

Fiscal Impact Review

2018 General Assembly Session

Date: February 1, 2018

Bill number: SB 318 (Engrossed); Department of Small Business and Supplier Diversity; implementation of certification programs

Review requested by: Chairman Ruff, Senate General Laws and Technology

JLARC Staff Fiscal Estimates

JLARC staff do not concur with the Fiscal Impact Statement prepared by the Department of Planning and Budget for SB 318. The bill would require businesses to meet the U.S. Small Business Administration's small business size standards to be eligible for small business certification through Virginia's Department of Small Business and Supplier Diversity (DSBSD). The bill would also direct DSBSD to contract with independent certifying entities to certify small businesses, women-owned businesses, minority-owned businesses, and employment service organizations.

Depending on the interpretation of how a small business certification would be applied, the fiscal impact could be \$54,000 (general funds) or \$904,000 (general funds and non-general funds) beginning in FY19, with additional costs occurring in later years. This fiscal impact would be related to additional staffing and systems reprogramming costs. SB 318 is also expected to have a fiscal impact of \$945,583 (general funds) beginning in FY19 due to the bill's requirement that DSBSD contract with independent certifying entities. Amending or removing this provision could remove this cost.

An explanation of the JLARC staff review is included on the pages that follow.

Authorized for release:



Hal E. Greer, Director

Bill summary

SB 318 would require businesses to meet the U.S. Small Business Administration's (U.S. SBA's) small business size standards for their dominant business activity to be eligible for small business certification through the Virginia Department of Small Business and Supplier Diversity (DSBSD). Size standards would vary by industry, and each industry would have a North American Industry Classification System (NAICS) code. These standards would take effect July 1, 2019 for all new businesses pursuing small business certification; however, any business with a valid certification prior to July 1, 2019 would have its certification automatically extended for three years through July 1, 2022.

The bill would also require DSBSD to (1) contract with independent certifying entities to assist with the certification of small businesses, women-owned businesses, minority-owned businesses, and employment service organizations; (2) periodically review the certification process and its administrative burden on businesses; and (3) prepare businesses for the changes to the small business certification process.

Fiscal implications

SB 318 would have a fiscal impact on DSBSD, and it may have a fiscal impact on the Department of General Services (DGS) and the Department of Accounts (DOA). However, whether the bill has a fiscal impact on all of these agencies, and the magnitude of the fiscal impact, would largely depend on the way the bill is interpreted. Specifically, the fiscal impact of this bill would vary depending on whether a small business certification would apply to:

- only a business's dominant business activity, or
- all of a business's activities.

According to staff from the Attorney General's Office, it is unclear how this element of SB 318 should be interpreted, as it is currently written. Therefore, clarifying language could be considered for the bill.

The fiscal impact of the bill would also be affected by the requirement that DSBSD contract with independent certifying entities to process certain certifications. This portion of the bill could be amended to reduce the bill's fiscal impact.

Small business certification interpretation

The definition of "small business" contemplated by SB 318 (lines 64-69) could be interpreted two ways:

- Interpretation 1 - a business that meets the U.S. SBA's small business size standards for its dominant business activity can receive a small business certification that applies to only its dominant business activity; or
- Interpretation 2 - a business that meets the U.S. SBA's small business size standards for its dominant business activity can receive a small business certification that applies to all of its business activities.

Interpretation 1

Under Interpretation 1, DSBSD would incur additional staffing and systems costs, while DGS and DOA would incur additional systems costs. The costs anticipated by these three agencies would be \$904,000 (\$54,000 general funds / \$850,000 non-general funds) in FY19 and \$1.2 million (non-general funds) in FY20 (Table 1).

DSBSD

Interpretation 1 would have a one-time fiscal impact of \$54,000 (general funds) on DSBSD to update its certification portal to reflect the small business certification status of each small business, by NAICS code. The system is not currently equipped to display this information. This system update would occur in FY19 in preparation for the new small business size standards to take effect July 1, 2019.

Interpretation 1 would also cost DSBSD \$149,325 (general funds) annually starting in FY23 in additional staffing costs because two new full-time certification officers would be needed to process small business certifications under the new standards.

According to DSBSD staff, one certification officer would only be able to process 70 certifications per month instead of the current 100 per month, because certification officers would have to assess multiple NAICS codes to determine whether a business has the necessary level of staff/revenue for their dominant business activity to qualify as a small business. Currently, certification officers only check one staff/revenue definition per business (Figure 1).

DSBSD would not need additional certification officers immediately, because of the provision in SB 318 that would grant a three-year certification extension to any small business with a valid certification prior to July 1, 2019. Approximately 25 percent of the certifications that DSBSD staff process each month are re-certifications, many of which are for small businesses. Therefore, SB 318 would temporarily decrease DSBSD's workload (assuming that it does not prompt an increased demand for new small business certifications), and DSBSD would not need additional certification officers until July 1, 2022.

FIGURE 1
DSBSD review process: proposed vs. current

Proposed review process under SB 318

DSBSD Staff to Review:

Dominant Business Activity: Wood Product Manufacturing			
NAICS code	NAICS industry description	Size standard (# of employees)	Size standard (\$)
321113	Sawmills	500	N/A
321114	Wood Preservation	500	N/A
321212	Softwood Veneer & Plywood Manufacturing	1,250	N/A
321214	Truss Manufacturing	500	N/A
321219	Reconstituted Wood Product Manufacturing	750	N/A

Current review process

DSBSD Staff to Review:

Size standard (# of employees)	Size standard (\$)
250	\$10 million

SOURCE: U.S. SBA Table of Small Business Size Standards (2017), DSBSD website, and DSBSD staff.

NOTE: Under Virginia's current single definition of "small business," a business can have 250 or fewer employees, or average annual gross receipts of \$10 million or less averaged over the previous three years.

DGS

Interpretation 1 would have a one-time fiscal impact of \$850,000 (non-general funds) in FY19 on DGS to update the state's central electronic procurement system (eVA) to show the small business certification status of each small business, by NAICS code. This would be needed to show that businesses are certified as small for their dominant business activity (and associated NAICS codes), but not necessarily their other business activities. Currently, the system simply shows whether a business is certified as small regardless of the business's activities. According to DGS staff, funds that were reserved but not used for an eVA integration project could fund this system change. DGS would require authorization through the Appropriation Act to use existing funds for this purpose. This update to eVA would occur in FY19 to prepare for the new small business size standards to take effect July 1, 2019.

DOA

Interpretation 1 would have a one-time fiscal impact of \$1.2 million (non-general funds) in FY20 on DOA to update the state's Cardinal financial system to reflect the small business certification status of each small business, by NAICS code. Cardinal expenses are funded through non-general fund internal service funds. However, these funds are supported through charges to state agencies, which are paid with a combination of general and non-general funds.

The update to Cardinal would include several large changes, including modifying the system's programming, interfaces, and reports. DOA staff do not anticipate being

able to implement these changes until FY20 because staff are currently working to replace the state's payroll system by September 2019. If staff prioritized the changes to Cardinal necessitated by SB 318, DOA would have to delay completion of the payroll replacement project, which could cost approximately \$1.4 million each month it is delayed.

Interpretation 2

Interpretation 2 would have a much smaller fiscal impact. Under Interpretation 2, DSBSD would incur additional staffing and systems costs, totaling \$54,000 (general funds) in FY19 and \$149,325 (general funds) in FY23 and each year thereafter. These costs would be the same as those cited for DSBSD under Interpretation 1, because DSBSD would still make all of the aforementioned changes to their small business certification process.

Under Interpretation 2, DGS and DOA would not incur additional systems costs, because eVA and Cardinal would not need to display the small business certification status for businesses by NAICS code. A small business certification would apply to all of a business's activities, as is the case now. Therefore, system updates would not be needed.

TABLE 1

Estimated fiscal impact of small business certification interpretation

	FY19	FY20	FY21	FY22	FY23
Interpretation 1					
DSBSD	\$54,000	\$0	\$0	\$0	\$149,325
DGS	\$850,000	\$0	\$0	\$0	\$0
DOA	\$0	\$1,200,000	\$0	\$0	\$0
Total	\$904,000	\$1,200,000*	\$0	\$0	\$149,325
Interpretation 2					
DSBSD	\$54,000	\$0	\$0	\$0	\$149,325
DGS	\$0	\$0	\$0	\$0	\$0
DOA	\$0	\$0	\$0	\$0	\$0
Total	\$54,000	\$0	\$0	\$0	\$149,325

SOURCE: Fiscal Impact Statement for SB 318 and staff from DSBSD, DGS, and DOA.

*DOA's projected fiscal impact does not assume a delay in the state's payroll system replacement, and it does not include costs that agencies would incur to modify their system interfaces with Cardinal.

Cost of DSBSD contracting with independent certifying entities

SB 318 would require DSBSD to contract with independent certifying entities to assist with certifications for small businesses, women-owned businesses, minority-owned businesses, and employment service organizations. This part of the bill could have a fiscal impact on DSBSD of approximately \$945,583 annually (general funds) in

contracting costs, beginning in FY19. (Small businesses are currently re-certified every three years, and these certifications are staggered based on the business's initial certification date.)

Independent certifying entities charge fees that range from approximately \$350 to \$1,500 per certification (excluding subscription and late fees), depending on the size of the business being certified. Therefore, if the state used independent entities to certify all of its 3,718 women-owned businesses and 4,387 minority-owned businesses, and paid the lowest certification fee, it would cost approximately \$945,583 annually. DSBSD would require additional funding to cover this cost, unless the state required businesses to pay the certification fees. Certifications conducted by DSBSD are currently free to businesses.

According to DSBSD staff, contracting with independent certifying entities may be problematic because (1) no independent entities are available to assist with small (or micro) business certifications, which are part of the vast majority of DSBSD's certifications; (2) the three independent entities that are available to assist with women-owned and minority-owned business certifications likely lack the capacity to handle all of Virginia's women-owned and minority-owned business certifications; and (3) DSBSD would have to process the small business portion of certifications for businesses that apply for multiple designations (e.g., small, women-owned business), so DSBSD's workload would not be greatly reduced by using an independent entity.

DSBSD staff indicate that they would process most certifications internally unless they were required to contract with independent certifying entities. Therefore, removing the requirement that DSBSD contract with independent certifying entities would eliminate this part of SB 318's fiscal impact.

Budget amendment necessary? Yes, a budget amendment would be required to provide an appropriation for DSBSD. Depending on how SB 318 is interpreted, budget amendments may also be required for DGS and DOA.

Agencies affected: Department of Small Business and Supplier Diversity; Department of General Services; Department of Accounts.

Prepared by: Lauren Axselle

Date: February 1, 2018