



United States General Accounting Office
Washington, DC 20548

December 20, 2002

The Honorable Christopher S. Bond
Ranking Minority Member
Committee on Small Business and Entrepreneurship
United States Senate

Subject: *Waivers of the Small Business Administration's Nonmanufacturer Rule Have Limited Effect*

Dear Senator Bond:

Under section 8(a) of the Small Business Act, the Small Business Administration (SBA) conducts a program for developing small businesses that are owned by socially and economically disadvantaged individuals. Participants can receive contracts under acquisitions that federal agencies offer to the 8(a) program as well as business development assistance from SBA. In fiscal year 2001, there were 5,110 small businesses that participated in the program.

A firm that receives a supply contract under the 8(a) program or a small business set aside can be either a manufacturer or a nonmanufacturer of a product. Under SBA's rules, however, a nonmanufacturer who receives one of these contracts must agree to supply the product of a domestic small manufacturer or processor.¹ This nonmanufacturer rule is one key mechanism for ensuring that procurement dollars under the 8(a) program and small business set-asides are spent on products made by small businesses.² SBA can waive this requirement when there are no small manufacturers or processors available to supply the product. There are two types of waivers to the nonmanufacturer rule: (1) individual waivers, which apply only to a specific contract and are effective for the life of that contract, and (2) class waivers, which apply to categories of items and continue in effect unless revoked by SBA. Once a waiver of the nonmanufacturer rule is approved, a firm may supply the product of a large manufacturer.

In response to your concern about the extent waivers of the nonmanufacturer rule may be resulting in 8(a) procurement dollars going to firms that are not small businesses, we determined: (1) the number of individual waivers SBA approved in fiscal year 2001 and the dollar amount of fiscal year 2001 contract obligations that resulted from those waivers, and (2) the number of class waivers

¹ A nonmanufacturer is also required to be small and a regular dealer primarily engaged in the retail or wholesale trade.

² Section 303(h) of P.L. 100-656 and section 210 of P.L. 101-574 incorporated the nonmanufacturer rule and the waiver provision into the Small Business Act. The nonmanufacturer rule applies only to contracts that exceed \$25,000. For contracts at or below that amount, an eligible 8(a) firm is not required to supply the product of a small business. In January 2002, SBA published a proposed rule that would raise the threshold to \$100,000. As of November 2002, the final rule had not been published.

available for use during fiscal year 2001 and the dollar amount of fiscal year 2001 obligations that resulted from those waivers.

Results in Brief

SBA approved 23 individual waivers of the nonmanufacturer rule in fiscal year 2001. Sixteen of the waivers were used on ten 8(a) contracts with a total of \$6.3 million in fiscal year 2001 obligations. The remaining seven waivers either did not result in 8(a) contracts during fiscal year 2001 or did not involve fiscal year 2001 funds.

SBA approved one class waiver in fiscal year 2001, and there were 84 other class waivers still in effect from prior years. Five of these 85 class waivers resulted in contracts with \$20.5 million in fiscal year 2001 obligations. The other 80 approved class waivers were not used on 8(a) contracts during fiscal year 2001.

In sum, we identified close to \$27 million in fiscal year 2001 obligations for contracts covered by individual or class waivers.³ This represents 4.4 percent of the \$606 million obligated in fiscal year 2001 for supplies and equipment under the 8(a) program, and a fraction of 1 percent of the \$6.2 billion obligated for all 8(a) contracts during the fiscal year.

We are not making recommendations in this report. During our review, however, we determined that some of the information disseminated by SBA on existing class waivers was inaccurate. We discussed this problem with SBA officials and suggested that the information be revised. SBA revised the class waiver information and made changes to its Web site on November 15, 2002.

We received written comments on the draft of this report from the Small Business Administration. SBA concurred with our findings but suggested two changes in our discussion of the nonmanufacturer rule. We made the suggested changes. SBA's written comments are enclosed.

Background

To be eligible for SBA's 8(a) program, a firm must be a small business that is at least 51-percent owned by one or more socially and economically disadvantaged individuals.⁴ An eligible firm generally must have been in business for at least 2 years and have a reasonable prospect for success in the private sector.

SBA's Associate Administrator for Government Contracting is responsible for approving requests for individual and class waivers of the nonmanufacturer rule. Only a contracting officer of a federal agency can request an individual waiver. After conducting market research and determining that no domestic small business exists that can supply the product in the quantity, time frame, or specifications needed by the agency, a contracting officer can submit a waiver request to SBA. Class waivers may be requested by anyone, including suppliers, subject to approval by SBA. Class waivers

³ There could have been additional obligations in fiscal year 2001 related to individual waivers approved in prior years. Our scope did not include a review of these waivers.

⁴ A firm is considered a small business if it meets size standards established by SBA for the firm's particular industry. Size standards are based on either the average number of employees during the previous 12 months or sales averaged over the previous 3 years.

may be approved for all contracts involving a particular class of products⁵ if no small manufacturer is available to participate in the federal procurement market. Such classes currently include construction equipment, mainframe computers, and certain chemicals.

Contracts can be classified into three categories: (1) research, (2) other services and construction, and (3) supplies and equipment. The nonmanufacturer rule applies only to contracts for supplies and equipment. In fiscal year 2001, 87 percent of the 8(a) purchases were under services and construction contracts while research contracts accounted for just 3 percent. The remaining 10 percent, about \$606 million, was used for contracts for supplies and equipment. (See table 1.)

Table 1: 8(a) Program Obligations by Category for Fiscal Year 2001

(Dollars in millions)

Contract category	Obligations	% of total obligations
Research	\$180.8	2.9
Supplies and equipment	605.9	9.8
Other services and construction	5,389.8	87.3
Total	\$6,176.5	100.0

Source: Federal Procurement Data System (FPDS)—includes obligations greater than \$25,000.

Use of Individual Waivers in Fiscal Year 2001 Was Limited

SBA approved 23 individual waivers in 2001. Seven individual waivers were approved for one multiple-year contract at the National Institutes of Health, which contracted with Integrated Concepts and Research Corporation, an Alaskan Native Corporation participating in the 8(a) program. The waivers allowed the firm to supply seven different types of medical testing equipment from large manufacturers, including scanners and cameras. The other waivers were requested for 16 separate proposed contracts—4 at the Department of Energy, 3 at the U.S. Army, and 9 at eight other agencies. In one of these cases, for example, the Department of Energy obtained a waiver and contracted with an 8(a) firm to make a one-time purchase of fiber optic ground wire.

Our analysis showed that \$6.3 million in fiscal year 2001 obligations were associated with individual waivers approved in fiscal year 2001. This represents a fraction of 1 percent of the total of \$6.2 billion obligated on 8(a) contracts during the fiscal year. Although the 23 individual waivers were requested for 17 contracts, only 10 of these contracts had obligations during the fiscal year. Six of the contracts did not have fiscal year 2001 obligations because the contracts were not signed during fiscal year 2001 or there was no delivery order issued until fiscal year 2002. One contract was awarded to a company that was not an 8(a) firm. The results of our analysis are shown in table 2.

⁵ A class of products is defined based on the North American Industry Classification System and the General Services Administration's Product and Service Codes Manual. In each six-digit code, there are subdivisions of products that can be considered for waiver.

Table 2: Summary of 8(a) Contracts Resulting from SBA-Approved Individual Waivers in Fiscal Year 2001

Product	Dollars obligated in fiscal year 2001
Medical test equipment	\$818,176
Fiber optic equipment	1,991,000
Microsoft computer equipment	2,192,000
Microsoft software upgrades/licenses	39,118
Cisco video telecommunication equipment	103,000
Data tapes	149,000
Xerographic paper	442,866
TV/camera equipment	261,222
Generator engines	32,000
Custom configured information technology	300,000
Total	\$6,328,382

Source: Obligation data was obtained from the FPDS and supplemented by data provided by agency contracting officers.

In the first 6 months of fiscal year 2002, the waivers approved in fiscal year 2001 resulted in additional obligations of \$5.9 million on 8(a) contracts.

Obligations Using Class Waivers Also Limited

During fiscal year 2001, there were 85 SBA-approved class waivers that contracting officers could use. Of these, 84 had been approved in prior years. During fiscal year 2001, there were 209 purchases for products covered by five class waivers, totaling \$20.5 million in obligations on 8(a) contracts. This was a very small percentage of the total \$6.2 billion obligated on 8(a) contracts during the fiscal year. The most frequently used class waiver was for fruit and vegetable canning, as shown in table 3.

Table 3: Class Waiver Obligations on 8(a) Contracts in Fiscal Year 2001

Product	Actions	Dollars
Telephone apparatus	5	\$ 926,000
Electronic computer	13	4,554,000
Other computer peripheral equipment	49	2,205,000
Fruit and vegetable canning	141	12,817,000
Iron and steel	1	26,000
Total	209	\$ 20,528,000

Source: FPDS.

Some of SBA's Information on Class Waivers Was Inaccurate

During our review of class waivers, we analyzed SBA information used by agency contracting officers when they decide whether a class waiver is available to purchase a product from an 8(a) firm. We determined that SBA's listing of class waivers dated October 2000 included many instances where product codes were not accurate or the product codes were inconsistent with product definitions. For example, one product was miscoded and classified as a nuclear battery when it should have been classified as a storage battery. In another case, several different chemicals were

matched with a North American Industry Classification System code that did not exist. According to SBA officials, the inaccurate information on the class waiver listing existed prior to the last change to its Web page in October 2000.

We discussed this problem with SBA officials and suggested that the class waiver listing be revised. As a result, SBA revised the listing for the 85 class waivers in effect during fiscal year 2001, and made changes to 47 of the waiver codes or product descriptions. SBA incorporated these changes into its Web site on November 15, 2002. SBA did not know whether these inaccuracies affected any contracting officer's decision to use the class waivers.

Agency Comments and Our Evaluation

We provided a draft of our report to SBA for its review and comment. SBA concurred with our findings, but suggested two changes in our discussion of the nonmanufacturer rule. We agreed, and made the suggested changes where appropriate. SBA's comments are enclosed.

Scope and Methodology

To determine the extent of fiscal year 2001 obligations on 8(a) contracts using waivers of the nonmanufacturer rule, we focused on individual waivers approved by SBA in fiscal year 2001 and class waivers available for use during that year. We discussed the waiver process with officials at SBA headquarters (Washington, D.C.) and reviewed case files for individual waivers approved during that period. We then contacted federal agency contracting officers who requested the individual waivers to identify which 8(a) firms were awarded the contracts, and the number and value of purchases under those contracts. Further, we compared this information to obligations reported in the Federal Procurement Data System (FPDS). For the class waivers, we reviewed SBA's listing of all active waivers in effect during fiscal year 2001 and compared the product codes cited to all codes reported in FPDS. We also relied on previous GAO reports, SBA reports, and applicable laws and regulations for background information on waivers and the 8(a) small business development program. We conducted our review from May through October 2002 in accordance with generally accepted government auditing standards.

As we agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. We will then send copies of this report to the Administrator, SBA, and the Director, Office of Management and Budget. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have any questions on this report, please contact me at (202) 512-8214 or Karen Zuckerstein at (202) 512-6785. Major contributors to this report were William Bricking, Jean Lee, Sylvia Schatz, and Robert Swierczek.

Sincerely yours,

A handwritten signature in black ink that reads "William T. Woods". The signature is written in a cursive style with a large, prominent 'W' and 'T'.

William T. Woods
Director, Acquisition and
Sourcing Management

Enclosure

Comments From the U.S. Small Business Administration



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

DEC 13 2002

Mr. William T. Woods
Director
Acquisition and Sourcing Management
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Woods:

Thank you for your letter of November 27, 2002, requesting the U.S. Small Business Administration's (SBA) comments of your draft briefing report on Waivers of the Small Business Administration's Nonmanufacturer Rule Have Limited Effect (GAO code 820028).

While GAO made no formal recommendations, we concur with the findings in the report with the following exceptions found on page 1, paragraph 2, which needs to be clarified that the nonmanufacturer rule is a requirement that applies equally to 8(a) and small business set-aside programs. Also, refer to page 3, paragraph 3, concerning guidance on existing class waivers. We suggest that the word "guidance" on existing class waivers be changed to "information" on existing class waivers.

Should you have questions, please contact Linda Williams, Associate Administrator for Government Contracting, at (202) 401-8150.

Sincerely,

A handwritten signature in black ink, appearing to read "Fred C. Armendariz".

Fred C. Armendariz
Associate Deputy Administrator
for Government Contracting
and Business Development