the CCR and SBA's PRO-Net in an effort to streamline the procurement process for small businesses. Small businesses should be required to identify its status and indicate the date it entered this information into CCR. If a small business size standard status changes it should be required to enter the change in status and date into the system.

4. Purchasing from Small Businesses Using Federal Credit Cards.

Require all purchases under $2,500 be set aside for small businesses. This will expand the goods and services being purchased from small businesses. In addition, the federal government should use statistical sampling processes to determine the amount of credit card purchases with small businesses. This approach will addressed the problems raised in GAO Report-03-56 (*Government Faces Challenges in gathering Socioeconomic Data on Purchase Card Merchants)*, and potentially save the government, the participating service providers (i.e. Bank of America) and the small business merchants millions of dollars and thousands of hours in reporting and data collection costs and time. This approach will also enable federal agencies to receive their Major Procurement Preference Goals (MPPG) credit for credit card purchases and provide a monitoring tool for managing credit purchase awarded to small businesses. Currently, $0 small business credits are received by agencies from the over $13 billon annually in credit card purchases and there is no agency accountability for their efforts to make credit card purchases from small businesses.

5. Establishing One Small Business Procurement Development Program within the Federal Government. The 8 (a) program, administered by the SBA, is one of the federal government's primary programs for developing small businesses that are owned by socially and economically disadvantaged businesses. About 6,000 small businesses participate in the nine year business development 8(a) program and $6 billion is awarded annually in 8(a) contracts. One important authority under the program provides for agency procurement contracting officers to make sole source awards to 8(a) certified small businesses. Small businesses participate in the program over a nine year period. Congress should consider establishing this program as the federal government's central small business development program and make it available for all small businesses that are economically disadvantaged. To ensure current socially and economically disadvantaged firms are treated fairly, all currently certified firms should be given the option to be grandfathered for a new nine year period. All other SBA certified small businesses i.e. small disadvantaged, 8(a),veteran-owned, service-disabled veteran-owned, HUBZone etc.. should be given the option to be certified under the 8(a) program. The result will be one Small Business Procurement Development Program for the federal government. My two pages are up (Smile).

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