

STATEMENT OF
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BEFORE THE
COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP,
UNITED STATES SENATE

CONCERNING A HEARING ENTITLED:
“STRENGTHENING PARTICIPATION OF SMALL BUSINESSES IN
FEDERAL CONTRACTING AND INNOVATION RESEARCH PROGRAMS”

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Introduction. Chair Snowe, Ranking Member Kerry, distinguished Members of the Committee, thank you for inviting me to testify today about our activities and concerns regarding the award of government contracts to small businesses.

The Small Business Act establishes a goal of awarding small businesses not less than 23 percent of the total value of prime contracts issued government-wide each fiscal year. The Act further recognizes the Small Business Administration's (SBA) advocacy role for small businesses, and directs the SBA, in essence, to take all reasonable steps to promote opportunities for small businesses, including firms owned by minorities, women, service disabled veterans, and other disadvantaged persons, to obtain government contracts.

As you know, each year we issue a report on the major Management Challenges facing SBA. One of the challenges refers to flaws in the procurement process that have allowed large companies to receive and perform small business awards and agencies to receive small business credit for contracts performed by large businesses.

My remarks today will focus on four issues concerning small business contracting: (1) regulatory loopholes that allow agencies to count contracts as meeting their annual small business goals even if companies have been acquired, or have grown large after being awarded the contract; (2) large companies committing fraud to obtain small business contracts or using small firms to hide the fact that a large business is actually performing the work; (3) contracting personnel who may be unfamiliar with small business procurement requirements or who may not exercise proper diligence to ensure that only legitimate small businesses obtain small business contracts; and (4) inaccurate recording of contracts in the Federal Procurement Data System – Next Generation (FPDS – NG) as awarded to small businesses when, in fact, they were awarded to large businesses, and the large businesses did not make any representations that they were small businesses. I will briefly discuss each of these issues in turn.

Regulatory Loopholes. Regarding the first issue, there are several regulatory loopholes that allow large companies to perform small business contracts. Studies by the OIG, the Government Accountability Office (GAO), and SBA's Office of Advocacy have found that agencies are allowed to count towards their small business procurement goals contracts that are performed by companies that have either been acquired by large firms, or have outgrown small business size standards after obtaining the contract, but are exercising subsequent contract options or task orders.

As noted above, the OIG has identified as a Management Challenge for the SBA the need to take action to reduce regulatory loopholes that allow over-reporting of small business procurements. We believe this is a very serious issue for the Federal Government for two reasons: (1) legitimate small businesses lose out as agencies have little incentive to identify other small business contracting opportunities; and (2) policy makers are deprived of accurate information needed to assess the effectiveness of governmental policies.

Although the extent of such over-reporting is unknown, studies that we and the GAO have conducted suggest that the problem may be widespread. In fact, one review we conducted of SBA procurement (*SBA Small Business Procurement Awards Are Not Always Going to Small*

Businesses, Report No. 5-14) disclosed that four out of six large-dollar SBA contracts (procured from 2000 to 2002) were awarded to companies that were no longer small. SBA reported these contracts toward meeting its small business goals. Although this was allowed by regulation, the fact that SBA is reporting contracts performed by large firms towards meeting its small business goals makes it appear highly likely that other agencies, which have less interest in promoting the interests of small companies, are doing the same thing.

Another problem relates to multiple award contracts where firms may not be small for all of the goods or services covered by the contract. In other words, a contractor that only meets small business criteria for a portion of a multiple award contract is considered to be a small business for any work done under that contract. Thus, agencies may obtain small business credit for using a firm classified as small even if the firm is not designated as small for all of the procured goods or services. This is contrary to SBA regulations, which require that a contractor meet the size standard for each product or service for which it submits an offer (13 C.F.R. § 121.407). An example of this problem was recently described in a June 14, 2006, GAO briefing report entitled *Commerce Information Technology Solutions Next Generation Governmental Acquisition Contract*.

Large Businesses Fraudulently Obtaining Small Business Contracts. With respect to the second issue – large businesses fraudulently obtaining small business contracts – the Small Business Act provides for penalties of up to \$500,000 and 10 years in prison for such fraud in connection with an SBA small business contracting program. In the past 5 years we have opened 69 cases involving government contracting fraud and obtained 24 criminal fraud convictions, resulting in fines, restitutions, and settlements of over \$17 million. These cases have arisen under the 8(a) Business Development Program and other SBA government contracting programs, but we have yet to obtain a criminal prosecution of a large business that has misrepresented its status as a small business in order to obtain a small business contract. Reasons for the difficulty in obtaining such a conviction vary, but one problem certainly lies with the fact that, in the case of small business contracting fraud, prosecutors are reluctant to accept cases where it is difficult to show a financial loss to the U.S. Government. Unlike where a contractor has falsified invoices, in many cases of small business contracting fraud the Government paid for and obtained the particular good or service that it sought to procure. The fraud occurred in how they acquired the contract, not in its execution. Nonetheless, there is a definite programmatic and societal loss – a company that obtains a small business contract under false pretenses deprives a contracting opportunity for a legitimate small business. In a recent case jointly investigated with the General Services Administration (GSA) OIG, we obtained a \$1 million settlement from a company that made a false representation as a small business when receiving a GSA multi-year contract. We believe this settlement sends an important message to the government contracting community that false representations of size will have significant repercussions. It bears mentioning, however, that the parent company denied any liability (as is customary in civil settlements) and that the alleged misrepresentation was made by a subsidiary that had been acquired after the misrepresentations had occurred.

Contracting Officer Error. Our efforts to bring to prosecution cases of small business contracting fraud have been complicated by the third issue that I want to focus on – contracting officer error. Good cases have been undermined by contracting personnel at Federal agencies

who do not comply, or are just unfamiliar with small business contracting requirements. We have seen errors where agencies accepted bids from contractors on small business contracts, even though the contractors had not certified that they were small businesses. Other errors have included failing to request size certifications from businesses, misuse of small business set-asides to procure the products of large businesses (such as personal computers), relying on databases containing inaccurate information about small businesses, misuse of the North American Industrial Classification categories used to define small businesses, and failing to investigate discrepancies that suggest that the contractor may not meet small business criteria. Although we will continue to diligently investigate cases of contractor fraud, the reality is that juries are reluctant to return guilty verdicts in a government contracting fraud case if the Government has been negligent, or has failed to look into obvious discrepancies.

Incorrect Entries in FPDS-NG. The fourth issue concerns incorrect entries in FPDS-NG – the database used to develop and report government-wide statistics to Congress on small business awards. While we have anecdotal evidence on this issue, we do not know the extent of the problem. Over the past 3 years, we have received various complaints about large businesses being reported in FPDS-NG as receiving small business awards. In some instances, this occurred because the large business acquired a small business, or the business had been a small business and grew large. The other common reason this occurred, however, was due to input errors. As we followed up on these complaints, we found some awards where the procurement was processed using “free and open” procedures and the award recipient had not represented that it was a small business. Contracting offices have admitted that the small business designations were simply input errors. Because FPDS-NG is the database for tracking government awards to small business, it is important that the data is correct.

What can be done to correct the problems with small business contracting? To its credit, SBA has taken some steps in this area. SBA issued a proposed regulation in 2003 to require contractors performing on multiple award contracts to annually recertify their small business size. The OIG believes that an award recertification would provide a significant control over the accuracy and integrity of small business contracting. In 2004, SBA issued final regulations requiring that agencies obtain a recertification as to size when the contract is sold to another company. However, it has now been more than 3 years since SBA issued its proposed rule on annual certification. This rule needs to be finalized. Alternatively, Congress could amend section 15(g) of the Small Business Act to require annual certification. Another positive step to reduce contracting officer error would be to increase training on small business procurement for contracting personnel. While maintaining that training is the responsibility of each procuring agency, SBA stated that it has helped develop training modules and does provide training to other agencies. Even if providing small business procurement training to contracting personnel is not a direct SBA responsibility, we believe that as the advocate of small business, SBA needs to provide whatever assistance it can in this area.

SBA has also submitted proposed legislation recommended by the OIG to revise section 16(d) of the Small Business Act, clarifying that SBA has the authority to debar a contractor for size misrepresentation. In a recent case, the Agency was reluctant to proceed with debarment because it was uncertain whether it had the necessary authority under section 16(d). Therefore, this matter was referred to another agency for consideration. SBA officials suggest it is not

feasible for them to debar contractors who make size misrepresentations. While we agree that it may be administratively easier in some cases for other agencies to process such debarments, other agencies have little incentive to pursue the matter. We believe that, due to SBA's unique role as the agency primarily responsible for the set-aside programs, it should share in the responsibility for policing these programs. We urge Congress to enact the legislation we have suggested to make it clear that SBA can undertake a debarment for size misrepresentation.

Congress could also establish control processes within SBA. For instance, some SBA officials have taken the position that, since the contracting agencies verify to GSA that the information input into FPDS-NG is accurate, accuracy is an internal control issue for each procuring agency – not SBA. However, legislation could create an office within SBA to monitor contract integrity. That office could be responsible for determining whether procuring agencies are complying with small business contracting requirements and whether the agencies are accurately reporting on their negotiated small business contracting goals. Legislation could also require the head of a procuring agency to certify as to the accuracy of the reported information, and to conduct a review, through statistically valid sampling techniques or otherwise, to verify that reported information correctly reflects small business contracting activity.

Conclusion. To ensure that all opportunities are pursued to help small and disadvantaged businesses obtain government contracts, we will continue to challenge SBA to improve government-wide compliance with the goals of small business contracting; to aggressively pursue prosecutions and debarments where warranted; and to seek creative and effective ways to enhance the ability of small businesses to do business with the U.S. Government.

Thank you for the opportunity to comment. I look forward to answering any questions that you may have.