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U. S. Senate

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**REGULATORY  
FLEXIBILITY ACT**

**Status of Agencies'  
Compliance**

Statement of Johnny C. Finch  
Assistant Comptroller General  
General Government Division



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## REGULATORY FLEXIBILITY COMPLIANCE

SUMMARY OF STATEMENT OF  
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The Regulatory Flexibility Act requires federal agencies to assess the effects of their proposed rules on small entities. The Small Business Administration (SBA) is required to monitor and report on agencies' compliance with the act. GAO reviewed 12 SBA annual reports to determine how SBA assessed agencies' compliance. GAO reported on the results of that review in April 1994.

The SBA reports indicated agencies' compliance with the Regulatory Flexibility Act has varied widely from one agency to another. Some agencies (e.g., the Environmental Protection Agency) reportedly had exemplary compliance records, while other agencies (e.g., the Internal Revenue Service) were repeatedly viewed as failing to comply with the act. GAO concluded that certain agencies' apparent lack of compliance with the act were because: (1) the act does not expressly authorize SBA or any other entity to interpret key statutory provisions such as "significant economic impact" or "substantial number of small entities;" (2) the act does not require SBA or any other entity to develop criteria for agencies to follow in reviewing their rules; (3) in the absence of this express authority or requirement, no guidance has been issued to federal agencies defining key statutory provisions; and (4) the act does not authorize SBA or any other entity to compel rulemaking agencies to comply with its provisions. GAO also concluded that the Office of Management and Budget (OMB) could help ensure certain rulemaking agencies' compliance with the act.

GAO recommended several actions SBA and OMB could take to improve agencies' compliance with the act, such as ensuring that SBA notifies OMB of any concerns it has about an agency's compliance. GAO also noted that Congress could strengthen the implementation of the act by clarifying SBA's authority and responsibilities. SBA and OMB have taken some actions to work together more closely, but the act still does not specify who is responsible for interpreting key statutory language and issuing related guidance.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our April 1994 report on agencies' compliance with the Regulatory Flexibility Act of 1980.<sup>1</sup> In my testimony today, I will briefly summarize our major conclusions, recommendations, and matters for congressional consideration in that report and discuss actions taken since the report was issued.

The Regulatory Flexibility Act requires federal agencies to assess the effects of their proposed rules on small entities. As a result of their assessment, an agency must either (1) perform a regulatory flexibility analysis describing the impact of the proposed rule on small entities or (2) certify that the rule will not have a "significant economic impact on a substantial number of small entities." However, the act does not define what is meant by the terms "significant economic impact" or "substantial number." The agency's regulatory flexibility analysis must indicate the objectives of the rule and its projected reporting, recordkeeping, and other compliance requirements. The agency must also consider alternatives to the proposal that will accomplish the agency's objectives while minimizing the impact on small entities.

The SBA Chief Counsel for Advocacy is required to monitor and report at least annually on agency compliance with the Regulatory Flexibility Act. In conducting our study for the April 1994 report, we reviewed the 12 SBA annual reports available at the time of our review (for the years 1980 through 1992) to determine SBA's assessment of agencies' compliance. We did not make an independent determination of agencies' Regulatory Flexibility Act compliance.

#### SBA REPORTS INDICATE VARIABLE AGENCY COMPLIANCE WITH THE ACT

The SBA annual reports indicated agencies' compliance with the Regulatory Flexibility Act has varied widely from one agency to another. Some agencies, such as the Internal Revenue Service (IRS), were repeatedly regarded by SBA as failing to comply with the act. On the other hand, SBA said agencies such as the Environmental Protection Agency had exemplary compliance records during this 12-year period. Still other agencies' compliance reportedly varied over time or varied by subagency.

The SBA reports indicated a variety of reasons why certain agencies have failed to comply with the Regulatory Flexibility Act. The reports said that some agencies did not consider the act applicable to their regulations, and therefore did not

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<sup>1</sup>Regulatory Flexibility Act: Status of Agencies' Compliance  
(GAO/GGD-94-105, Apr. 27, 1994).

perform the analyses that the act prescribes. For example, IRS has consistently considered the vast majority of its rules to be "interpretative," and therefore not subject to the requirements of the act. IRS also said that its notices, revenue rulings, and revenue procedures or circulars were "pronouncements," not "rules," and therefore were not subject to the Regulatory Flexibility Act's requirements. SBA said these "interpretative" rules and "pronouncements" had a substantial effect on small entities, and said IRS had "avoided its responsibilities to consider the impact of its rules on small businesses."

SBA said other agencies erroneously certified that their rules did not have a significant economic impact on a substantial number of small entities. For example, the SBA report for 1992 concluded that certifications the Agricultural Marketing Service issued regarding its marketing orders and rules were "boilerplate certifications representing nothing more than a post hoc rationalization for actions that the Service wants to take." The report said the Service's "lack of compliance demonstrates a cavalier disregard of the analytical requirements of the (act)," and that its certifications "are a model of conclusory findings supported by little or no analysis."

Still other agencies accepted the fact that the Regulatory Flexibility Act applied to their rules and that they affected small entities, but reportedly still did not fully comply with either the letter or intent of the law. The SBA Chief Counsel testified in a hearing before the Senate Governmental Affairs Committee in 1988 that about half of the Office of Advocacy's time is spent trying to convince agencies to go further in their analysis of regulatory impact or to make the regulatory decision more flexible.

#### SBA SURVEY SHOWED MANY AGENCIES HAD NOT PLANNED FOR OR CONDUCTED REVIEW OF RULES

We also reviewed SBA's survey of agencies' compliance with Section 610 of Title 5 of the U.S. Code, which required each agency to publish, by mid-1981, a plan for the periodic review of its rules that "have or will have a significant economic impact upon a substantial number of small entities." All such rules in effect on January 1, 1981, were to be reviewed within 10 years of that date. The plan was also required to provide for the review of all rules adopted after that date within 10 years of their publication as a final rule. In reviewing their rules, agencies were required to consider such factors as the continued need for the rule, its complexity, and any complaints or comments from the public.

In April and May 1992, the Chief Counsel for Advocacy sent letters to the heads of all 14 executive departments and at least 69 other federal organizations requesting that they furnish a

copy of their original periodic review plan and any amendments. At least 55 executive departments and other federal organizations responded to the Chief Counsel's request. Of these, 13 (24 percent) stated that they had published the required plan for the review of their rules. Most of the remaining respondents indicated that their agencies were not required to publish a plan because none of their regulations had a significant economic impact on a substantial number of small entities.

## CONCLUSIONS

In our April 1994 report, we concluded that there were several reasons for agencies' apparent lack of compliance with the Regulatory Flexibility Act: (1) the act does not expressly authorize SBA or any other entity to interpret key statutory provisions such as "significant economic impact" or "substantial number of small entities;" (2) the act does not require SBA or any other entity to develop criteria for agencies to follow in reviewing their rules; (3) in the absence of this express authority or requirement, no guidance has been issued to federal agencies defining key statutory provisions;<sup>2</sup> and (4) the act does not authorize SBA or any other entity to compel rulemaking agencies to comply with its provisions.

We also concluded that the Office of Management and Budget (OMB) could help ensure certain rulemaking agencies' compliance with the Regulatory Flexibility Act by reviewing and commenting on those agencies' significant regulatory actions pursuant to its responsibilities under Executive Order 12866. A rulemaking agency covered by the executive order must submit any significant regulatory action to OMB before publication of the rule for notice and comment and before final publication. OMB can return most regulatory actions to agencies for further consideration if it believes the actions are inconsistent with the Regulatory Flexibility Act.

However, we found that OMB's authority to play an enforcement role was limited in several respects. Under the executive order, OMB cannot review rules proposed by independent regulatory agencies. For the past several years, language in OMB's appropriation has prevented it from reviewing agricultural marketing orders from the Agricultural Marketing Service. Also, OMB did not have established criteria or procedures to determine

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<sup>2</sup>By requiring the Chief Counsel to monitor compliance with the Regulatory Flexibility Act, SBA is presumably permitted to at least provide agencies with nonbinding guidance on how it believes the act should be implemented. SBA issued some general guidance in 1981, but did not attempt to define terms in the statute. SBA has not issued any further guidance on the act's compliance since 1981.

whether agencies have complied with the Regulatory Flexibility Act. Finally, while SBA reportedly notified rulemaking agencies in writing of its Regulatory Flexibility Act concerns during the rulemaking notice and comment period, it did not normally provide OMB with a copy of those concerns and only occasionally telephoned OMB about SBA's compliance concerns. Therefore, OMB's ability to ensure agencies' Regulatory Flexibility Act compliance was diminished because it was often unaware of SBA's concerns regarding an agency's compliance.

#### MATTERS FOR CONGRESSIONAL CONSIDERATION

We said that, if Congress wishes to strengthen the implementation of the Regulatory Flexibility Act, it should consider amending the act to (1) provide SBA with clearer authority and responsibility to interpret the Regulatory Flexibility Act's provisions and (2) require SBA, in consultation with OMB, to develop criteria as to whether and how federal agencies should conduct Regulatory Flexibility Act analyses. We said Congress could also consider focusing its Regulatory Flexibility Act oversight on the independent regulatory agencies and agricultural marketing orders over which OMB's review and comment authority is limited.

#### RECOMMENDATIONS FOR AGENCY ACTIONS

We recommended that the OMB Director, in consultation with SBA, establish procedures OMB can use to determine agencies' compliance with the Regulatory Flexibility Act. We said that these procedures should be incorporated into OMB's processes for reviewing regulations before they are published for notice and comment and before they are published in final. We also recommended that the SBA Administrator direct the SBA Chief Counsel for Advocacy to send OMB a copy of any written notification of Regulatory Flexibility Act noncompliance the Chief Counsel sends to an agency.

#### OMB AND SBA HAVE TAKEN SOME ACTIONS

SBA and OMB agreed with our recommendations and have taken some actions. On January 11, 1995, the SBA Chief Counsel for Advocacy and the Administrator of OMB's Office of Information and Regulatory Affairs (OIRA) exchanged letters that commit the two offices to work together more closely in enforcing the Regulatory Flexibility Act. Specifically, SBA said it would develop guidance for agencies to follow in complying with the act, and OIRA offered its assistance in developing that guidance. OIRA said it would consider whether an agency should have prepared a regulatory flexibility analysis in its review of the agency's notice of proposed rulemaking. If it appears that the agency should have done so, OIRA said it would include SBA in the review process. OIRA also asked SBA to let OIRA know of any concerns

regarding the need for a flexibility analysis or the adequacy of any analysis. Finally, SBA said it would provide OIRA with a copy of any correspondence or comments it files with an agency concerning compliance with the act.

While these actions are commendable, congressional action is still needed to clarify statutory authority in this area. Specifically, the act does not expressly authorize SBA or any other entity to interpret key provisions in the statute and does not require SBA or any other entity to develop criteria for agencies to follow in reviewing their rules. Without clear statutory authority, rulemaking agencies may question the basis under which voluntary guidance is issued.

In commenting on our report's recommendations, the SBA Chief Counsel for Advocacy said SBA would welcome clarification of its authority to interpret Regulatory Flexibility Act provisions. OMB said it had no objection to any changes in the statute or in the rulemaking process that would strengthen its position in ensuring compliance with the act. Congressional action in these areas would reinforce the voluntary actions OMB and SBA have taken. Congress could also improve compliance by focusing its Regulatory Flexibility Act oversight on the independent regulatory agencies and agricultural marketing orders over which OMB's review and comment authority is limited.

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Mr. Chairman, this concludes my prepared statement. We will be pleased to answer any questions.

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