



# FEDERAL ACQUISITION REGULATIONS AND SMALL BUSINESS CONCERNS: WHAT DO YOU NEED TO KNOW?

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**W**hen executing federal project construction contracts, navigating federal laws and regulations can be burdensome, especially for small business concerns that are just beginning or are expanding. Misinterpreting these small business requirements can result in significant penalties, so understanding the Federal Acquisition Regulations (FAR), the principle set of rules regarding the procurement process in the United States, is essential for small business concerns to ensure compliance with all aspects of a federal construction contract.

*What is a small business concern?*

Under the FAR, a small business concern is defined as “any business entity organized for profit with a place of business located in the United States or its outlying areas and that makes a significant contribution to the US economy through payment of taxes and/or use of American products, material, and/or labor, etc.” “Concern” includes but is not limited to an individual, partnership, corporation, joint venture, association, or cooperative.

*How does a construction company determine if it is considered a small business concern under the FAR?*

The Small Business Administration (SBA) determines the small business size standards for each industry through the North American Industry Classification System (NAICS). A size standard of a small business is usually “stated in number of employees or average annual receipts, [and] represents the largest size that a business (including its subsidiaries and affiliates) may be to remain classified as a small business for SBA and federal contracting programs. The definition of ‘small’ varies by industry.” Generally, the construction industry uses average annual receipts, and all other industries are based on number of employees.

*How does the SBA calculate the average annual receipts under the appropriate industry NAICS codes?*

The SBA considers “annual receipts” to be total income and costs of goods sold, as defined by the appropriate Internal Revenue Service tax return forms. As such, this constitutes all revenue that is received or accrued from any source, including the sales of products, services, interest, dividends, rents, royalties, fees, or commissions but reduced by returns and allowances. However, receipts do not include (1) net capital gains or losses; (2) taxes

collected for and remitted to a taxing authority, if included in the total income; (3) proceeds from transactions occurring between the small business concern and an affiliate; and (4) amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder, or customs broker.

Generally, the average annual receipts of a small business concern in business for five or more completed taxable years is calculated as the total receipts of the small business concern over its most recent five taxable years divided by five. A small business concern in business for fewer than five completed taxable years is calculated as the total receipts for the period that the small business concern has been in business divided by the number of weeks in business and then multiplied by 52. In order to assist in this process, the NAICS contains industry codes that state the maximum average annual receipts for each industry. Typically, barring certain construction industries such as dredging, the maximum average annual receipt for a construction company to maintain its small business status is \$39.5 million.

*How does the SBA determine the number of employees of a small business concern under appropriate industry NAICS code?*

The SBA counts all employees of a small business concern, including full-time, part-time, and other employees such as, but not limited to, employees from a temporary employment agency. The calculation of the size standard for the average number of employees is based on the number of employees for each pay period for the prior twelve calendar months. If a small business concern has been in business for fewer than twelve complete calendar months, the average number of employees is calculated for all pay periods the small business concern has been in business.

*How does a small business concern understand its primary industry under the NAICS?*

In order to determine the primary industry of a small business concern, the SBA considers numerous factors such as receipts, employees, costs of doing business in the different industries that the small business concern operates in, distribution of patents, contract awards, and assets occurring in the most recent completed fiscal year.

*What are some limitations for subcontracting under a project reserved for small business concerns?*

Under FAR 52.219-14, the limitations on subcontracting for contracts reserved for small business concerns are: (1) for services, except for construction, at least fifty percent of the cost of the contract performance must be expended for employees of the small business; (2) for general construction, the small business concern is required to perform at least fifteen percent of the cost of the contract with its own employees, excluding the cost of materials; and (3) for construction by special trade contractors, the small business concern must perform at least twenty five percent of the cost of the contract with its own employees, excluding the costs of the materials.

*Does the FAR contain any mandatory reporting requirements for subcontractors?*

Under FAR 52.204-10, there are certain requirements for reporting executive compensation and first-tier subcontract awards. In part, a first-tier subcontract is defined as a “subcontract award by the contractor for the purpose of acquiring supplies or services (including construction) for performance of a prime contract.” A small business concern that has entered into a subcontract agreement with a first-tier subcontractor must report, by the end of the month following the month of the award of the first-tier subcontract, certain background information to the Federal Funding Accountability and Transparency Act Subaward Reporting System (FSRS) about the first-tier subcontracting company and the subcontract agreement.

Within that same time period, the small business concern is also required to report the names and total compensation of each of the five most highly compensated executives of the first-tier subcontractor for the preceding fiscal year to the FSRS, if in the prior completed fiscal year the first-tier subcontractor received

(1) eighty percent or more annual gross revenue from federal contracts or subcontracts, loans, grants, subgrants, cooperative agreements, and other forms of federal financial assistance; and (2) the first-tier subcontractor received \$25 million or more annual gross revenue from federal contractors, subcontracts, loans, grants, subgrants, cooperative agreements and other forms of federal financial assistance. The first-tier subcontractor must meet both of these requirements to trigger the small business concerns’ reporting requirement.

*What are the penalties for misrepresentation of size status by a small business concern?*

If a small business concern misrepresents its size status as a small business when submitting a bid, proposal, or application for a project that is reserved for small businesses; when registering in a federal electronic database as a small business; or when signing any certification related to the procurement of a project reserved for a small business, the SBA retains the authority to suspend or debar the small business concern. Further, the small business concern may be subject to severe civil penalties under numerous federal laws, such as, but not limited to, the Fraud Claims Act and the Fraud Civil Remedies Act. Additionally, individuals of a small business concern may be subject to criminal penalties if it is determined that these individuals knowingly misrepresented the size status.

#### *Conclusion*

It is important to have a comprehensive understanding of the SBA requirements for construction projects and NAICS codes before bidding and entering into contracts for projects reserved for small business concerns. Prior to initiating the procurement process, you may want to contact counsel to ensure that your project qualifies as a small business concern and to avoid potential penalties.

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