



**U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL**

**ADVISORY MEMORANDUM
REPORT NO. 12-04**

DATE: DECEMBER 6, 2011

To: Joseph G. Jordan
Associate Administrator
Government Contracting and Business Development

SUBJECT: Small Business Administration's Rationale for Excluding Certain Types of Contracts from the Annual Small Business Procurement Calculations Needs to be Documented

This is to notify you that we have terminated the audit of the *Reliability of the Small Business Administration's (SBA) Small Business Goaling Report*. However, in the course of that audit we found that the SBA had not updated its *Goaling Guidelines for the Small Business Preference Programs*¹ (*Goaling Guidelines*). The *Goaling Guidelines* provide policy direction to Federal agencies pertaining to the establishment of annual small business goals and the reporting of procurement activity. Specifically, SBA officials did not revise the *Goaling Guidelines* to reflect the Office of General Counsel's opinions on excluding certain types of contracts from the dollar base to calculate the various small business goals. In addition, in August 2001, the General Accounting Office² reported on SBA's contract exclusions and recommended that the SBA document its rationale for excluding contracts from the small business baseline.

The objective of this review was to determine the adequacy of SBA's actions toward implementing the GAO's recommendations. To achieve our objective, we reviewed applicable legislation, prior GAO audit reports, regulations, policies and procedures, and other Agency guidance and reports on goaling guidelines for the small business preference programs. We also interviewed personnel from the SBA's Office of Government Contracting and Business Development, and Office of General Counsel. We conducted our review between December 2010 and February 2011, in accordance with *Government Auditing Standards* prescribed by the Comptroller General of the United States.

Background

The Small Business Act (the Act) establishes policy that small businesses should be given the maximum practicable opportunity to participate in providing goods and services to the Federal government. To facilitate the government's ability to track small business procurement achievement, agencies report their contract award data in the Federal Procurement Data System-Next Generation database administered by the Federal Procurement Data Center – a unit of the General Services Administration. The Act also establishes a goal that not less than 23 percent of prime contracting³ dollars be awarded to

¹*Goaling Guidelines for the Small Business Preference Programs for Prime and Subcontract Federal Procurement Goals & Achievements*, July 3, 2003.

²Now known as the Government Accountability Office (GAO).

³A prime contract is any direct contract between the government and a contractor.

small businesses each fiscal year. The SBA includes the total dollars obligated on all prime contracts awarded each fiscal year using appropriated funds and that are subject to the Federal Acquisition Regulations (FAR) to calculate the goaling baseline. As such, the SBA excludes contracts not covered by the FAR and those awarded with non-appropriated funds from the goaling baseline. They also exclude certain other contract categories from the goaling baseline, including those:

- awarded to mandatory⁴ and directed⁵ sources;
- awarded and performed abroad⁶;
- performed entirely abroad⁶;
- made by credit card that are less than \$2,500, or
- acquisitions made by agencies on behalf of foreign governments or international organizations.

The SBA provides goaling guidance — including information on exclusions from the goaling baseline — in its *Goaling Guidelines*. The *Goaling Guidelines* are the only source of instruction available to participating agencies on exclusions to the small business goaling baseline.

Results

SBA officials implemented the GAO's recommendations by establishing the rationale for contract exclusions and the "reason for non-report" in its 2003 *Goaling Guidelines*⁷. However, in late fiscal year 2007, officials from the SBA's Office of Policy and Research and the Office of Government Contracting and Business Development requested that the Office of General Counsel (OGC) provide an opinion regarding the legal basis for the goaling report contract exclusions. As a result of the research, the OGC prepared two memoranda during fiscal year 2008 to provide a legal and statutory analysis for the goaling exclusions.

In the first memorandum⁸ (prepared in final), the OGC opined that it was reasonable to include contracts awarded and/or performed overseas in the small business goaling baseline. However, SBA officials did not revise the *Goaling Guidelines* so that small business contracts performed abroad were included in determining the goaling baseline.

In the second memorandum⁹ (prepared in draft), the drafter discussed other excluded procurements that could and/or should be included in the small business goaling baseline. Since the memorandum was not finalized, it is unclear whether the draft reflects SBA's final position on these issues. Therefore, SBA officials did not revise the *Goaling Guidelines* to address these exclusions. As a result, if there are other procurements that should be included in the small business baseline, the goaling baseline may not accurately measure small business procurements.

⁴By law, agencies must award certain contracts to "mandatory sources." Examples include commodities produced by the Federal Prison Industries (known as UNICOR) or the JWOD Participating Nonprofit Agency (formerly Sheltered Workshop).

⁵The "purchasing" agency has no discretion in making the award.

⁶Based on a study cited in House of Representatives Report No. 110-111, Part 1 (2007), inclusion of foreign contract opportunities in the Federal prime contracts baseline would have reduced small business participation to 19.3 percent of all Federal contracts.

⁷www.sba.gov/sites/default/files/goals_goaling_guidelines.pdf

⁸*Application of Small Business Act (Act) to Federal procurement contracts awarded and/or performed outside of the United States*, July 2, 2008.

⁹*Exemptions from Goaling*, January 25, 2008.

Conclusion

As of November 2011, the OGC had not finalized the draft memorandum and SBA officials had not updated the *Goaling Guidelines* to address certain types of contract exclusions. Agency officials were unable to provide a clear explanation for not finalizing the draft memorandum on *Exemptions from Goaling* and for not revising the *Goaling Guidelines* to address the OGC's analyses. Consequently, SBA's analyses on goaling guidance remain unclear and incomplete. Additionally, some procurement actions may be inappropriately excluded from the small business goaling calculation. Incomplete data weakens the ability of Congress and other Federal policy makers to determine whether the Government is maximizing contracting opportunities for small businesses.

We believe that SBA officials should complete its analyses of the legal basis for exclusions and revise the *Goaling Guidelines* to explain its rationale to the public either on its website or through a Federal Register Notice.

Recommendations

We recommend that the Associate Administrator, Government Contracting and Business Development:

1. Revise the *Goaling Guidelines for the Small Business Preference Programs* to include contracts awarded and/or performed overseas in the small business goaling baseline beginning with fiscal year 2011.
2. Request the Office of General Counsel to finalize the draft memorandum entitled, *Exemptions from Goaling*, January 25, 2008.
3. Based on the Office of General Counsel final opinion on the *Exemptions from Goaling*, revise the *Goaling Guidelines* as appropriate.
4. Notify the General Services Administration — Federal Procurement Data Center — of any necessary programming updates to the Federal Procurement Data System-Next Generation resulting from changes to goaling guidance on contract exclusions.
5. Issue revised *Goaling Guidelines* in the Federal Register notifying participating agencies of any changes to goaling guidance on contract exclusions.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On October 12, 2011, we provided a draft of this advisory memorandum to the Associate Administrator for Government Contracting and Business Development for comment. On November 2, 2011, the acting director for the Office of Government Contracting submitted formal comments, which are contained in their entirety in Appendix I. The acting director generally disagreed with the recommendations. It should be noted that we made five recommendations in the advisory memorandum. The agency's comments address only four of the recommendations, as they did not address recommendation number 3 and re-numbered our recommendations. A summary of management's comments and our response follows.

Management Comments

Management agrees that there is no exception in the Small Business Act for contracts awarded or performed overseas and that its programs apply to contracts awarded or performed overseas. Management contends, however, that a provision in the Federal Acquisition Regulations (FAR) limits the application of SBA's small business programs to the United States and its outlying areas. Management asserts that until the Government changes the FAR, procuring agencies will not apply the Small Business Act to contracts awarded and/or performed overseas, and the SBA will not include those contracts as part of its small business goaling baseline. According to Management, the SBA attempted to change the FAR provision at issue, but was not successful.

Management was also concerned over our reference to a draft legal memorandum. They indicated the draft legal memorandum is a predeliberative and predecisional document that merely reflects the personal opinions of the writer and not the policy of the agency. As a result, they do not believe the OIG can require or instruct an agency to finalize a draft document, especially a legal document. Further, Management objects to any reference to the draft memorandum in the OIG advisory report since it would be exempt from public release under the Freedom of Information Act as a privileged document. Finally, Management stated there is no need to implement our recommendations four and five.

OIG Response

The Small Business Act sets a minimum Government-wide goal for participation by small business concerns of not less than 23 percent of the total value of all prime contracts. The 2008 legal opinion by OGC stated "it would be a reasonable interpretation of the Act to state that its goaling provisions applied to contracts awarded and/or performed overseas." The Management response, however, takes a different approach based upon the FAR § 19.000(b). We do not believe the FAR provision cited by Management determines whether a contract awarded to a domestic small firm that is performed overseas can be recorded as a small business contract for goaling purposes. That provision (FAR § 19.000(b)) states only that "This part, except for Subpart 19.6, applies only in the United States or its outlying areas." The question of whether agencies use the procedures in Part 19 to award contracts to small and socio-economically disadvantaged firms appears to be separate from the question of whether contracts that are awarded to such firms for performance overseas should be counted toward meeting agency goaling obligations.

In addition, Management's response advises that SBA has actually rendered an interpretation that under the FAR, "the Small Business Act applies to contracts awarded by contracting offices located within the United States, but where contract performance takes place overseas." However, Management believes

that most agencies are likely taking the position that the Act does not apply to contracts performed and/or awarded overseas. We believe this response does not give adequate consideration to the fact that Congress has charged SBA, not procuring agencies, with authority to interpret the Small Business Act and to establish the goaling guidance. The SBA Administrator appears to have sufficient authority to define which government contracts should be included in the goaling calculations.

Regarding Management's comment on requiring or instructing an agency to finalize a document, the OIG continues to recommend completion of the memorandum; it is the SBA's decision whether to implement this recommendation. Given that goaling baseline exclusions have been of concern, it seems logical to complete the analysis since substantial legal research was devoted to draft a position, if for no other reason than transparency. In addition, the OIG has not disclosed the contents of memorandum, merely the fact that the memorandum exists, which is not privileged information. Concerning Managements' dismissal of recommendations four and five, as stated above, we believe the SBA has the authority to revise the *Goaling Guidelines* based on SBA's legal opinion; therefore, it should do so. We reaffirm our recommendations.

Actions Required

Please provide your management decision for each recommendation on the attached SBA Forms 1824, *Recommendation Action Sheet*, within 30 days from the date of this report. Your decision should identify the specific action(s) taken or planned for each recommendation and the target date(s) for completion.

We appreciate the courtesies and cooperation of the Small Business Administration during this review. If you have any questions concerning this report, please call me at (202) 205-7390 or Riccardo R. Buglisi, Director, Business Development Programs Group at (202) 205-7489.

/s/ Original Signed

John K. Needham

Assistant Inspector General for Auditing

Appendix I: Agency Comments



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: November 2, 2011

To: John K. Needham
Assistant Inspector General for Auditing

Re: Draft advisory memorandum titled: “Small Business Administration’s Rationale for Excluding Certain Types of Contracts from the Annual Small Business Procurement Calculations Needs to be Documented”

This is in response to the Office of Inspector General’s (OIG’s) draft advisory memorandum titled: “Small Business Administration’s Rationale for Excluding Certain Types of Contracts from the Annual Small Business Procurement Calculations Needs to be Documented”. In the draft memorandum, the OIG has made the following recommendations to the U.S. Small Business Administration (SBA): (1) revise the SBA’s Goaling Guidelines to include contracts awarded and/or performed overseas in the small business goaling base; (2) finalize a draft legal memorandum concerning exemptions from goaling, dated January 2008; (3) notify the U.S. General Services Administration (GSA) of any necessary changes to the Federal Procurement Data System (FPDS) resulting from changes to the goaling guidance; and (4) issue revised Goaling Guidelines addressing the finalized legal memorandum. We thank the OIG for their support of our programs and have considered fully your recommendations.

The OIG’s first recommendation is based upon two memoranda issued by SBA’s Office of General Counsel (OGC), which explain that the Small Business Act applies to contracts awarded overseas and/or performed overseas. The legal memoranda are based upon SBA OGC’s review of the Small Business Act. At this time, the Federal Acquisition Regulations (FAR) contain specific exemptions for contracts awarded and performed overseas from the Small Business Act. According to FAR § 19.000(b), FAR Part 19, which addresses the SBA’s small business programs “applies only in the United States or its outlying areas.” 48 C.F.R. § 19.000(b). FAR subpart 19.6, which address the Certificate of Competency program, applies worldwide. Id.

As noted above, the SBA believes that there is no exception in the Small Business Act for contracts awarded or performed overseas and that its programs apply to contracts awarded or performed overseas. However, the issue of whether the SBA’s programs apply to such contracts is not settled.

In addition, one of the memorandum specifically addressed in the OIG audit explained the following:

In addition, the above analysis shows that the FAR precludes application of the Small Business Act (except the COC program) to ‘overseas’ acquisitions. Although the application of the FAR preclusion is clear with respect to contracts both awarded and performed in the United States (it applies) and to contracts both awarded and performed outside the United States (it does not apply), it is unclear as to whether the FAR states that the Small Business Act applies to contracts awarded by contracting offices located in the United States but where contract performance takes place overseas. SBA’s OGC has opined previously that the FAR states that the Small Business Act applies to contracts awarded by contracting offices located in the United States, but where contract performance takes place overseas; however, this issue has not be clarified in the FAR and we believe that most agencies are likely taking the position that the Act does not apply to contracts performed and/or awarded overseas.

Consequently, until the FAR is amended procuring agencies will continue to follow its regulatory direction. As a result, the SBA will not include such contracts as part of its goaling baseline. We also note that SBA previously initiated a proposal through the FAR regulatory process to apply the Small Business Act to overseas acquisitions. The voting members of the FAR unanimously rejected SBA’s proposal.

With respect to the OIG’s second recommendation, we do not believe that your office can require or instruct an agency to finalize a draft document, especially a legal memorandum. SBA’s program officials and OGC make the decision whether to even draft, let alone issue, a legal memorandum. Further, the draft legal memorandum is a predeliberative and predecisional document. One court has explained that “examples of predecisional documents include ‘recommendations, draft documents, proposals, suggestions, and other subjective documents which reflect the personal opinions of the writer rather than the policy of the agency.’” Citizens For Responsibility and Ethics in Washington v. National, 583 F.Supp.2d 146, 166 (D.D.C. 2008) (quoting Coastal States Gas Corp. v. Dep’t of Energy, 617 F.2d 854, 866 (D.C.Cir. 1980); see also Citizens For Responsibility and Ethics in Washington v. National, 715 F.Supp.2d 134, 139 (2010). Therefore, unless a document is final, including a legal memorandum, it is a document that merely reflects the personal opinions of the writer and not the policy of the agency. As a result, it is not clear how the OIG can recommend that the program office finalize a draft document. Further, there is no need to implement recommendations three and four -- notify GSA of any changes to FPDS resulting from changes to the goaling guidance based upon the finalized legal memorandum or issue revised Goaling Guidelines addressing the finalized legal memorandum.

We are also concerned that the advisory memorandum references the draft legal memorandum since it is exempt from public release under the Freedom of Information Act (FOIA), Exemption 5, as “inter-agency or intra-agency memoranda” since the document is protected by: (1) the deliberative process privilege; (2) the attorney-client privilege; and (3) the attorney work-product privilege. See Citizens For Responsibility and Ethics in Washington, 583

F.Supp.2d at 156. Thus, this draft legal memorandum should not be referenced or discussed in an advisory memorandum that may be made publicly available.

Thank you for the opportunity to respond to the draft advisory memorandum.

John W. Klein

Acting Director
Office of Government Contracting