

Review of  
the  
Certificate of Competency  
Program

April 1993

*Inspection Report*

No. 93-04-003

Office of Inspector General  
U.S. Small Business Administration



U.S. Small Business Administration  
Washington, D.C. 20416

OFFICE OF  
INSPECTOR GENERAL

April 19, 1993

The Honorable John J. LaFalce  
Chairman, Committee on Small Business  
United States House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

Per your request of December 7, 1992, I am pleased to provide our inspection report on the Small Business Administration's (SBA) Certificate of Competency (COC) program. Included in the report is a discussion of the widespread misperceptions about the COC program's purpose and operations, the possible threat to the program posed by recent Federal procurement initiatives, and the legislative actions we believe are needed to strengthen the program.

SBA officials are still reviewing the report. We will submit their comments and our response to those comments to you under separate cover by May 3, 1993.

I appreciate your interest in our findings and your willingness to call upon the Office of Inspector General for such independent assessments. My staff and I would be pleased to answer any questions that you may have.

With best wishes,

Sincerely,

EX. 6

James F. Hoobler  
Inspector General

Enclosure

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## **EXECUTIVE SUMMARY**

### **Objectives and Background**

The Office of Inspector General conducted this inspection of the Small Business Administration's (SBA) Certificate of Competency (COC) program at the request of the Chairman of the House Committee on Small Business. The objective was to assess selected aspects of the program's management and operations and make recommendations for any administrative and legislative actions needed to correct problems that may be identified. The inspection team gathered its information in interviews with nearly 70 officials and staff in Congress, SBA, and Federal procuring agencies; from extensive records, memoranda, and other documentation obtained from the SBA, the Congress, the General Accounting Office, the Office of Management and Budget, and the procuring agencies; and from data bases maintained by the SBA and the Federal Procurement Data Center. The short timeframe for the inspection precluded a complete evaluation of the program.

Administered by SBA's Office of Procurement Assistance, the COC program provides an appeals process for small businesses that are low offerors on Government procurements but are not selected because the contracting officers (COs) deemed them to be "nonresponsible." If SBA, based on its own evaluation, certifies a firm as responsible to perform the specific contract involved, the procuring agency is required by law to award the contract to that firm. After increasing fourfold between 1976 and 1986, the number of COCs issued has fallen by 30 percent over the past five fiscal years, from 816 to 574, reflecting in part the decline in Department of Defense (DOD) procurements. On average, 40 percent of the firms eligible to apply for a COC each year have done so, and SBA has awarded COCs to 40 percent of the applicants. In dollar value, COC awards in FY 1992 amounted to less than 0.2 percent of total U.S. Government procurement.

### **Findings and Recommendations**

The Federal procurement community has widespread misperceptions about the purpose, operations, and results of the COC program. We found that many procurement officials believe the program runs counter to the Government's interests and to the SBA's mandate to advance small business because COCs, in their view, too often support marginal firms at the expense of more responsible small businesses. This perspective, which we consider unwarranted, appears to be sustained by a number of widely held misperceptions: that COC firms are substantially worse performers than non-COC firms, in spite of studies and data suggesting there is in fact little difference in performance; that SBA merely rubber-stamps COC applications, in spite of the fact that SBA rejects more than half of the firms that apply; that SBA's evaluation of a firm's responsibility simply rehashes information provided by the CO's preaward survey, in spite of the clearly different approach taken by SBA that includes an effort to develop more in-depth information; and that SBA performs no follow-up to determine how well a COC recipient is performing, in spite of established procedures to monitor COC firm performance. In the past,

procurement officials may have had a legitimate complaint that SBA was not furnishing adequate justification when it issued COCs, but we believe that SBA has corrected this problem.

We recommend that SBA make a stronger effort to inform the Federal procurement community about the COC role, its operations, and its results to reduce these misperceptions. Specifically, to correct the misunderstandings cited above, SBA should disseminate on a routine basis a clear statement that the COC function is exclusively to provide an appellate process for individual small businesses, along with a summary of operational results that includes COC approval rates, delinquency/default data on COC recipients, and SBA follow-up activities. We do not expect all COs to endorse the purpose of the COC program, but there are simple and low-cost means available by which SBA could disseminate existing COC data that would set the record straight for procurement officials willing to give it consideration.

Recent Federal procurement initiatives pose a threat to the existence of the COC program. Various procuring agency initiatives designed to ensure "best value" in goods and services acquired by the Government create risks to the continued operation of the COC program. The intent of the COC program is not focused on improving the efficiency of the procurement process, but rather on ensuring equitable treatment for small businesses trying to compete in the Federal procurement market. If the procurement initiatives expand, however, and lists are compiled of small-business vendors determined in advance to be acceptable for contracts, they are likely to eliminate the actions that currently trigger COC referrals, rendering the program moot. At the time of our inspection, we were unable to predict which procurement changes may occur or what their effect might be on the COC program. Once the future of several DOD quality-vendor programs becomes more clear, SBA and the Congress will need to reassess whether the COC process will continue to have a viable role in an era of heightened attention to cost-effectiveness and of well-established small business participation in Government procurements.

We recommend that after the current GAO report on two DOD best-value programs is issued, SBA prepare a position paper that responds to any GAO recommendations that endorse best-value or related procurement procedures. The paper should include justification for the continued operation of the COC program within the changing procurement environment and options for adapting, as necessary, the role and operations of the program.

Legislative actions are needed to strengthen the COC process. Two legislative actions would enhance the effectiveness of the COC program: repeal of the recently enacted provision requiring DOD's COs to notify firms of the COC option and establishment of a threshold to exempt all procurements of \$25,000 or less from consideration for COCs. In each case, we believe the arguments on cost-effectiveness grounds outweigh any possibly detrimental effects either to procuring agencies or to small businesses.

The notification provision was intended to reduce procurement time, but it appears more likely to increase paperwork for COs with little or no savings in time. It also is likely to confuse small businesses pursuing contracts with both DOD and civilian agencies because it creates two

different statutory requirements in place of one. Finally, SBA has justifiable concerns that COs may be tempted to intimidate prospective COC firms and that it would be unable to detect such efforts in time to counteract them. The provision may have been a well-intentioned compromise designed to strike a balance between efficient procurement and independent review, but it appears to serve the interests of neither DOD nor SBA nor small business.

We also found that the COC program has had a negligible effect on small business participation in Federal procurements of \$25,000 or less, and we believe that applying the COC process in such cases creates disproportionate administrative costs for all parties involved. Although specific cost data on COC processing was scarce, particularly for the procuring agencies and for small businesses that apply for COCs, the relative inefficiencies of processing COCs for low-dollar procurements appear to be unnecessary costs for a Government seeking ways to reduce spending. In the interest of procurement efficiency, we believe a COC threshold should be established that precludes procurements of \$25,000 or less. (In the absence of compelling arguments to the contrary, we believe that the threshold should remain at \$25,000 even if, as expected, the small-purchase ceiling is raised.)

We recommend that the Congress repeal Section 804 (b) of the FY 1993 National Defense Authorization Act, which requires DOD's COs to notify firms of the COC option, and eliminate all procurements involving \$25,000 or less from consideration for COCs.

**NOTE:** Office of Procurement Assistance comments on this report were not available at time of publication. The OIG will submit them separately upon receipt.

## OBJECTIVES AND BACKGROUND

**Objectives.** This inspection was requested by the Chairman of the House Committee on Small Business, who sought a timely, independent review of the Certificate of Competency (COC) program. The areas examined include COC-related problems perceived by Federal procurement officials, possible effects of recent procurement initiatives on the program, and legislative action needed to strengthen the COC process. Our recommendations are intended to improve program management and operations. The short timeframe for the inspection required us to focus on selected COC activities rather than perform a complete evaluation of the program.

**Congressional intent.** The Certificate of Competency (COC) program was originally established by Congress in 1942 to encourage small businesses to contribute to the war effort. As part of the Small Business Mobilization Act, the program was designed to help small businesses receive a larger share of wartime Government contracts, thereby enabling the Government to expand and diversify its sources of supply. Subsequently, the Small Business Act of 1953 stipulated that a "fair proportion" of Federal procurements be awarded to small business. Amendments introduced in 1977 were intended to eliminate inequities and abuses in the way procurement officials were handling offers from small businesses. Unfair practices stemmed from loopholes that allowed contracting officers (COs) to decline to let a contract after a firm had received a COC, declare an "urgent need" in order to proceed with a non-COC contractor while a COC appeal was still pending, and misuse the Walsh-Healey Act by applying excessively harsh criteria in the case of small businesses.<sup>1</sup> To remedy these problems, the Congress expanded SBA's authority by subjecting these CO actions to a full review. SBA was authorized to certify that a small business was "responsible" and, therefore, eligible for specific contracts, and the procuring agencies were directed to award such contracts.

In 1984, the Small Business and Federal Procurement Competition Enhancement Act required procuring agencies to refer all small business low offerors deemed "nonresponsible" to SBA for review under COC procedures. Previous regulations exempting small purchases from the COC process were abolished, as was SBA's option to decline a referral. The most recent legislative action came out of the FY 1993 Defense Authorization Act, which required COs at the Department of Defense (DOD) to start providing written notification to small concerns judged nonresponsible advising them of their option to apply for a COC. This action resulted from a compromise between Congressional advocates for small business and for the Department of Defense, which was attempting to restrict the COC program after a major dispute involving SBA and a \$250 million Navy contract discussed in the methodology section below.

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<sup>1</sup>The Walsh-Healey Act stipulates the requirements for a firm to qualify as a manufacturer or regular dealer. As an example of abusive application, a CO in one case improperly cited Walsh-Healey to disqualify a bidder because he did not manufacture the pencils to be included in a kit to be produced for the Government. [8]

The current mandate of the Small Business Act, as amended, for the COC program is as follows:

To certify to Government procurement officers . . . with respect to all elements of responsibility, including, but not limited to, capability, competency, capacity, credit, integrity, perseverance, and tenacity, of any small business concern or group of such concerns to receive and perform a specific Government contract. A Government procurement officer . . . may not, for any reason specified in the preceding sentence, preclude any small business concern or group of such concerns from being awarded such contract without referring the matter for a final disposition to the [Small Business] Administration.<sup>2</sup>

**COC process.** Whenever a CO determines that a small business submitting the lowest offer on a contract is "nonresponsible" and, therefore, ineligible for the award, he or she must refer the firm to SBA, which, in turn, notifies the firm of the COC option (recent legislation requires DOD's COs to notify the firm directly). The firm has five working days to submit an application for a COC to SBA, if it so chooses; in DOD's case, the firm has 14 days to respond to the CO. If the firm declines to apply for a COC or fails to respond before the deadline, the CO may proceed with the award to the next lowest offeror. If the firm applies for a COC, SBA has 15 days from the date of referral to evaluate the firm against the responsibility criteria and render a decision. COs, at their discretion, may grant extensions to SBA. According to SBA, extensions are most often caused by delays on the part of the firm in preparing its application. SBA employs teams in its field offices to conduct technical and financial assessments of the firm, which are then presented to a regional COC review committee. The SBA Regional Administrator may decline to issue a COC, regardless of dollar value, or issue a COC for a procurement involving up to \$5 million. With procurements that exceed \$5 million, regional recommendations to issue COCs must be approved by SBA's Central Office. In 1986, GAO concluded that SBA's procedures for determining a prospective contractor's capabilities were consistent with Federal Acquisition Regulation standards and provided the basis on which SBA staff could make sound COC decisions.<sup>3</sup> If SBA certifies the firm as responsible for the specific contract at issue, the CO is required by law to award the contract to that firm.

**COC activity.** The total dollar value of the 574 COCs issued in FY 1992 was approximately \$336 million; an additional 81 COC applicants were awarded \$103 million worth of contracts from COs who decided to issue the contracts to COC applicants before SBA had completed COC processing. Over the past five fiscal years, more than 3,300 COCs have been issued, representing 16 percent of referrals and 40 percent of COC applications. Excluding the extraordinary \$250 million Navy contract, the average dollar amount of a COC contract during the five-year period was approximately \$590,000. After increasing fourfold between 1976 and

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<sup>2</sup>Section 8 (b)(7) of the Small Business Act of 1958, as amended.

<sup>3</sup>U.S. General Accounting Office, Small Business Administration: Status, Operations, and Views of the Certificate of Competency Program (Washington: GAO, April 1986), p. 17.

1986, the volume of referrals, applications, and COCs has been steadily declining. During the past five years, referrals and applications have dropped nearly 40 percent, and COCs have fallen 30 percent. The decreases roughly parallel the volume of Federal procurement overall, which also tended to peak in the mid- to late 1980s. The current volume of referrals, applications, and COCs is, however, still ahead of that of the 1970s. COC staffing decreased slightly between FY 1988 and FY 1992, from 44 to 42, and the average number of COC applications per COC specialist dropped 34 percent, from 47 to 31 applications. COC specialists also prepared over 4,800 follow-up reports on the performance of COC firms during FY 1992.

To keep the COC program in perspective, total U.S. Government procurement for FY 1992 amounted to approximately \$200 billion, of which about 15 percent was awarded to small businesses and less than 0.2 percent involved COC contracts. Most COs handle only an occasional COC, and, because very few SBA decisions on COCs are appealed, senior management in the procuring agencies rarely becomes involved with COC issues.

## METHODOLOGY

The review was conducted by a team of two inspectors over a three month period. The methodology consisted primarily of interviews with key Government officials involved in the COC process, including SBA staff in the central office, regional COC personnel in SBA's Newark office, staff members of the House and Senate Small Business and Armed Services Committees, and COs, Small and Disadvantaged Business Utilization Office (SADBU) staff,<sup>4</sup> and procurement officials in the two major Federal agencies affected by the COC program -- DOD and the General Services Administration (GSA). Within DOD, we met with procurement officials in the Navy, Army, and Defense Logistics Agency (DLA), as well as with respective legal counsel offices that handle the most egregious problems involving contract management and performance. The interviews were structured to address the role, management, and operations of the COC program. We also reviewed selected case files, data compiled by COC program officials, and SBA administrative files, as well as other reports, memoranda, and other documents prepared by SBA, procuring agencies, the General Accounting Office (GAO), the Office of Management and Budget, the Federal Procurement Data Center, and Congress. Finally, we checked with the Offices of Inspector General at both DOD and GSA to see if they had addressed any COC-related matters during the past three years.

**Constraints.** Our assessment of the management and impact of the program was constrained by two factors: the limitations of the data that were available and the inspection's short timeframe, which restricted the gathering of original data to verify existing records or

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<sup>4</sup>Section 15(k) of the Small Business Act of 1958, as amended, establishes a SADBU office in each Federal procuring agency to help small businesses expand their contracting opportunities and resolve related problems. The SADBU director, who reports to the head of the agency or the deputy, also assesses all requests for COC appeals submitted by COs and makes recommendations to the agency head. [11]

compensate for deficiencies. Although individual COs maintain records on their own COC activity, neither DOD nor GSA routinely collects COC data in the aggregate. The Federal Procurement Data Center provides useful contextual data but does not reach the detail of COC contracts or performance. The SBA data base is experiencing problems associated with the ongoing effort to computerize reports from the field, and discrepancies between the electronically generated numbers and those supplied in surviving hard-copy reports indicate a number of computer problems that SBA acknowledges still need to be resolved. We believe that the figures we present concerning small-purchase COC activity are adequate for estimating the relative proportion of small purchase contracts to total COC activity, but they should not be considered as precise indicators. Similarly, terminations for default and delinquency rates are widely used to indicate the success or failure of contractors, but close analysis shows that they are not reliable measures of contract performance. Depending on whose figures are being used, they often do not account for contract modifications, e.g., extensions of due dates or other intermediate steps taken by COs or others to mitigate performance problems. Moreover, some systems do not distinguish problems that are the fault of the contractor from those that are beyond the firm's control, often leaving the cause of a performance delay or failure indeterminable. The inspection timeframe precluded extensive sampling of file data maintained in the field or the use of surveys of COC recipients, SBA field personnel, and COs that would have provided a more fully substantiated, statistically valid representation of the effect of the COC program.

Preparing a credible cost-benefit analysis of the program was also beyond the scope of this review due to the lack of reliable cost figures for the range of COC-related activities. The savings estimated by SBA for the COC program, \$43 million in FY 1992 based on the difference between the total offers of COC recipients and those of the next lowest offerors, provide a useful starting point but do not present the whole picture. More accurate estimates would have to be calculated after contract completion and, to the extent allowed by available data, would take into consideration the costs associated with preparation of referral packages by the COs, contract award delays caused by COC processing, administration of the COC program, time of SBA and/or the CO in working with the firm to resolve issues or needs during contract performance, and any post-award adjustments, such as product or time modifications, that could be attributed to COC firms' deficiencies. As far as we could determine, accurate cost data on referral preparation by COs, appeals by procuring agencies, assistance during contract performance, and post-award actions, including terminations, do not exist.

**Flight International case.** We decided that the controversial FY 1991 COC issued to the Flight International Group, Inc. for a Navy contract, which significantly raised the profile of the COC program in Congress and prompted the request for this inspection, was not useful as a case study of COC program deficiencies because it represents an extreme anomaly for the program. First, the dollar amount of the Flight International contract was nearly 400 times the size of the average of all other COC contracts for the FY 1991-1992 period: \$250,000,000 vs. \$635,797, respectively. Thus the COC program, which normally maintains a relatively low profile in the procurement world, was suddenly thrust into the spotlight and threatened with being purged from DOD contracting, its major activity. Second, the case required substantially more SBA attention

than normal for COC processing, as indicated by the numerous meetings with Navy contracting officials, a complicated and unusual arrangement between Flight International and a second firm bearing on the applicant's financial qualifications, and the Navy's appeals challenging that arrangement on size standard grounds. Third, actions taken in the case by the Navy, which deemed the services to be performed "critical," were exceptionally aggressive and, in GAO's view<sup>5</sup>, of questionable propriety. SBA contended that the whole matter would never have arisen if Navy had used the correct Standard Industrial Classification (SIC) code to define the competition in the first place (criteria for qualifying as a "small business concern," which all COC applicants must be, vary according with SIC codes.) The GAO also concluded that the Navy had improperly evaluated Flight International's financial condition and ". . . effectively made a determination of nonresponsibility which the [Navy] was required to refer to SBA."<sup>6</sup> In effect, it appears that the Navy was deliberately trying to circumvent the COC process. The resulting fray in Congress appeared to be stoked by excessive actions on both sides, and the Chairman and Ranking Minority Member of the House Small Business Committee, joined by the Chairman and Ranking Minority Member of the Subcommittee on Government Contracting and Paperwork Reduction, made an unusual request to SBA for reconsideration of the issuing of the Flight International COC. In short, we found the circumstances behind the award to be too aberrant to justify using the case to assess the management and operations of the COC program.

This inspection was conducted in accordance with the Quality Standards for Inspections issued in March 1993 by the President's Council on Integrity and Efficiency.

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<sup>5</sup>U.S. General Accounting Office, Decision in Matter of Flight International Group, Inc (Washington: GAO, September 28, 1990), pp. 12-13. [49]

<sup>6</sup>Ibid., p. 9.

## FINDINGS

**Finding 1. The Federal procurement community has widespread misperceptions about the purpose, operations, and results of the COC program.**

### SUMMARY

Within the Federal procurement community, there appears to be needless, but rectifiable, confusion about the role, operations, and results of the COC program. We found that many procurement officials believe the program runs counter to the Government's interests and to the SBA's mandate to advance small business because COCs, in their view, often support marginal firms at the expense of more responsible small businesses. We found a number of widely held misperceptions: that COC firms were substantially worse performers than non-COC firms, in spite of studies and data suggesting little difference in performance; that SBA merely rubber-stamps COC applications, in spite of the fact that SBA rejects more than half of the firms that apply; that SBA's evaluation of a firm's responsibility simply rehashes information provided by the CO's preaward survey, in spite of the different approach taken by SBA, including an effort to develop more in-depth information; and that SBA performs no follow-up once it has issued a COC to a firm, in spite of established procedures to monitor COC firm performance. In the past, procurement officials may have had a legitimate complaint that SBA was not furnishing adequate justification when it issued COCs, but we believe that SBA has corrected this problem. Finally, we found that the procuring agencies may have reason to be unhappy with the COC appeal process, because they usually do not succeed in having a COC overturned, but it appears that appeal-related delays also occur in the processing conducted within the agencies themselves.

We recommend that SBA make a stronger effort to inform the Federal procurement community about the COC role, its operations, and its results to reduce the widespread misperceptions that hurt its reputation. We do not expect all COs to endorse the purpose of the COC program, but we believe that simple and inexpensive channels are available for disseminating existing data that would set the record straight for those willing to give it consideration.

## DISCUSSION

**Confusion about the purpose of the COC program.** In our discussions, SBA program managers, staff members of the House and Senate Small Business Committees, and SADBUs personnel in DOD and GSA consistently focused on the role of the COC program in ensuring that individual small businesses receive the contracts to which they are entitled. They described the COC role as that of enforcer of "contract justice" for small business, as a "watchdog" to ensure that firms receive the contracts they deserve, as an arbiter to provide a "second opinion" in cases where firms believe they have been treated unfairly, as a counterbalance to biases held by COs, and as a check on CO decisions that are sometimes arbitrary or inadequately supported.

In contrast, many procurement officials focused on SBA's broad mandate to serve the community-wide needs of small business and construed the COC function as incongruent with SBA's goal of improving the lot of small business in Federal contracting. This perspective is based on the fact that the firms against which COC applicants compete are most often other small businesses. Roughly half of the COC cases involve small business set-asides, which by definition include only small firms, and, in about half of the remaining procurements, the next low offeror is also a small business. Contracting officials, especially in DOD, frequently argue that the COC process simply pits one small business against another and takes contracts for COC firms that would have gone to small businesses that were, in their view, better qualified. From this perspective, the program appears to run counter to the needs not only of the Government but also of small business at large.

Although some COC awards have potential for increasing small business awards by winning for a small business a contract that would otherwise have gone to a large firm, we believe that this objective should be deleted from SBA's Congressional budget submissions and any other Agency documents in which it appears. COC officials generally agreed that it represents neither the true aim nor the practical value of the program. In fact, COC staff assess an applicant without regard to the size of the next lowest offeror.

**Conflicting objectives.** A certain level of tension between the COC program and the procuring agencies is probably unavoidable given their different roles and objectives. The goal of procurement officials -- to employ the most efficient procurement procedures available to acquire goods and services for their agencies -- does not always comport well with the COC goal of providing small businesses with an opportunity to appeal COs' determinations of nonresponsibility. When the economy worsens, the pressure can become more intense for both SBA and the procuring agencies, i.e., small businesses experience greater difficulty obtaining the work they need to survive, and COs feel compelled to reduce risk and conserve increasingly scarce funds by reducing the potential for unsatisfactory performance. On the operational level, SBA's task in COC cases is essentially to review the professional judgment of the COs, and COs naturally resent such intervention. Exceptions exist, however, including instances in which a CO, facing a negative preaward survey on a firm he or she believes could perform the contract, may let SBA know that he or she would not object to a COC being issued. In other cases, SBA may simply provide a convenient scapegoat if a firm fails to perform satisfactorily.

**Misperception of COC firms as "losers."** Several previous analyses suggest that there is no significant difference in the performance of COC firms and non-COC firms. Nevertheless, in our interviews, procurement officials frequently demanded to know why SBA insists on propping up what one termed a "bunch of losers," especially when economic conditions cause even firms with solid performance records to struggle to survive. An extensive evaluation by GAO in 1986 included a survey of COs that revealed that 56 percent of those who had experience with the COC program believed that contract performance by COC firms was about the same as or better than non-COC small businesses.<sup>7</sup> More cursory analyses by two DOD agencies in 1979 and 1983 and by GAO in 1980 and 1983 also concluded that the contract performance of COC and non-COC small businesses was essentially equivalent. Terminations for default, though clearly not a definitive measure of contract performance, represent the worst possible outcome in a contract and are often cited by both sides arguing the issue. In part because they tend to reflect failed performance, rather than simply poor performance, and because such failures in turn reflect poorly on CO performance, defaults are relatively rare in Federal procurement. According to Government-wide statistics compiled by the Federal Procurement Data Center, only about 0.5 percent of small business contractors are terminated for default each year. By way of rough comparison (there may be some variances in methods of calculation), an average of 2.7 percent of COC firms are terminated for default each year, according to SBA data for FY 1988-1991. While the aggregate data suggest that COC firms are more likely to be terminated for default than the average small business contractor, we do not consider a default rate of less than three percent to signal a major problem, especially in light of the findings of the other analyses.

In short, the characterization of COC recipients as losers is, in our judgment, unsupported by available data. As one SADBUD director put it, often there is more smoke than fire in complaints about the COC program. Our interviews indicated, however, that many procurement officials still hold to the view that the COC program frequently displaces responsible performers with firms prone to failure. We believe, therefore, that clarification of both the purpose of the program and the performance of COC recipients is needed.

**Misperception that SBA merely rubber-stamps COC applications.** A common impression among procurement officials is that SBA gives COC applicants little more than a cursory look and ultimately issues COCs in almost every case. SBA can afford such superficial treatment, according to some COs, because it does not suffer the consequences, like the non-delivery of critical goods if the COC firm fails to perform. SBA data indicate, however, that approval of COC applicants is far from automatic. In fact, in each of the last five fiscal years, only 40 percent of the firms referred to SBA subsequently applied for a COC, and COCs were issued to only 40 percent of those applicants (an additional 7% received direct awards from COs who decided to issue the contracts to COC applicants before SBA had completed COC processing). In our opinion, the fact that SBA rejects more than half of the firms that apply for a COC effectively refutes the rubber-stamp charge.

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<sup>7</sup>GAO, *op. cit.*, p. 42.

We believe that some of the misunderstanding stems from the different approaches taken by SBA and procuring agencies in assessing the responsibility of firms. The COs' preaward survey and SBA's COC evaluation are both designed to determine whether a COC applicant can demonstrate with reasonable assurance that the contract would be properly performed. Each assesses the applicant in terms of capacity, credit, integrity, tenacity, perseverance, and Walsh-Healey eligibility as a regular dealer or manufacturer. Preaward surveys and SBA assessments differ, however, in three important ways:

- First, SBA has the benefit of focusing full attention on the problems identified in the previously completed preaward survey. Although a number of procurement officials expressed reservations about the quality and sophistication of SBA assessments, they also acknowledged shortcomings in some of their preaward surveys. Also, SBA and procuring agencies often prepare their evaluations using different information; sometimes the situation of a firm has changed between the time of an agency's preaward survey and the completion of SBA's COC evaluation. In many cases, according to SBA, the COC review takes a more in-depth look at the causes of problems to determine the extent to which the firm should be held culpable. Where some preaward surveys may simply give the number of delinquencies and latenesses, for example, SBA asserts that it examines the reasons behind the delinquencies or latenesses.

Second, the COC review often gives a firm a chance to correct the problems identified in the preaward survey. Because SBA informs a COC prospect of the reasons for a CO's determination of nonresponsibility at the beginning of the COC evaluation process, the 15 days that follow can be used by the firm to remedy the deficiencies. SBA also helps new firms become more familiar with Federal contracting procedures and requirements, e.g., quality controls and product testing protocols.

- Third, SBA and the procuring agencies may differ on what constitutes an acceptable risk, particularly in the case of a struggling small business. A number of procurement officials complained that SBA was willing to take greater risks than COs in borderline cases. SBA's response is that it tries not to take more risks than it would expect of the COs, but that some COs want to take no risk at all. Moreover, SBA points to its record: more than half the firms that apply for a COC are rejected, 95 percent of the COCs issued in FY 1992 were on schedule or considered on schedule at year end, and a 1986 GAO study showed that the majority of COs reported that COC firms performed as well as non-COC firms.<sup>8</sup>

**Misperception that SBA performs no follow-up on firms issued COCs.** Many procurement officials appear to believe that SBA largely disengages from a procurement once a COC is issued, leaving the COs, as one official put it, to "live with SBA's mistakes." Some of these perceptions may have origins in the period of reduced monitoring and assistance during the mid-

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<sup>8</sup>GAO, *op. cit.*, p. 142.

1980s, when the huge volume of COC processing effectively precluded committing sufficient resources to COC follow-up. As applications for COCs have steadily declined over the last five years, SBA has in fact increased its attention to follow-up. For contracts over \$25,000, each region is required to submit a quarterly report on each active COC firm, and some regions report on a monthly basis. During FY 1992, COC specialists prepared 4,857 follow-up reports based on telephone calls, mail contacts, and site visits.

We were also advised that the COC program treats each termination for default as an opportunity to sharpen future follow-up: the SBA Assistant Regional Administrator for Procurement Assistance must explain in writing to the Director, Office of Industrial Assistance, the reasons for termination, the amount of SBA follow-up performed, specific SBA actions to help the contractor, and any lessons learned from the experience. The lessons learned are being compiled for use in future training of COC staff.

It was not possible to include an evaluation of the effectiveness of the COC follow-up system in this inspection, but, on the surface, it appears to be appropriately designed and workable. The perception that SBA shows little or no interest in a firm's performance once the COC has been issued is, in our view, unwarranted. Because we found that very few of the COs and other procurement officials we interviewed were aware of any SBA follow-up, we believe that SBA would be well-served to make its process better known within the procurement community.

**Communications during COC reviews.** The issue of misunderstandings due to insufficient communication surfaced repeatedly during our inspection. Procuring agency officials stated that SBA often does not listen to their concerns during the COC process. For example, SBA has the option of obtaining more information from the CO; however, procurement officials stated that SBA often does not appear to use additional information available from COs during the COC evaluation, thus diminishing the quality of the evaluation. SBA disagrees with this contention, indicating that it uses information that is submitted in a timely manner within the short period SBA has for COC evaluation. SBA officials also noted, though, that they try to avoid tipping their hand on a COC decision prematurely for fear that a CO might cancel a solicitation to preempt the COC award.

In the past, SBA did not always explain to procuring agencies why COCs were issued, and its letters notifying the COs of the issuance of COCs often lacked justifications. This situation can create an atmosphere of mistrust between SBA and the procuring agency, especially when almost every COC decision -- like almost every procurement decision -- inevitably makes somebody angry. Over the past 18 months, however, SBA has strengthened procedures for providing a CO with SBA's rationale immediately before and after the issuance of a COC. Just before issuance of a COC, a CO now has an opportunity to review SBA documentation on the firm and submit new information to SBA. Whenever a COC is issued, the letter of issuance now has an explanation of the SBA review committee's decision attached regardless of the dollar value involved.

**SBA's appeal process.** The COC appeal process allows a procuring agency to argue for a reversal of an SBA decision to award a COC before the COC is actually issued. During FY 1991-1992, the 31 COC appeals received by SBA represented less than three percent of the total COCs issued. An appeal is handled by the COC Review Committee at SBA's Central Office, and either the SBA Administrator or the Associate Administrator for Procurement Assistance makes the final decision. Many of the procuring agency officials we interviewed, however, viewed the COC appeal process as time-consuming and futile. For example, Navy officials stated that the appeal process can delay contracts for weeks and COs throw up their hands when fighting the clock, and GSA officials indicated that battling SBA is too time-consuming and costly, especially for contracts under \$25,000. Army officials stated that COC appeals are not worth the effort because they further delay deliveries of needed goods to the field; thus, their appeals generally number only about one a year. SBA officials argued, however, that a major cause of time consumption in the appeals process is delay in the processing of appeals within the agencies' own bureaucracies.

Procuring agency officials also stated that most of their appeal attempts have been futile: the Navy indicated it seldom wins COC appeals, GSA said it had never won an appeal, and 9 out of 10 Army appeals reportedly fail. Data gathered by SBA appear to bear most of these estimates out: only four (13 percent) of the 31 COC appeals filed in FY 1991-1992 were successful in reversing SBA's COC decision. Thirteen (42 percent) were denied, 12 (39 percent) were withdrawn by the agencies after discussions with SBA, and two were halted due to cancellation of solicitation and contractor debarment. One reason appeals are rejected, according to SBA, is that the submitting agencies frequently fail to include new information or rebuttals to the arguments made previously by SBA in justifying the COC. COC officials stated that agencies often simply resubmit the original referral packages with little or no comment on the points raised by the COC evaluation. We were unable to corroborate this, but, on balance, we concluded that the paperwork, delays, and perceived futility of appealing COCs are sufficient in most instances to persuade a busy CO that the easiest, quickest, and most practical course is to accept a COC, hope for the best, and point a finger at SBA if performance problems ensue.

## CONCLUSIONS

We believe that the COC program provides an appellate process that has benefited individual firms with grievances and may have provided a deterrent effect that helps keep the system more honest. The reputation of the program, however, suffers from widespread misconceptions about its fundamental purpose. A commonly held impression among procurement officials, particularly at DOD, is that the COC program is supposed to represent the collective interests of the small business community as a whole, and that the program's more narrow focus on the plight of individual firms is inconsistent with the overall mission. Providing an appellate process for individual firms, however, is clearly the only COC mission.

In view of the apparently widespread misperceptions about the COC program, we believe SBA should expand its efforts to inform the Federal procurement community about the COC

program's role, its operations, and its accomplishments. Specifically, the information should include a description of the narrow appellate function as the exclusive purpose of the program, and it should focus on reducing the misperceptions of procurement officials concerning COC firms as losers, COC processing as rubber-stamping, COC assessments as warmed-over preaward surveys, and COC follow-up as a nonexistent activity. The method for disseminating this information need not be complicated, costly, or time-consuming. It could be as simple as attaching a one-page fact sheet to the COC determination letter sent to each referring CO and requesting the SADBU's to distribute the fact sheets via their channels to agency procurement officials. Alternatively, or perhaps as a complementary means, SBA could employ existing procurement newsletters or other publications for periodically communicating the COC information. Whatever channels are selected, the criteria for success in this effort would include (1) whether the appropriate information had been disseminated and (2) whether the information had in fact reached front-line COs.

#### RECOMMENDATION

The OIG recommends that the Associate Administrator for Procurement Assistance:

**1. Expand efforts to inform the Federal procurement community about the COC program's role, its operations, and its results by routinely disseminating the following:**

- **A clear statement that the COC function is exclusively to provide an appellate process for individual small businesses.**

**A summary of COC operational results, including COC approval rates, delinquency/default data on COC recipients, and SBA follow-up activities.**

**Finding 2. Recent Federal procurement initiatives pose a threat to the existence of the COC program.**

SUMMARY

As economic restructuring forces the downsizing of DOD and the tightening up of virtually all Federal procurement activities, various initiatives designed to ensure maximum value in goods and services acquired by the Government create risks for the continued operation of the COC program. Most of the initiatives have existed for some time in one form or another, and each has as its fundamental aim making the contracting process more efficient. The intent of SBA's COC program, however, is not focused on improving the efficiency of the procurement process, but rather on ensuring equitable treatment for small businesses trying to compete in the Federal procurement market. Some of the proposed procurement initiatives pose a potential threat to the COC process by, in effect, eliminating actions that currently trigger COC referrals. At the time of the inspection, we were unable to predict which procurement changes will occur or what their effect might be on the COC program. Once the future of several DOD quality vendor programs becomes more clear, however, SBA and the Congress will need to reassess whether the COC process will continue to have a viable role in an era of heightened attention to cost-effectiveness and of well-established small business participation in Government procurement.

We recommend, therefore, that as soon as the current GAO report on two DOD best-value contracting programs has been issued, SBA prepare a position paper that responds to any recommendations endorsing best-value or related procedures. The paper should also justify the continued operation of the COC program and offer options for adapting the program to the changing procurement environment.

DISCUSSION

As described in the first finding, the advocacy role of SBA frequently appears to COs to work at cross-purposes with the Government's ongoing efforts to streamline and simplify Federal procurement procedures, and the COC program provides a battleground where the opposing forces meet. It is premature to recommend specific legislative actions to ensure continuation of the COC role in the face of potential challenges from initiatives designed to make contracting more efficient, because efforts to analyze the issues are still under way at GAO and at several affected agencies. The two initiatives that appear to pose the most significant threats are contract bundling and best-value contracting.

**Contract bundling.** In an effort to enhance the efficiency of the contracting process, procurement officials may consolidate, or "bundle," several projects that had previously been awarded as separate, smaller contracts into a single, large contract. The presumed advantage to Federal procurement is the achievement of greater economy of scale and reduction of contract administration costs. DOD, in particular, as it experiences the budget cuts associated with downsizing, appears to be making widespread use of the process. A major disadvantage of bundling is the potential loss to small business of contracts that it had previously been awarded due to the inability of small firms to handle the larger procurement packages. The most likely result is reduced opportunities for small business in Federal contracting. The practice also appears to run counter to Congressional intent to promote competition in the Federal marketplace and provide specific preferences to small business. The Small Business Act of 1958, as amended, requires SBA to review proposed procurements whenever the bundling may have the effect of precluding small businesses that have been providing the goods or services as prime contractors. By direction of the Small Business Credit and Business Opportunity Act of 1992, SBA is currently coordinating a study to assess the impact of contract bundling on small business participation in Federal procurement. The report is due to the Congressional Committees on Small Business by May 15, 1993.

**Best-value contracting.** While COs naturally prefer low offers, they are also charged with keeping the risk of nonresponsibility and poor performance to a minimum. Best-value initiatives are intended to focus procurement efforts on obtaining quality goods and services at a reasonable cost, rather than letting price and responsibility thresholds alone determine contract awards. They evolved from the 1986 Packard Commission's recommendations to inject more commercial buying practices into Federal procurement, including placing greater emphasis on quality and historical performance. Best value has been applied to large contracts for some time, but recent efforts have been made to expand into small contracting. One of several programs being developed in DOD is the Defense Logistics Agency's (DLA) Vendor Rating System. Following a three-year study, DLA recently proposed establishing the rating system to provide an automated best-value buying process. The purpose is to ensure that CO decisions reflect full consideration of each prospective contractor's historical quality and delivery performance. Using weighted computations of these factors, the rating system would generate "objective" ratings based on past performance for the COs to compare, along with price, in making source selections. The expected benefits spelled out by DLA in the Federal Register include improved performance on DLA contracts and "enhancement of [DLA's] ability to acquire quality items from proven suppliers on time."

This process poses significant risks for the COC program: its focus on performance history would almost certainly put small businesses with unproven track records or no Federal contracting experience at a severe disadvantage, and, despite stated intent, value-based decisions are likely to increase subjectivity in the award decisionmaking process to the detriment of firms with which a CO may feel less comfortable. Because price and performance would be given roughly equivalent consideration, there would be ample grounds for justifying awards to firms other than the lowest-priced responsible offeror, not to mention one held to be nonresponsible. SBA has argued that allowing COs to make awards to higher-rated offerors in place of lower-

cost, lower-rated firms violates the Competition in Contracting Act and that allowing COs to use elements of responsibility to determine competitive range for contract awards conflicts with the authority provided to SBA by the Small Business Act. COs could in effect circumvent the COC process by excluding many small firms that might have been COC candidates from the competitive range. As Federal funds for contracting continue to shrink, the procuring agencies will also feel squeezed for resources for administering contracts, and there will be even greater incentive for the COs to select contractors with whose performance they are already familiar and comfortable.

If no conditions are established specifically to preserve the right of small businesses to appeal CO decisions, the best-value initiative would effectively exclude the current clientele of the COC program, rendering the program's purpose moot. Being designated a responsible firm in competition for a contract would no longer ensure award to the lowest offeror, so the successful appeal of a nonresponsible determination loses significance, and COCs largely become obsolete. The issue then becomes whether any kind of appellate process is available to small businesses who feel cheated; relying on private sector forces alone will not always ensure equity. As a recent SBA legal opinion points out, the Government's goals do not always coincide with those of the commercial sector: ". . . Congress, by providing for bid protests and contract disputes and other requirements to level the playing field, has chosen to emphasize fairness over an entirely free market. Additionally, Congress has chosen to enact a detailed scheme to ensure that small businesses receive a fair proportion of government contracts. . . ." In the interest of saving contract administration costs, the initiatives would erect the kinds of barriers to entry that SBA has been tasked with breaking down. To compound the danger, best-value contracting would also have a potential secondary effect that reaches well beyond the COC program: the major contractors doing business with the Government, in an effort to remain competitive, could themselves adopt similar vendor quality programs, or tighten existing ones, with dire consequences for small businesses trying to enter the subcontracting market. If the underlying social goals remain viable and the American taxpayer is prepared to accept less-than-perfect efficiency in Federal contracting to attain them, new means need to be devised to provide a forum for small businesses that believe they have not been given fair consideration.

Two of the procurement programs, the Air Force's "Blue Ribbon Contractor Program" and DLA's "Quality Vendor Program," are currently being examined by GAO, which expects to issue a report in May 1993. SBA has expressed its legal and policy concerns based on its view that such programs contravene the Small Business and Competition in Contracting Acts. Despite the fact that these two specific programs apply only to negotiated procurements, SBA is apprehensive that they will allow the procuring agencies to circumvent the COC process, particularly with regard to new firms trying to enter the DOD procurement market. In December 1992, the chairmen of the House Committee on Small Business and the Committee on Government Operations also voiced alarm at these programs and the spread of contract bundling in general, and they cautioned DOD to resolve SBA's concerns before proceeding with these procurement initiatives.

## CONCLUSIONS

It is not clear at this point what effect current or future procurement initiatives may have on the COC program, but the momentum behind streamlining procurement procedures appears sufficient to spawn programs to implement at least some aspects of best-value contracting. SBA hopes that the current proposals will be declared illegal on the grounds that they violate the Small Business Act by denying segments of the small business community access to Federal contracting.

If some initiatives prevail, however, we believe procuring agencies are likely to enact best-value procedures by establishing lists of vendors determined in advance to be acceptable for contracts. In that event, one of two outcomes for the COC program is certain: either the role of the program will in effect be eliminated, or new COC procedures, preferably backed by legislation, will be needed to keep the program viable. COC intervention might be triggered, for example, by the requirement that the procuring agencies refer to SBA all small businesses excluded from their vendor lists. The program would then perform the appellate function, albeit in a very different manner, for small firms that felt unjustly denied a place on a list. Other scenarios may also emerge, including some that, in the interest of greater overall efficiency, adopt a more Darwinian approach, focusing on the level of total small business participation rather than the fate of the more marginal few. Under those circumstances, Congress may need to determine if a new role should be established for the COC program within the changing procurement environment. Obviously, it is difficult to anticipate all possible outcomes of the current debate, but if we assume both that best-value contracting will survive in some form and that the Congress, representing the interests of the American taxpayers, continues to show a willingness to forgo some procurement efficiency to support the struggling elements of small business, SBA will need to develop an effective appellate process for aggrieved small businesses under significantly changed conditions.

## RECOMMENDATION

As soon as the forthcoming GAO report on the Air Force's "Blue Ribbon Contractor" and DLA's "Quality Vendor" programs is issued, the OIG recommends that the Associate Administrator for Procurement Assistance:

2. Prepare a position paper that responds to any GAO recommendations that endorse best-value or related procurement procedures. The paper should include justification for the continued operation of the COC program within the changing procurement environment and options for adapting, as necessary, the role and operations of the program.

**Finding 3. Legislative actions are needed to strengthen the COC process.**

SUMMARY

Two legislative actions are needed to enhance the effectiveness of the COC program: the recently enacted provision requiring the COs for DOD contracts to notify firms of the COC option should be repealed, and a threshold should be established to bar COCs for all contracts of \$25,000 or less. In each case, we believe that arguments on cost-effectiveness grounds outweigh any possible detrimental effects either to small businesses or to procuring agencies.

DISCUSSION

**Notification by COs.** Section 804 of the FY 1993 National Defense Authorization Act modified the COC process for DOD by requiring COs to notify in writing all small-business low offerors deemed nonresponsible that they have the option of applying to SBA for a COC. Previously, DOD simply referred all such cases to SBA, which, in turn, notified the firms directly. The anticipated benefit was to give COs an earlier indication when a firm chooses not to apply for a COC, allowing the CO to proceed with the contract award without further delay. We believe, however, that the drawbacks of this provision will outweigh the possible benefits for each of the parties involved.

For DOD, the procedure is likely to increase the paperwork burden on the COs without providing any apparent savings in net contracting time. The precedent requirement, which still applies to non-DOD agencies, allowed five days for a firm to decide whether to apply for a COC and a total of only 15 days from time of referral for completion of both the firm's response and SBA's evaluation. Only with the concurrence of the CO could the 15-day period be extended. Under the original system, according to COC officials, SBA often obtained oral notification from the firms and advised the COs within several days. The new provision gives the firms 14 days in which to advise the CO whether they want to apply. Contracting time may be saved in cases where firms promptly decline the COC option; on the other hand, when a firm either decides to apply for a COC or is slow to inform the CO one way or the other, the contracting process will experience additional delays. The DOD representatives we contacted saw little benefit from the new requirement, and most stressed that it will not accomplish the procuring agencies' main objective of speeding up the contracting process. In DLA, for example, it is likely to impede

the "just-in-time" inventory control system adopted to maximize the efficiency of its support and supply services by keeping stock on hand at the lowest practicable levels. For prospective COC firms, the fact that the provision applies only to DOD contracts is likely to cause confusion, especially for those competing for both DOD and civilian business. If small businesses already found Federal contracting procedures daunting, they will now face two different sets of statutory requirements. Finally, for SBA, the provision creates new vulnerabilities for the COC process. The Agency is concerned, for example, that direct contact between COs and the prospective COC firms for purposes of initial notification will provide COs with a tempting opportunity to try either to intimidate firms or to offer enticements to dissuade them from applying for a COC. If such activity occurred, it would be difficult for SBA to detect such efforts in time to counteract them. As a result, SBA has urged repeal of the requirement.

In short, the requirement may have been a well-intentioned compromise designed to strike a balance between efficient procurement and independent review and to end, at least for the time being, the heated debate between Navy and SBA over the Flight International case discussed earlier, but it appears to serve the interests of neither DOD nor SBA nor small business. We concur, therefore, with SBA's proposal in its FY 1994 budget submission and with the recommendation of the Acquisition Law Advisory Panel (also known as the Section 800 Panel) that the provision be repealed without waiting for its test period to expire on September 30, 1995.

**Procurements of \$25,000 or less.** The efficiency of COC processing becomes a greater concern when smaller contracts are involved, i.e., the proportional costs of administering a COC are likely to grow for all concerned -- COC applicants, procuring agencies, and SBA alike -- with lower contract dollar amounts. For small firms, the relatively low percent that apply suggests there may be substantial doubts that the potential rewards of pursuing a contract outweigh the time and cost of preparing a COC application. COC statistics indicate that for FY 1988-1992, only 27 percent of the firms referred to SBA for contracts of \$25,000 or less chose to apply for a COC, as opposed to 44 percent for contracts greater than \$25,000. For the procuring agencies, various costs occur with the roughly 480 COC referrals each year involving procurements of \$25,000 or less, for each of which the CO has to submit to SBA a file that includes the solicitation, a determination letter explaining the reasons for the nonresponsible assessment, and any available specifications, drawings, or other pertinent information. The Federal Acquisition Regulation, which governs the Federal contracting process, expressly cautions COs to be mindful of administrative costs when making small purchase awards.<sup>9</sup> The Government may also incur costs due to COC-related delays in making the awards -- the small purchase process was intended, after all, to be streamlined, quick, and simple. For SBA, workload costs include staff time committed to processing COC referrals and applications in cases where the potential inequity involves amounts as low as \$1000. SBA officials stated that less documentation is required from the procuring agencies for small-purchase procurements, reducing the costs for both the COs and SBA. In the absence of more specific budget data from

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<sup>9</sup>Federal Acquisition Regulations, Part 9.106-1 (a).

the procuring agencies and SBA, we were unable to determine actual costs for processing COCs or the extent to which the simplified procedures for small-purchase COCs may have created cost savings.

We believe that one of two alternative actions is indicated: either restricting COCs by discontinuing automatic referrals for procurements of \$25,000 or less, which was proposed by members of the Senate Small Business Committee in 1991, or eliminating the COC option altogether for procurements under \$25,000. Neither alternative is likely to have a significant effect on small business as a whole, given the low volume of COC applications for small-purchase procurements. Nor would they, in our opinion, significantly diminish the role of the COC program in Federal procurement. On average for the last five years, only 134 of the roughly 1,250 COC applications received and only 56 of the 535 COCs issued each year are for procurements of \$25,000 or less. Moreover, the total dollar value of all such procurements averages less than \$530,000 a year, compared to over \$386,660,000 a year for COC procurements in amounts over \$25,000 (excluding the \$250 million Flight International case).

We conclude that if just over one in ten COCs and only 0.1 percent of the value of COC awards may be affected each year, discontinuing COCs for procurements under \$25,000 would have little or no detrimental effect on SBA, while also offering desirable relief for the procuring agencies in a tightening Federal market. Nor would the impact on small business be noticeable - the dollar value of COC small purchases is barely 0.007 percent of total small purchases awarded to small business. The SBA resources made available by establishing the threshold would not be large, but they could be applied to other needs within the COC program, such as increased followup on COC recipients.

## CONCLUSIONS

We believe that the compromise legislation that emerged from the 1991 dispute over the COC program between SBA and DOD will complicate rather than enhance the process for all parties involved. The COs at DOD must contend with additional paperwork with no clearcut benefits in reducing procurement time, SBA is concerned that it would be unable to detect any efforts by COs to misuse the responsibility and attempt to dissuade firms from applying for COCs, and prospective COC firms may well become confused by the two different sets of requirements, one pertaining to DOD and the other to all other Federal agencies. In practice, the provision appears very unlikely to achieve its objective of reducing procurement time. For these reasons, we believe it should be repealed now, rather than waiting for the test period to expire in 1995.

The COC program has had negligible effect on small business participation in Federal procurements of \$25,000 or less, and applying the COC process in such cases appears to create disproportionate administrative costs for both SBA and the procuring agencies. Small businesses have shown substantially less interest in the COC option for small purchases than in procurements involving larger dollar amounts, in all likelihood for cost reasons. Specific data on COC processing costs was not available for our analysis, but the inefficiencies of processing

COCs for low-dollar procurements represent, in our opinion, an unnecessary cost to the Federal Government, particularly when small business appears to be well-established in the small-purchase market. On procurement efficiency grounds, therefore, we believe a COC threshold should be established that precludes procurements of \$25,000 or less. (If the small purchase threshold is raised above \$25,000, as widely expected, we believe that the COC floor should remain at \$25,000 unless further analysis produces persuasive evidence that it should also be revised.)

#### RECOMMENDATIONS

The OIG recommends that the Congress:

3. **Repeal Section 804 (b) of Public Law 102-484, the FY 1993 National Defense Authorization Act, which requires DOD contracting officers to notify in writing all small-business low offerors deemed nonresponsible of the COC option.**
4. **Eliminate procurements involving \$25,000 or less from consideration for COCs.**

**APPENDIX A**

**REQUEST FOR THE INSPECTION  
FROM THE  
CHAIRMAN, COMMITTEE ON SMALL BUSINESS,  
U.S. HOUSE OF REPRESENTATIVES**

JOHN J. LaFALCE, NEW YORK  
CHAIRMAN

NEAL SMITH, IDWA  
KEI SKELTON, MISSOURI  
DOMAMANO L. MAZZOLI, KENTUCKY  
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ROBERT E. ANDREWS, NEW JERSEY  
THOMAS K. ANDREWS, MAINE  
BILL DORTCH, UTAH  
D. PASTOR, ARIZONA

# Congress of the United States

House of Representatives

102d Congress

Committee on Small Business

2361 Rayburn House Office Building

Washington, DC 20515-6515

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JOSEPH M. MCDADE, PENNSYLVANIA  
WM. E. BROOMFIELD, MICHIGAN  
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LARRY COMBEST, TEXAS  
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December 7, 1992

Dr. James F. Hoobler  
Inspector General  
U.S. Small Business Administration  
409 Third Street, SW  
Washington, DC 20416

Dear Dr. Hoobler:

The Committee on Small Business believes that it is in both the Committee's and the Small Business Administration's interest to have the Inspector General conduct an independent review of the Agency's Certificate of Competency (COC) process. As Chairman, I am especially concerned that the COC process, which came under serious attack a year or so ago, may yet undergo another challenge early in the new administration. The Committee would, therefore, like to have a timely, independent assessment by the Office of Inspector General, so that its members may be prepared to address any new challenge on substantive, objective grounds.

While the Committee will leave the review's scope and "terms of reference" up to you, we would like you to be thorough in your review and include an assessment of the SBA's management of the COC program. I would also be interested in your view regarding any perceived problems that could be rectified legislatively by the new Congress. Mr. Don Terry, the Committee's Staff Director, and other members of the professional staff, will be available as-needed.

Thank you for your consideration in this matter.

Sincerely,

JOHN J. LaFALCE  
Chairman

JJLjmk

Ex. 6

## APPENDIX B

### MAJOR CONTRIBUTORS TO THIS REPORT

Tim Cross, Director, Inspection Staff

Phillip Neel, Inspector



**U.S. Small Business Administration**  
Washington, D.C. 20416

OFFICE OF  
DIRECTOR GENERAL

May 3, 1993

The Honorable John J. LaFalce  
Chairman, Committee on Small Business  
United States House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed is the response of the Associate Administrator for Procurement Assistance, U.S. Small Business Administration (SBA), to our inspection of the Certificate of Competency (COC) program. The inspection report was transmitted to you on April 19, 1993.

The Procurement Assistance response indicates general acceptance of three of our recommendations and disagreement with the fourth. Our position in each case has not changed; but I offer the following brief comments:

**Finding 1. The Federal procurement community has widespread misperceptions about the purpose, operations, and results of the COC program.**

While agreeing to test our recommended action, SBA expressed considerable reservations about the finding. The Agency takes issue with our methodology, which relied heavily on about 70 interviews with procurement officials, SBA staff, and others in the executive and legislative branches. As we noted in the report, a more extensive survey employing scientific sampling techniques would have been desirable, but the timeframe for the inspection simply would not accommodate it. Instead, we interviewed persons who by position or by referral were logical sources of information given their experience with or knowledge of the COC process. We diversified the group in an effort to cover the gamut of perspectives. The prevalence and consistency of the misperceptions we found, which are described in detail in the report, persuaded us that basic information on what the COC program was intended to do and on the results of its activities was not reaching a sizable segment of the procurement community at either the operational or policy levels. Our recommendation, therefore, was specifically aimed at correcting several of the most frequent misperceptions, using information that SBA already produces for its own purposes. We believe that the means exist for disseminating the information at very low cost, and we look forward to reviewing the results of SBA's pilot test.

**Finding 2. Recent Federal procurement initiatives pose a threat to the existence of the COC program.**

SBA appears to concur with this finding, which was based largely, though not exclusively, on information provided by SBA personnel both in the Central Office and in the field. Our intent was to highlight the fact that "best value" and other Federal initiatives intended to improve the efficiency of the procurement process could significantly undermine the role of the COC program. What written form the SBA chooses -- a position paper, a plan, or a proposal for legislative or regulatory changes -- for responding to the pending GAO findings on two of these initiatives is not of critical importance. We accept that it is the prerogative of management to make that determination when the response is required. We reiterate, however, that the response should include justification for the continued operation of the COC program, especially if the procurement environment is significantly changed.

**Finding 3. Legislative actions are needed to strengthen the COC process.**

SBA agrees with our recommendation that the Congress repeal the statutory requirement that Department of Defense contracting officers notify small businesses of the COC option.

SBA disagrees, however, with our recommendation to eliminate all procurements involving \$25,000 or less from consideration for COCs. As both our report and SBA's response point out, there were significant deficiencies in data, and it was impossible to prepare a definitive analysis of the volume of referrals, the reasons that nearly three out of four firms referred to SBA decline to apply for a COC for a small-purchase procurement, or the potential costs and savings associated with small-purchase COCs. Even in the absence of air-tight quantitative data, however, we believe that the Congress can determine whether providing an appeal process to every small firm seeking Federal procurement business is justified, no matter how small a particular procurement may be and regardless of possible cost inefficiencies. If the Congress has doubts, perhaps fueled by the overriding concern to reduce Federal program costs, we believe that eliminating the smallest procurements from COC consideration makes economic sense.

We respect the commitment of the COC program to ensuring that small firms seeking Federal procurement business receive fair treatment, and our inspection revealed nothing fundamentally unsound or improper either in the way the program has been managed or in the results it has achieved. The actions we recommend are intended to improve COC program performance by reducing misperceptions about the process, by anticipating and responding to a potentially significant threat on the horizon, and by increasing COC efficiency through legislative action. We believe they remain appropriate actions for SBA and the Congress to take.

My staff and I would be pleased to answer any questions you may have. Thank you for the opportunity to serve the Committee with this independent assessment of the COC program.

With best wishes,

Sincerely,

Ex. 6

James F. Hoobler  
Inspector General

Enclosure



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



APR 29 1993

MEMORANDUM

TO: James F. Hoobler  
Inspector General

THRU: Janice E. Wolfe  
Acting Associate Deputy Administrator  
for Finance, Investment and Procurement

FROM: Robert J. Moffitt  
Associate Administrator  
for Procurement Assistance

RE: Inspection Report: Certificate of Competency Program

Ex. 6

This is in response to the subject report provided to me on April 19, 1993.

Before offering specific comments, I would like to thank Messrs. Tim Cross and Philip Neel of your staff for their professional demeanor and courtesy during the course of their review of the Certificate of Competency (COC) program. While their time was very limited I believe that they made every reasonable effort to complete their review and to understand the complexities of the procurement process and the COC program; and, to work with the program staff in developing facts and recommendations. I believe any disagreements we may have with the findings of this study are the fault of circumstance and not of people.

My comments on the report and its recommendations appear below.

First, the report notes that "the Federal procurement community has widespread misperceptions about the purpose, operations, and results of the COC program." I do not doubt that there were such complaints by the contracting personnel interviewed. But I am concerned about the conclusions drawn from what must necessarily be an extremely limited sample. Although there is no indication of the specific basis of the finding, it would appear that interviews would be the source. I am not aware of any recent surveys or other studies which would support the finding. Remembering that the "nearly 70 interviews" conducted included "officials and staff in Congress, SBA, and Federal procuring agencies," which would also include personnel from the Offices of Small and Disadvantaged Business Utilization at buying agencies, I assume that there may have been as many as 40 interviews with actual contracting personnel. Bearing in mind that there are, at last report from the Federal Acquisition Institute, more than

30,000 Federal employees included in the procurement job classification series, I believe the conclusion drawn (that the problem was "widespread") should have been much more tentative and/or much more narrow in scope.

Another concern about the source of this view is that it may reflect the attitudes of senior, rather than operational, personnel. This is pertinent because it is common for SBA contacts to be with contract specialists, working for contracting officers. The former are responsible for moving the paper through the system while the actual (supervising) contracting officer and other management personnel are not involved at that level of detailed information about such things as COC program actions and other daily routine leading up to award or to administrative actions. This practice raises additional question concerning the characterization of the interview information.

Tension will always exist between the SBA COC program and Government agencies over SBA's decision to issue a COC. The current Federal procurement process, by its very nature, is protracted from its inception. The fact remains that prior to the time a decision is reached by a contracting officer to refer a small business for a COC, months have already elapsed in the procurement cycle. This time is spent for bid openings (IFB) or negotiations (RFP), preaward surveys, further negotiations, review of the preaward recommendations and the decision to award or not award a contract. The entire COC process adds 15 additional work days to the procurement cycle, and this is only if the small business decides to submit an application. Time beyond the 15-day period is granted or denied by the contracting officer. Otherwise, it takes 6 work days for SBA to notify the contracting officer in instances where a small business declines to apply for a COC. The COC process represents a small percentage of the overall time spent in the procurement cycle.

The report also notes that the basic misperception is supported by other incorrect impressions. But those misperceptions must have been formed independently of experience, given the statistics of the COC program. The specifics which demonstrate this are: the belief that "SBA merely rubber-stamps COC applications;" and, the idea that "SBA performs no follow-up to determine how well a COC recipient is performing." In the first case this belief exists despite the fact that the same personnel who are advised of affirmative COC results are also informed when a small business has not applied for a COC or when one has been denied. The report points out that approximately 40% of referrals result in applications; and, only 40% of the applications result in the issuance of a COC. In the second case, the contracting agency personnel contacted by SBA Industrial Specialists to follow up on a COC performance must be aware that there is a continuing contact, directed toward following the success of the COC recipient.

I can only conclude that, if this information is held concurrently with the misperceptions that the report addresses, then the contracting personnel are clinging to them irrationally; or, alternatively, the full story is not reaching the level at which the interviews were conducted. I suspect that both answers may have some validity. But in either case--or both cases--it is doubtful that reality will replace misperception through the routine dissemination of information, as the report seems to suggest.

I would also like to note that the report includes an error regarding follow ups on COC's. The report states that the SBA only performs follow-up actions on cases over \$25,000 in value. Actually, SBA performs follow-up actions on all certified contracts regardless of dollar value in order to track contractor performance.

Further, there seems to be some confusion as to when SBA will entertain "additional or new" information from a contracting officer. When a COC referral is received, we assume we have received all the information at the contracting officer's disposal which led to the non-responsibility determination, since FAR 19.602-1(c)(2) requires that a referral include "any...pertinent information that supports the contracting officer's determination." The COC review is performed based on that information. If a contracting officer wishes to submit "additional information" in reference to the proposed issuance of a COC, SBA is more than willing to accept the information and evaluate its relevance to the issue at hand. In fact, FAR 19.602-3(a) provides that "when disagreements arise about a concern's ability to perform, the contracting officer and the SBA shall make every effort to reach a resolution before the SBA takes final action on a COC." SBA's Standard Operating Procedure (SOP) 60 04 3 (paragraph 33.b.(2)) states that if a procuring agency supplies new information the COC Review Committee may be reconvened and reconsider an application.

The view that SBA does not provide information on the reasons for issuance of a COC is also inconsistent with the facts with which contracting officers should be familiar by experience. Contracting officers have always been informed of the reasons leading to the issuance of a COC. Prior to 1991, SOP 60 04 3 (paragraph 33) required that the contracting officer be orally advised of the factors which led to the decision to issue the COC. At that time, they were invited to supply new or additional information for SBA's consideration; or, they were invited to visit the regional office to review the case folder to examine all the information in SBA's COC case file which led to the determination of responsibility. If a contracting officer still was not convinced, he or she was informed of the right to appeal the proposed decision to SBA's Central Office.

Secondly, the report notes that "recent Federal procurement initiatives pose a threat to the existence of the COC program." The reference is to initiatives ("best value," "blue-chip vendor," "quality vendor," etc.) by procuring agencies which have the effect of converting what would normally be sealed bid procurement to negotiated procurement. The process then would give preference to those offerors with which the Government has favorable experience, by using what would ordinarily be "responsibility" factors as "source evaluation" factors; or, by giving additional evaluation credit for previous successful performance; or, by using pre-qualification to exclude prospectively non-responsible offerors. As the report indicates, these approaches offer opportunities to avoid actions which would trigger COC referrals. While SBA is opposed to such approaches and considers that they present too great an opportunity for abuse of the system to the detriment of small businesses, the adoption of these techniques would not render the COC program "moot," as the report states.

It is highly unlikely that the entire competitive procurement structure will be shifted to negotiated procurement, abandoning sealed bidding. (In fact, Federal Acquisition Regulations (FAR) 6.401 require a separate justification when sealed bidding is not used.) Even if that change were to occur, FAR 9.103 would still prohibit award of contracts without an "affirmative determination of responsibility." FAR 19.602-1 notes that a non-responsibility determination on small businesses is referred to SBA for consideration for COC. While use of the "quality vendor" concepts may reduce the number of referrals and deny some small firms the opportunity for a second review of responsibility, the applicability of the program to much of the procurement system would continue.

The concern which SBA has about the "quality vendor" or "best value" ideas is the application of the techniques to procurements in such a way as to make responsibility determinations pro forma because of the evaluation methodology. In essence, the apparent successful offeror will be found responsible through the evaluation process, not after it. While this may reduce the volume of the COC referrals it is extremely unlikely to end the program; supply schedule contracts would continue, if nothing else.

The other concern I have about the wording of the report on this point is the apparent working assumption that the proposed techniques would improve "efficiency of the procurement process." While the COC program is directed toward assuring small firms a fair review of "responsibility," the effect of the program must be to the benefit of the Government.

The fact that COC contracts are awarded at lower cost than would otherwise be the case must be construed as improved efficiency for the Government, unless one accepts as valid the misperceptions identified earlier in the report.

The problem to be addressed is not the continued existence of a COC program but whether small firms, especially the minority and women-owned firms most likely to be new to the procurement system, will have some form of protection against biased evaluation by contracting agencies. The best timing for attacking the problem, as the report points out, may be when GAO completes its report on two of DOD's quality vendor program. The preparation of a "position paper" may or may not be the best method of responding to events. The method chosen, whether it be in the form of legislative or regulatory change or a "paper," I believe, should be the prerogative of management, depending upon the conclusion reached by GAO.

I must also question the phrase "underlying social goals" which appears on page 15, 2nd paragraph, the next to last sentence. The report is assigning a social value to an economic situation. The preservation of small businesses in the Federal marketplace and the infusion of new competition into the Federal arena is an economic consideration without regard to social issues. Allowing a buying activity the opportunity to subjectively rate responsibility issues, which can go unchallenged, as the basis of awarding or denying contracts, opens the door to blatant abuse affecting economic issues. Without the availability of an appeal process for small businesses, competition, whether between small businesses or between large and small businesses for the award of a Government contract will be seriously threatened. The entire paragraph also continues to accept the premise that the quality vendor programs offer increased efficiency. This is not proven.

Finally, the report concludes that "Legislative actions are needed to strengthen the COC process." The report recommends that recent changes to the law complicating the COC process at the Defense Department, which also applies to the National Aeronautics and Space Administration (NASA) and the U.S. Coast Guard, be rescinded; and, it proposes that procurements of \$25,000 or less be exempt from the COC procedures. I concur with the former, and a recommendation for such a rescission was included in OPA's Fiscal Year 1994 Legislative Proposal package. I disagree, however, with the latter conclusion for two reasons.

My first objection to trimming COC eligibility is that the program is intended to provide assurance of a fair review for responsibility. Several years ago, when SBA departed from the law by making referrals optional at \$10,000 or less, Congress rightly brought the agency back to the point: the COC procedure applies at any value level. There is no basis for a cost effectiveness comparison of fairness.

This is particularly true for the small firms most likely to be found not responsible on a small purchase: the minority and women-owned firms which have just begun to find their way through the Federal procurement process and which have little to offer in the way of established credentials. The COC program provides them with an opportunity for a second chance to understand what is going on and how to show their capability. We should continue to provide that opportunity.

My second objection to accepting the proposal that such a cut would be cost-effective is that we simply have no basis for comparison. While the report makes the recommendation on grounds of cost-effectiveness, it also acknowledges that there is no data available on which to base cost-effectiveness comparisons. The inspectors were advised of streamlined procedures for small purchase COC's, which minimize costs. There is no data now available to establish costs of the overall process. Neither has there been any quantification of the value of providing "fair" reviews for small businesses. It may be that, intuitively, the inspectors believed that there is no return to the Government worth the costs of a small purchase COC. Our belief is that a second chance to show capability on an award which may be 20 percent or 40 percent or more of anticipated receipts is worth an unmeasurable amount to a small business. It should be worth almost as much to a Government which values equity and involvement of the minority and women-owned businesses which are just getting started.

FAR 13.106 provides that purchases valued at under 10% of the small purchase ceiling may be awarded without competition if a contracting officer considers the price to be reasonable. In those circumstances, the practical questions of responsibility are resolved before the contracting officer opens conversations with the contractor. At that level, currently \$2,500, I would agree that the COC process may be unnecessary. Above that value, however, I continue to believe that small business deserves the benefit of a second review.

We advised the inspectors that the data we supplied to them for FY 1988 through FY 1991 may not contain all of the small purchase contract COC referrals sent to us by contracting officers over that period. We were, therefore, surprised by the relatively small number of referrals, 480, under \$25,000 cited in the report at page 18. We therefore requested three of our regional offices to supply us with information at their disposal relative to the number of referrals they received under \$25,000 for the fiscal years cited in the report. A review of the hard data shows that in just three regions (II, V and IX) SBA received a total of approximately 580 referrals for each of the fiscal years cited in the report. This represented approximately 30% of the total COC Referrals received by those regions.

This recommendation continues the view that "efficiency" should justify elimination of an appeal process available to small businesses. To support this position, the report cites the costs for "all parties concerned" to administer COC's under \$25,000. Irrespective of what the report states, COC applications under \$25,000 represented 30% of the COC workload and COC applications received during FY 1988-FY 1992. In order to pare down the amount of documentation required of a small business for this type of referral, we initiated new procedures which allowed small businesses to present condensed information for our review. In all instances, the contracting officer's referral to SBA for these cases, consists of the one-page Request for Quotation (RFQ) used by the agency to obtain pricing information, and a one-page Determination of Nonresponsibility. No other information is supplied by the contracting officer to support the nonresponsibility determination because small purchase contracting procedures merely require informal documentation on the part of the contracting officer to justify their decisions.

While I have expressed my concerns about the report recommendations as presented, I also wish to advise you that I propose to test the first recommendation. OPA has, for over a year, been developing "Fact Sheets" on various specialized elements of our programs (e.g., a fact sheet on the Nonmanufacturer Rule and waivers of that rule). We are now preparing summaries of the various basic programs themselves. When the "Fact Sheet" on the COC program is ready, I plan to ask our regional offices to include a copy with each letter to a contracting officer advising of the completed action on a referral.

Regarding the second recommendation, I will of course provide to the Administrator, at the proper time, my proposals for SBA's response to whatever conclusions the GAO may reach on the "quality vendor" concepts.

I concur with your third recommendation.

As to the fourth recommendation, I do not believe there is data which justifies the termination of the availability of the COC "second chance" at any dollar level. Cost-effectiveness can not be applied when actual costs are unknown and no value has been assigned to imponderable benefits. I can, however, endorse a threshold of \$2,500 before the COC process is used since I believe that the responsibility issue is usually resolved before a potential contractor is approached by the contracting officer.

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I appreciate this opportunity to expand on my comments previously submitted. I would be happy to discuss them further with you if that would be helpful.

EX. 6

Robert J. Moffitt