



Report to the Chairman, Subcommittee
on Financial and Contracting
Oversight, Committee on Homeland
Security and Governmental Affairs,
U.S. Senate

September 2014

8(a) SUBCONTRACTING LIMITATIONS

Continued
Noncompliance with
Monitoring
Requirements Signals
Need for Regulatory
Change

GAO Highlights

Highlights of [GAO-14-706](#), a report to the Chairman, Subcommittee on Financial and Contracting Oversight, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

SBA's 8(a) program is one of the federal government's primary means for developing small businesses owned by socially and economically disadvantaged individuals. To ensure that 8(a) firms do not pass along the benefits of their contracts to their subcontractors, regulations limit the amount of work that can be performed by subcontractors. In 2013, the Small Business Act was amended to make several changes related to these subcontracting limitations. GAO was asked to review how federal agencies and small businesses monitor the amount of subcontracted work under 8(a) contracts and the potential effects of the changes to the Small Business Act.

This report examines (1) the extent to which contracting officers and firms monitor compliance with 8(a) subcontracting limits and (2) the implementation status of changes to the Small Business Act and potential effects. GAO reviewed a nongeneralizable sample of 10 8(a) contracts at the three agencies with highest 8(a) obligations in fiscal years 2011 and 2012. GAO selected a small sample to delve more deeply into the circumstances of the contracts. GAO also examined the amendments to the Small Business Act.

What GAO Recommends

GAO recommends that the OFPP Administrator take the appropriate steps to amend the FAR to reflect contracting officers' responsibilities for monitoring 8(a) subcontracting limits and require 8(a) contractors to regularly report on the amount of subcontracted work. OFPP agreed with GAO's recommendations.

View [GAO-14-706](#). For more information, contact Michele Mackin at (202) 512-4841 or mackinm@gao.gov.

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What GAO Found

Similar to prior GAO findings from April 2006 and January 2012, contracting officers are generally not collecting information on the amount of subcontracted work performed under the 8(a) contracts reviewed, as required. The amount of work prime contractors must perform differs according to what is being procured. For example, the subcontractor's personnel costs are not to exceed 50 percent of the total work under service contracts. Two of the contracting officers associated with the 10 contracts GAO reviewed had monitored and ensured that the subcontracting limitations were not exceeded. In these cases the contractors had been asked to provide necessary information. In the other cases, however, contracting officers did not monitor and were not fully aware of what they were required to do, in part because their responsibilities are not set forth in the Federal Acquisition Regulation (FAR), the primary source for federal procurement policies, to which they regularly turn for guidance. Instead, these responsibilities are outlined in agency agreements with the Small Business Administration (SBA).

Reasons Contracting Officers Cited for Not Ensuring Compliance with Subcontracting Limitations	Total
Not responsible for monitoring compliance with subcontracting limitations	2
Not fully aware of responsibilities in agency agreements with SBA	5
Did not have access to information on the extent of subcontracted work	6
Primarily concerned with contractors satisfactorily performing the contracted services but not compliance with subcontracting limitations	6

Source: GAO analysis of interviews with nine contracting officers. | GAO-14-706

Note: Some contracting officers cited more than one reason. One contracting officer was not available for interview due to separation from the agency.

All 10 contractors GAO met with stated that they maintain and are willing to provide information to demonstrate compliance with subcontracting limitations, if required. While all 8(a) contracts GAO reviewed must comply with the limitations, 5 of the 10 contracts had an increased risk of exceeding these limits. These situations, which underscore the need to monitor, included cases where a subcontractor had been the prime contractor under a prior contract for the same or similar work.

In January 2014, SBA took an initial step in the federal rule making process by announcing that it was drafting a rule to implement the amendments to the Small Business Act. It will take more actions and could take years, however, to incorporate any changes into the FAR, which is maintained by a council chaired by the Administrator of the Office of Federal Procurement Policy (OFPP). Contracting officers and contractors stated that pending changes could make it easier to determine compliance with subcontracting limitations. At the same time, however, contractors had some concerns that it could be more challenging to comply because previously excluded subcontracted costs, such as materials, will be considered as subcontracted work. Contractors said that new monetary penalties—a minimum of \$500,000—for violating subcontracting limitations are high but would encourage firms to perform the required amount of work.

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Abbreviations

COR	contracting officer's representative
DHS	Department of Homeland Security
DOD	Department of Defense
eSRS	electronic Subcontracting Reporting System
FAR	Federal Acquisition Regulation
FSRS	Federal Funding Accountability and Transparency Act Subcontracting Reporting System
IDIQ	indefinite delivery, indefinite quantity
HHS	Department of Health and Human Services
NDAA	National Defense Authorization Act
OFPP	Office of Federal Procurement Policy
SBA	Small Business Administration

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September 16, 2014

The Honorable Claire McCaskill
Chairman
Subcommittee on Financial and Contracting Oversight
Committee on Homeland Security and Governmental Affairs
United States Senate

Dear Madam Chairman:

Government agencies obligated about \$14.5 billion to firms participating in the Small Business Administration's (SBA) 8(a) Business Development program in fiscal year 2013. As one of the federal government's primary means for developing small businesses owned by socially and economically disadvantaged individuals, this program sets aside federal contract awards solely for 8(a) firms. To participate in the program, a firm must be certified by SBA as meeting several criteria. For example, the firm must be a small business as defined by SBA and be unconditionally owned and controlled by one or more socially and economically disadvantaged individuals. Upon certification, for a 9-year period, 8(a) firms can obtain federal contracts through sole source awards or by competing against other 8(a) firms rather than large businesses for the work. The Federal Acquisition Regulation (FAR) limits the percentage of work that may be subcontracted under 8(a) contracts, in part, to ensure that small businesses do not pass along the benefits of their contracts to their subcontractors.¹ For example, under the current regulations for service contracts, the 8(a) prime contractor must expend at least 50 percent of the total labor costs associated with the contract on its own employees. Contracting officers are responsible for ensuring compliance with this requirement. Our prior work dating back to 2006, however, has found that contracting officers generally did not do so.²

¹The focus of this report is on 8(a) contracts but the FAR subcontracting limitations apply to all contracts set aside for small businesses concerns.

²GAO, *Contract Management: Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight*, [GAO-06-399](#) (Washington, D.C.: Apr. 27, 2006); and *Federal Contracting: Monitoring and Oversight of Tribal 8(a) Firms Need Attention*, [GAO-12-84](#) (Washington, D.C.: Jan. 31, 2012).

The National Defense Authorization Act (NDAA) for Fiscal Year 2013 amended the Small Business Act to change what costs are considered to be subcontracted work under contracts set aside for small businesses, including 8(a) contracts. It also required SBA to, among other things, take such actions as are necessary to ensure that an existing federal subcontracting reporting database is modified to notify key individuals when contractors violate subcontracting limitations. The act also established penalties for such violations.³ You asked us to review how federal agencies monitor the work performed by subcontractors under 8(a) contracts and the potential effects from these changes in the Small Business Act. This report examines (1) the extent to which contracting officers and small businesses monitor compliance with subcontracting limitations under 8(a) contracts and the reasons they may not and (2) the status of federal agency efforts to implement the revisions to the Small Business Act and the potential effects of these revisions as reported by contracting officers and small businesses.

To determine the extent to which contracting officers and small businesses monitor compliance with subcontracting limitations, we used the government's procurement database—the Federal Procurement Data System-Next Generation—to identify the departments with the highest total obligations under 8(a) contracts in fiscal years 2011 and 2012.⁴ Those were the Departments of Defense (DOD), Health and Human Services (HHS), and Homeland Security (DHS). Obligations to 8(a) contracts awarded by these three departments represented approximately 75 percent of all federal agencies' total obligations under 8(a) contracts across the two fiscal years. We selected a sample of 10 8(a) contracts with subcontracting awarded by the Departments of the Army, Navy, Air Force, HHS, and DHS.⁵ Findings from our prior work in April 2006 and January 2012 established that subcontracting limitations were not monitored by contracting officers.⁶ We selected a small sample because this approach allowed us to obtain more in-depth information for each contract. For each of these departments, we selected one stand-

³Pub. L. No. 112-239, §§ 1651, 1652.

⁴Complete fiscal year 2013 data were not available at the time we started our review.

⁵We excluded manufacturing contracts, as those could be more likely to contain waivers to the subcontracting limitation requirements.

⁶[GAO-06-399](#) and [GAO-12-84](#).

alone contract, completed in fiscal year 2012, because contractors are required to comply with subcontracting limitations by the end of the performance period.⁷ In addition, for each department, we selected one active IDIQ contract awarded in fiscal year 2011 or 2012 because contractors were required to demonstrate compliance with subcontracting limitations every 6 months during the performance period for IDIQ contracts. To select the contracts for review, we used several criteria, including total value, total obligations to date, the type of service provided, and contracting office location. For each contract, we validated that each was awarded through the 8(a) program and was either a stand-alone or IDIQ contract as reflected in the Federal Procurement Data System-Next Generation. We reviewed documentation in the contract files, such as solicitations, contractor proposals, and invoices, to determine how, if at all, the contracting officer or contracting officer's representative (COR) monitored compliance with subcontracting limitations. We also used this documentation to help identify situations that could indicate the potential to exceed these limits. We interviewed the contracting officer and COR, when available, for each contract to determine whether and how subcontracted work was monitored and, if it was not monitored, the reasons why. In addition, we met with representatives from the 8(a) contractors associated with the 10 contracts in our sample to discuss their approaches to monitoring compliance with subcontracting limitations and the extent to which federal agencies requested information on the amount of subcontracted work. The results of our contract analysis are not generalizable to the population of 8(a) contracts but, when coupled with the results of our interviews and past work, provide useful insight into the extent to which subcontracting limitations are monitored and situations that present an increased risk that subcontracting limitations may be exceeded.

To determine the status of federal agency efforts to implement revisions in the Small Business Act, we compared the subcontracting limitation requirements for 8(a) contracts prior to and after the Small Business Act was amended. We also reviewed an SBA announcement of current and projected rules to amend small business regulations. We interviewed SBA, General Services Administration, and Office of Federal

⁷Stand-alone contracts are any non-indefinite delivery, indefinite quantity (IDIQ) contracts. An IDIQ contract provides for an indefinite quantity, within stated limits, of supplies or services during a fixed period. Under an IDIQ contract, the government issues task orders for services or delivery orders for supplies for individual requirements. FAR § 16.504

Procurement Policy (OFPP) officials. The Administrator of OFPP serves as the chair of the Federal Acquisition Regulatory Council, which oversees the development and maintenance of the FAR. We also interviewed contracting officers, CORs, and representatives from the 8(a) contractors, when available, associated with the 10 contracts in our sample to obtain their insights into potential effects of these provisions.

We conducted this performance audit from September 2013 to September 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Subcontractors can perform work under 8(a) contracts, but certain limitations apply regarding the percentage of personnel costs that these firms may incur under service, supply, and construction contracts. For example, for service contracts, the 8(a) prime contractor must incur at least 50 percent of the personnel costs with its own employees. In other words, the total personnel costs associated with the employees of the 8(a) prime contractor must be equal to or greater than the total personnel costs associated with the employees of all subcontractors performing work under the service contract. Table 1 identifies how much work the firm awarded the 8(a) contract must perform according to the requirements in the subcontracting limitation clause currently in the FAR and applicable to the contracts reviewed for this report.

Table 1: Amount of Work 8(a) Contract Awardees Must Perform as Currently Required in the Federal Acquisition Regulation, by Contract Category

Category of contract	Minimum percentage of work awardees must perform
Services (excluding construction services)	50 percent of personnel costs ^a
Supplies	50 percent of manufacturing costs ^b
General construction	15 percent of personnel costs ^{a, b}
Specialty construction	25 percent of personnel costs ^{a, b}

Source: Federal Acquisition Regulation § 52.219-14 Limitations on Subcontracting and also included in 13 C.F.R. §125.6(a). | GAO-14-706

^aPersonnel costs are considered direct labor costs and associated overhead and general and administrative costs.

^bThis excludes the cost of any materials purchased under the contract.

Procuring agency contracting officers are responsible for monitoring whether 8(a) contractors are in compliance with subcontracting limitations. For all of the agencies in our review, SBA has delegated responsibility for contract administration to the procuring agencies through partnership agreements. Partnership agreements between the agencies and SBA outline the responsibilities of both parties in the 8(a) contracting process. These agreements delegate SBA's contract administration responsibilities, such as overseeing the contractor's performance, to the procuring agencies after SBA has accepted the procurement into the 8(a) program. The partnership agreements explicitly address subcontracting limitations in a few ways by requiring the agencies to

- at the time of the contract award, conduct and document an assessment of the 8(a) firm's ability to comply with the subcontracting limitations;
- include monitoring and oversight provisions in all 8(a) contracts to ensure that the contractors comply with the subcontracting limitations; and
- ensure that 8(a) contractors comply with the subcontracting limitations.

SBA, DOD, DHS, and HHS officials responsible for administering the 8(a) program stated that contracting officers are responsible for implementing these requirements. Our past work and the work of others, however, have found that contracting officers generally do not do so. In our April 2006 report, we reviewed 16 contracts awarded to 8(a) firms owned by Alaska Native Corporations and found almost no evidence that agencies were monitoring compliance with subcontracting limitations.⁸ Contracting officers we spoke with were generally confused about whose responsibility it was to monitor compliance or were unclear about how to monitor the subcontracting limitation requirements under IDIQ contracts. We recommended that SBA take steps to clearly assign accountability for monitoring compliance. SBA did not state if it agreed or disagreed with our recommendations but, in response, the agency provided training to procurement officials and revised the 8(a) partnership agreements to more clearly delineate responsibility to the procuring agency for the monitoring. SBA also provided training to procuring agencies on the contents of the partnership agreements.

⁸[GAO-06-399](#).

Nevertheless, about 6 years later, we reported that of 71 8(a) contracts confirmed to have subcontracting, we found no evidence of regular and systematic monitoring of the subcontracting limitations.⁹ Contracting officers were still unclear who was responsible for the monitoring and uncertain about how to conduct the monitoring. In this January 2012 report, we noted that the FAR requires contracting officers to include the subcontracting limitations clause in 8(a) contracts but does not state who is accountable for monitoring compliance with the required percentages.¹⁰ In addition, many contracting officials told us that they did not know how to monitor the percentage of work that is subcontracted, in part, because they did not have visibility into subcontractor costs. Lastly, we found no evidence that the contracting officers were enforcing requirements that 8(a) contractors semi-annually demonstrate compliance with subcontracting limitations under IDIQ contracts, in part, because these requirements were not referenced in the FAR. We recommended that OFPP, in consultation with SBA, take a number of actions, such as amending the FAR to direct contracting officers to document in the contract file the steps they had taken to ensure compliance and to clarify the percentage of work required by an 8(a) participant under IDIQ contracts. OFPP agreed with our recommendations and some actions have been taken to address them. For example, SBA amended its regulations regarding subcontracting limitations under IDIQ contracts, issuing a final rule on October 2, 2013.¹¹ Prior to this change, the 8(a) participant was to demonstrate semi-annually that it had performed the required amount of work for the combined total of all task or delivery orders at the end of each 6-month period under an IDIQ contract. The amended regulations require the 8(a) firm to demonstrate compliance with the subcontracting limitations after each performance period—e.g., for the base period and any option period thereafter. OFPP and SBA stated that they would address the other recommendations as they developed regulations to comply with the most recent amendments to the Small Business Act.

⁹[GAO-12-84](#).

¹⁰The FAR also requires contracting officers to include the subcontracting limitations clause in 8(a) solicitations.

¹¹78 Fed. Reg. 61113, 61143 (Oct. 2, 2013) (codified at 13 C.F.R. § 125.6(f) (2013). This final rule is currently being reviewed for incorporation into the FAR.

SBA has also found that contracting officers are generally not monitoring compliance with the subcontracting limitations. To address FAR requirements, SBA conducts surveillance reviews each fiscal year at various contracting offices to monitor their compliance with small business policies, statutory requirements, and applicable regulations. As part of these reviews, SBA examines a sample of small business contracts to determine whether the contract files contain evidence that the contracting officer monitored compliance with the subcontracting limitations.¹² According to SBA officials, these reviews generally find that the contracting officers are not taking steps to ensure such compliance. For example, through these reviews, SBA has found that contracting officers were either not including the FAR subcontracting limitations clause in contracts or were not monitoring compliance. SBA has made recommendations to these contracting offices to provide training or issue guidance on the requirement so contracting officers better understand their responsibilities to monitor subcontracting limitations.

Responsibilities for Ensuring Compliance with Subcontracting Limitations Still Not Fully Met or Understood

Contracting Officers Are Generally Not Ensuring Compliance with Subcontracting Limitations

With two exceptions, the contracting officers we met with generally do not monitor the amount of subcontracted work to ensure 8(a) contractors comply with subcontracting limitations, which is consistent with our past findings. Table 2 shows that contracting officers rarely performed all

¹²As part of the surveillance reviews, SBA examines contracts awarded through small business contracting programs, such as contracts awarded under the 8(a) Business Development, small business set-aside, woman-owned small business, and service-disabled veteran-owned small business programs. The FAR and small business regulations require the firms awarded contracts through any of these programs to perform a certain amount of work under the contracts.

subcontracting limitations-related responsibilities in their agency's 8(a) partnership agreements with SBA.

Table 2: Analysis of Contracting Officers' Implementation of Responsibilities in Small Business Administration Partnership Agreements for the 10 8(a) Contracts We Reviewed

Partnership responsibilities	Total
Contracting officer documented and assessed if offeror could comply with subcontracting limitations before awarding contract	4 of 9^a
Contract included monitoring and oversight provisions to ensure compliance with subcontracting limitations	0 of 10
Contracting officer ensured that 8(a) contractor complied with subcontracting limitations	2 of 10

Source: GAO analysis of Small Business Administration partnership agreements, contract documentation, and interviews with contracting officers. | GAO-14-706

^aIn one case, the contractor's proposal noted that subcontractors would not be used, so the contracting officer did not assess whether the contractor could comply with the subcontracting limitations.

As noted in the table, only four contracting officers documented and assessed if the offeror could comply with the subcontracting limitations prior to contract award. These assessments varied from questioning the offeror on how it would comply with the subcontracting limitations to using award evaluation criteria that required the offeror to identify the steps it would take to ensure it was in compliance. As required by the FAR, all of the contracts included the subcontracting limitations clause, which requires the contractor to perform a certain percentage of the work.¹³ None of the contracts, however, included a monitoring and oversight provision to require the contractor to demonstrate the percentage of work it performed.

Subcontracting limitations were monitored for an HHS and a Navy contract we reviewed. In addition to assessing if these contractors would be able to comply, these two contracting officers required the contractor to regularly provide information on the extent to which work was subcontracted. The contracting officers told us that it was their standard practice to monitor subcontracting for this purpose. We did not find evidence that these limitations were monitored in the other eight

¹³Section 19.811-3(e) of the FAR requires the inclusion of FAR clause 52.219-14 in solicitations and contracts issued under the 8(a) program.

contracts. In reviewing these eight contracts, we also did not find sufficient evidence in the contract files to independently determine the extent of work subcontractors completed. The other contracting officers we spoke with stated that they do not monitor the extent of subcontracted work to ensure contractors comply with subcontracting limitations.

Contracting officers cited many reasons for not ensuring 8(a) contractors complied with subcontracting limitations. We often found that contracting officers, even one of the two who monitored subcontracting limitations, were not fully aware of what they were required to do under the partnership agreements or were unclear on how to ensure compliance (see table 3).

Table 3: Reasons Contracting Officers Cited for Not Meeting All Subcontracting Limitation Responsibilities in Their Agency's Partnership Agreements

Reasons cited by contracting officer	Total
Not responsible for monitoring compliance with subcontracting limitations	2
Not fully aware of responsibilities in agency's partnership agreement with Small Business Administration	5
Did not have access to information on the extent of subcontracted work performed	6
Primarily concerned with contractors satisfactorily performing the services in the contract but not compliance with subcontracting limitations	6

Source: GAO analysis of contract documentation and interviews with the nine contracting officers. | GAO-14-706

Note: Some contracting officers cited more than one reason. In addition, for one contract in our sample, the contracting officer was not available for interview due to separation from the agency.

Generally, contracting officers understood that they had some responsibility to monitor compliance with subcontracting limitations, but told us that this responsibility was also shared with CORs, in part, because contracting officers are not always onsite to oversee contractor performance as CORs generally are. CORs associated with the 10 contracts we reviewed, however, stated that contracting officers have not delegated this responsibility to them and they do not take steps to monitor the amount of subcontracted work.

In addition, some contracting officers stated that the contractor was responsible for ensuring compliance with subcontracting limitations, in part, because the contract included the limitation on subcontracting FAR clause. For example, one HHS contracting officer stated that the 8(a) contractors he works with understand the amount of work they must perform, should be monitoring the amount of subcontracted work, and

should inform the government if subcontractors perform more work than allowed. This contracting officer, however, was not aware if the contractor had performed the required amount of work on the contract we reviewed, and contractor representatives for this contract told us that they were not in compliance with the subcontracting limitations at the time we spoke with them.

In several interviews during this review and in prior work, contracting officers told us that they primarily rely on the FAR and their agencies' policies and guidance to understand what their responsibilities are and how to implement them.¹⁴ While agencies' policies and guidance may supplement parts of the FAR, the purpose of the FAR is to provide uniform policies and procedures for federal acquisitions, and most agencies must follow these regulations. The FAR requires contracting officers to include the subcontracting limitations clause in any solicitation and contract awarded under the 8(a) program, but it does not address the contracting officers' responsibilities as outlined in the 8(a) partnership agreements. Three contracting officers told us they were fully aware of the contents of the 8(a) partnership agreements, but had not fully implemented those responsibilities, and only one had taken steps to ensure the contractor was in compliance with subcontracting limitations. Four contracting officers were aware of the partnership agreement generally but were not aware that it required them to include, among other things, a monitoring and oversight provision in the contract. Another contracting officer was completely unaware of the partnership agreement.¹⁵ DHS, DOD, and HHS procurement and small business contracting officials we met with stated that their agencies have not developed any specific policies or guidance for contracting officers to reinforce or re-state these responsibilities. When contracting officers are not aware of or do not implement their responsibilities to monitor 8(a) subcontracting limitations, there is an increased risk that contractors are not in compliance.

Further, six contracting officers also expressed confusion about their ability to monitor subcontracted work performed under 8(a) contracts, stating that they did not have access to the costs of the subcontracted

¹⁴[GAO-12-84](#).

¹⁵We did not obtain responses from two contracting officers due to their separation from the agency.

work. These contracting officers generally stated it was their understanding that only large businesses could be compelled to report on subcontracted work. Large businesses awarded contracts that are expected to exceed a certain amount are required to develop a plan detailing the extent to which they will subcontract work to small businesses, which is evaluated by contracting officers prior to awarding a contract.¹⁶ These businesses are then required to report on the amount of work subcontracted to those small businesses on a federal government website. While the FAR exempts small businesses from the requirement to submit a subcontracting plan, it does not prohibit contracting officers from requiring that small businesses report on subcontracting for the purposes of demonstrating compliance with the subcontracting limitations.¹⁷

Six contracting officers also generally thought that the government does not have access to the costs of subcontracted work under firm, fixed priced contracts but would under cost-reimbursement contracts.¹⁸ Contracting officers are not prohibited from requesting information on the amount of subcontracted work under firm, fixed priced contracts. In fact, we found that contracting officers were able to request and collect information on the amount of subcontracted work, regardless of the contract type. The two contracting officers that monitored subcontracting did so by requiring contractors to submit information on the amount of subcontracted work for both a cost-reimbursement contract and a fixed-priced contract. For example, prior to approving new work on a cost-

¹⁶Section 19.702 of the FAR requires large business concerns awarded contracts over the simplified acquisition threshold to agree in their contracts that various types of small business concerns will have the maximum practicable opportunity to participate in contractor performance. When acquisitions are expected to exceed \$650,000 (\$1.5 million for construction) and have subcontracting possibilities, the anticipated awardee is required to submit a subcontracting plan. FAR §§ 19.702(a), 19.704(a)(9). Section 19.704(a)(2) of the FAR requires that these plans detail the total dollars planned to be subcontracted to small business concerns of the total dollars planned to be subcontracted. For purposes of this report large businesses are other than small businesses.

¹⁷FAR §19.702(b)(1).

¹⁸Cost-reimbursement contracts generally require contractors to provide cost breakdowns and supporting factual data of costs, including subcontractor costs, in order for the contractor to be reimbursed for any costs which are determined to be allowable, allocable, and reasonable under the terms of the contract. Under firm, fixed-priced contracts, the government generally negotiates a set amount and contractors are not required to provide a detailed breakdown of their costs to receive payment.

reimbursement contract for conference logistics and planning services, an HHS contracting officer required the 8(a) contractor to propose how it would comply with subcontracting limitations. As work was performed, this contracting officer calculated how much work was completed by subcontractors using subcontractor invoices provided by the contractor. In the other instance, a fixed-priced contract for facility support services, a Navy contracting officer included evaluation criterion in the solicitation to ensure that any offeror would be able to perform the required amount of work. Even though this was a fixed-price contract, the contracting officer required the contractor to semi-annually report on the amount of subcontracted work from the start of the period of performance. These two contracting officers stated that 8(a) contractors they work with generally have no problem providing data or information required to demonstrate compliance with subcontracting limitations, regardless of the contract type.

8(a) Contractors Are Willing and Able to Provide Subcontracting Data If Required

All of the 10 8(a) contractors we met with said they are willing and able to provide information to demonstrate compliance with subcontracting limitations, but generally would only do so if required. They stated that contracting officers rarely ask for or require this information. All contractor representatives stated that they maintain information on the costs of their subcontracted work, but most do not track if they are in compliance with subcontracting limitations. They said, however, that they likely could demonstrate compliance if required. In some cases, construction contractors noted that they might need to obtain more information on the personnel costs associated with subcontracted work, in part, because some subcontractors invoice for total costs rather than providing details on all of their costs. Three contractor representatives explained that they monitor compliance as a regular practice by manually calculating the percentage of subcontracted work using subcontractors' invoices or generating automated reports through the firm's financial accounting system.

Contractor representatives stated that providing information to demonstrate compliance with subcontracting limitations would not burden them if such a requirement was put in place prior to or at the time of contract award. They said that the earlier such information is required or requested, the easier it is to determine and demonstrate compliance. Some contractor representatives added that they would be hesitant to provide details on costs they considered to be proprietary information under fixed priced contracts, but would provide information on the percentage of subcontracted work.

Observed Situations That Underscore the Need to Monitor Subcontracting

In the course of our review, we observed situations presenting an increased risk that subcontracting limitations may be exceeded. While all 8(a) contracts must comply with subcontracting limitations, these situations highlight the importance of monitoring the extent of subcontracting. Our observations included situations when the 8(a) prime contractor proposed subcontractors that were the agency's prior incumbent contractor or that had more experience in meeting the agency's current requirement than the prime contractor. Figure 1 shows that 5 of the 10 contracts in our sample exhibited one or more of these situations.

Figure 1: Five 8(a) Contracts Identified to Be at Increased Risk of Exceeding Subcontracting Limitations

Contract description	Situations indicating a potential to exceed subcontracting limitations					
	Incumbent contractor identified as a subcontractor in proposal	Proposal identified amount of subcontracted work would approach subcontracting limitations	Contracting officer thought but did not confirm that subcontracting limitations were exceeded	Subcontractors not identified in proposal but performed work on the contract	Subcontractor rather than prime contractor submitted documents to or corresponded directly with government officials	Contractor reported its subcontractor was more experienced with meeting requirements of contract
General construction				●	●	
File scanning and destruction	●	●				●
Facility support	●					●
Architecture and engineering						●
Classroom rehabilitation	●		●			

Source: GAO analysis of contract documentation and interviews with contracting officers and contractor representatives. | GAO-14-706

While we could not independently verify the amount of work subcontracted, of the five contracts we found to be at increased risk of not complying with the subcontracting limitations, contractor representatives from two of these firms stated that they were not in compliance at the time of our review. In both of these instances, the contracting officer did not monitor the amount of subcontracted work. In one of these cases, the contractor initially proposed that none of the work for general construction services on a U.S. Air Force base would be subcontracted. The Air Force program office, however, delayed the start of the project multiple times which required the firm to redirect its employees to perform work on other construction projects. This shift resulted in the firm hiring subcontractors to perform the contracted work. In reviewing the contract file, we found

evidence to suggest that subcontractor employees performed significant roles on the project, which the contractor representatives confirmed. Some of these roles, however, should have been performed by the 8(a) prime contractor, according to the contracting officials. For example, a subcontractor employee emailed program officials to request facility access for employees from other subcontractor firms. In another instance, the same subcontractor employee signed a material request form where the prime contractor would generally sign, identifying his title as the “PM” or project manager. Contractor representatives stated that while this subcontractor prepared these documents, an employee of the prime contractor served as the project manager. They noted, however, that the 8(a) firm did not collect specific data on the cost of its subcontracted labor to determine what percentage of work subcontractors performed.

In a DHS contract, for file scanning and destruction services, the prime contractor representative estimated that the firm was meeting the subcontracting limitations but could not confirm this. This representative, whose firm’s expertise was information technology services, told us that the firm did not have any experience providing the services required under the contract. Therefore, the firm had teamed with a subcontractor—recently graduated from the 8(a) program—who had been the incumbent contractor for the file scanning and destruction requirement. In its proposal, the 8(a) firm stated that its subcontractor would perform 49 percent of the work, nearly the maximum allowed under the subcontracting limitation requirements. DHS paid the prime contractor a fixed price for each scanned page and for each box of documents destroyed. The prime contractor had a similar pricing arrangement with its subcontractor and did not obtain the personnel costs associated with the subcontracted work, which are needed to demonstrate compliance with the subcontracting limitations. Instead, the firm maintained documentation on how many documents were scanned and boxes destroyed. Representatives from the firm stated that had the contracting officer included a monitoring provision in the contract or requested such information, the firm would have collected the information needed to determine the amount of work completed by its subcontractor.

For a Navy contract, the contracting officer found that for the first year, the 8(a) contractor was not in compliance with the subcontracting limitations. The contract was for facility support services, which included janitorial services and vehicle or equipment support. A representative from the 8(a) prime contractor told us that while the firm was experienced with providing janitorial services, it did not have any experience providing vehicle and equipment support. The 8(a) firm teamed with a

subcontractor who had been the incumbent contractor for the same requirement but had graduated from the 8(a) program and needed a partner to continue performing the work. The firm's proposal identified that the incumbent contractor would be a significant subcontractor but that the 8(a) firm would be able to perform at least 50 percent of the work. Contractor representatives explained, however, that the initial task orders awarded under the IDIQ contract were for vehicle and equipment support, which were generally completed by the subcontractor. During this time, the Navy contracting officer required the contractor to submit a report every 6 months on the amount of subcontracted work. The 8(a) firm eventually complied with the subcontracting limitations after it was awarded a high-dollar task order for janitorial and other services. The firm's representative said that reporting on the amount of subcontracted work every 6 months was an easy requirement to meet and helped the firm understand the steps it needed to take to be in compliance.

Initial Step Taken but Statutory Changes to Subcontracting Limitations Could Take Years to Implement and Would Reportedly Have Mixed Effects

While SBA has taken an initial step to implement the statutory changes to subcontracting limitations by announcing that it is drafting a proposed rule, it could take years to reflect these changes in regulation. Many actions are needed to revise small business regulations, which in this case will lead to revisions in the FAR. Contracting officers and contractors reported that these pending changes could have mixed effects on monitoring compliance.

Changes to How Subcontracted Work Is Determined

The NDAA for Fiscal Year 2013 amended the Small Business Act to change what costs are considered to be subcontracted work under 8(a) contracts, in part, to make it easier for contractors to determine if they are in compliance.¹⁹ Because these changes are not yet implemented in the FAR, agency procurement officials told us that contracting officers are to enforce the current subcontracting limitations, that is, those that were in effect before this amendment. Table 4 compares the subcontracting

¹⁹Pub. L. No. 112-239, § 1651 (codified at 15 U.S.C. 657s).

limitations in the FAR, as implemented today, to those in the amended Small Business Act.

Table 4: Comparison of 8(a) Subcontracting Limitations Prior to and After Fiscal Year 2013 Amendments to Small Business Act

Subcontracting limitations prior to the amended Small Business Act and currently in the Federal Acquisition Regulation	Subcontracting limitations in the amended Small Business Act and not yet implemented in the Federal Acquisition Regulation
<p>8(a) prime contractors must perform at least:</p> <ul style="list-style-type: none"> • Service contract (except construction): 50 percent of the work based on the total personnel costs. • Supply contract: 50 percent of the work based on the total manufacturing costs.^{a, b} • General construction contract: 15 percent of the work based on the total personnel costs.^b • Specialty construction contract: 25 percent of the work based on the total personnel costs.^b 	<p>8(a) prime contractors must perform at least:</p> <ul style="list-style-type: none"> • Service contract (except construction): 50 percent of the work based on the total amount paid under the contract, including materials, supplies, and other non-labor costs. • Supply contract: 50 percent of the work based on the total amount paid.^{a, b} • General construction contract: Directs Small Business Administration to develop new rules through public rulemaking process. • Specialty construction contract: Directs Small Business Administration to develop new rules through public rulemaking process.
<p>Work performed by 8(a) subcontractors is counted toward subcontracting limitations.</p>	<p>Work performed by 8(a) subcontractors is not counted toward subcontracting limitations.</p>

Source: GAO analysis of the Federal Acquisition Regulation and the Small Business Act prior to and after amendments to the Small Business Act in the National Defense Authorization Act for Fiscal Year 2013. | GAO-14-706

^aIn the case of a contract with an 8(a) firm that sells but does not manufacture the supplies, the firm is not required to comply with the subcontracting limitations if the subcontractor that manufactures the supplies is a small business, unless the requirement is waived.

^bThis excludes the cost of any materials purchased under the contract.

The NDAA amendments to the Small Business Act were enacted on January 2, 2013, and it could take years to incorporate these changes into the FAR. For example, we recently reported on a small business regulation change that took 3 years to complete, a time frame that agency officials told us is typical.²⁰ In January 2014, SBA announced that it was drafting a proposed rule to implement these changes into federal regulations through the public rulemaking process, which is generally an initial step in the federal rulemaking process needed to amend the small

²⁰GAO, *Small Business Contracting: Updated Guidance and Reporting Needed for Consolidated Contracts*, GAO-14-36 (Washington, D.C.: Nov. 26, 2013)

business regulations as well as the FAR.²¹ According to SBA officials, the proposed rule will include the prescribed changes in the Small Business Act for service and supply contracts and revised subcontracting limitations for construction contracts. SBA officials stated that the agency had drafted the proposed rule in June 2014 and that it is currently in the review process. The officials stated that SBA will submit the final rule to the FAR Council, chaired by the Administrator of OFPP, which will then solicit comments from other interested parties and take steps to incorporate any changes into the FAR.²²

Some contracting officers and nearly all contractor representatives told us that they would need additional guidance on how to implement these changes but offered some varied perspectives on potential effects. Contracting officers said these changes could simplify the information needed to determine the amount of subcontracted work allowed under 8(a) service contracts, which was the intent of these amendments. Instead of needing information on both the 8(a) firm's and its subcontractors' total personnel costs, only the amount paid to subcontractors would be needed to determine the amount of subcontracted work. Contractor representatives stated that these changes could have mixed effects on their ability to perform the required amount of work. Several acknowledged that not counting work performed by other 8(a) firms as subcontracted work could make it easier to comply with the limitations and would encourage subcontracting to these firms. Yet almost all of the contractor representatives we met with noted that if the new subcontracting limitations do not exclude certain costs, such as costs for materials and travel, then it could make it more difficult to comply.

²¹The basic process by which agencies develop and issue regulations is spelled out in the Administrative Procedure Act. The act generally requires agencies to (1) publish a notice of proposed rulemaking in the *Federal Register*; (2) allow interested persons an opportunity to comment on the rulemaking; (3) issue a final rule accompanied by a statement of its basis and purpose; and (4) publish the final rule at least 30 days before it becomes effective.

²²The FAR Council's membership consists of the OFPP Administrator, the Secretary of Defense, the Administrator of the National Aeronautics and Space Administration, and the Administrator of the General Services Administration. The FAR Council issues rules to implement changes to the FAR.

Establishment of Monetary Penalties for Violating Subcontracting Limitations

The NDAA for Fiscal Year 2013 also amended the Small Business Act to impose a monetary penalty on contractors that violate the subcontracting limitations. The minimum penalty is \$500,000, and a contractor would be required to pay up to the difference between the amount of subcontracted work allowed and the actual amount expended on subcontracted work—whichever is greater. For example, if only \$5 million of work was allowed to be subcontracted out but the actual amount of subcontracted work was valued at \$6 million, the penalty could be up to \$1 million. Prior to this change, no such monetary penalty existed. SBA officials stated that the June 2014 draft proposed rule addresses this penalty.

According to a January 2014 semi-annual announcement of current and projected rules, SBA plans to incorporate the penalty into federal regulations and to provide protection to small businesses that, despite good faith efforts, exceed the subcontracting limitations.²³ SBA officials noted that the penalty could currently be enforced by the Attorney General, but were not aware of any such actions. Most of the contractor representatives told us that the monetary penalty for violating the subcontracting limitations would bankrupt or put an 8(a) firm out of business if enforced, which they noted creates a significant incentive for prime contractors to complete the required amount of work. Contractor representatives were particularly concerned because while they intend to complete the required amount of work, they may not always be able to for reasons outside of their control. For example, half of the representatives pointed to situations when the work performed under a contract differed from the work they expected to perform based on the government's solicitation. In such situations, they had to use subcontractors to perform work they were not able to complete.

Modifications to Existing Subcontracting Reporting System

SBA has recently started to take actions to ensure that a General Services Administration subcontracting reporting system is modified to notify key individuals if a contractor is not in compliance with the subcontracting limitations, as required by the amended Small Business Act.²⁴ While the act required a system to be modified by January 2, 2014, presently, no federal subcontracting reporting system identifies when

²³79 Fed. Reg. 1228, 1231 (Jan. 7, 2014).

²⁴These key individuals consist of the contracting officer, Director of the Office of Small and Disadvantaged Business Utilization, and SBA Administrator. See 15 U.S.C. § 645(g)(2).

contractors exceed the subcontracting limitations or notifies key individuals when those situations occur. Contractors currently report subcontracting data for federal contract awards into two systems: (1) the electronic Subcontracting Reporting System (eSRS) and (2) the Federal Funding Accountability and Transparency Act Subcontracting Reporting System (FSRS). The Small Business Act did not specify which system to modify. In February 2014, SBA notified the General Services Administration that FSRS would need to be modified to address the act's requirement. SBA officials told us the agency would draft a separate proposed rule to implement the requirement in its regulations, which would also be implemented in the FAR, but noted that this process would take years to complete. General Services Administration officials told us that they had not determined which system, eSRS or FSRS, would be modified, but that any system changes would not occur until after the public rulemaking process is complete and any necessary changes are made to the FAR.

Both eSRS and FSRS would require changes to fully address the requirement to modify an existing federal subcontracting reporting system. ESRS, for example, is used to monitor large businesses' progress in meeting small business subcontracting goals. Small businesses, however, are not required to report subcontracting information into eSRS. FSRS, on the other hand, provides the public with transparency into the extent of subcontracting performed under federal awards. Both large and small businesses report certain subcontract award information into the system, including the subcontractor's name and total dollar value of sub-award.²⁵ FSRS, however, does not capture all subcontract awards or the level of detail needed to identify instances when subcontracting limitations are exceeded. For example, the system

- includes subcontracting data only on prime contract and subcontract awards that are at least \$25,000; and
- includes only the total value of the subcontract awards and does not break out the costs for labor and materials needed to identify violations under the current and revised subcontracting limitations.

Conclusions

When contracting officers do not take steps to ensure 8(a) contractors can and do comply with subcontracting limitations, there is an increased

²⁵FAR clause 52.204-10.

risk that an improper amount of the work may be completed by subcontractors rather than the 8(a) firm awarded the contract. We previously reported on this issue in 2006, and to date, little has improved. Our prior recommendations that OFPP and SBA clarify how contracting officers are to monitor and document compliance with subcontracting limitations still need to be fully addressed. In general, contracting officers are unaware of their responsibilities in the 8(a) partnership agreements and are not taking appropriate steps to ensure that 8(a) contractors are in compliance. These findings are even more troubling when there are situations with an increased risk that a contractor may not be able to complete the required amount of work, such as when the prior contractor becomes a major subcontractor for the same requirement. As we found, however, monitoring can be done—as demonstrated by the two contracting officers who were diligent in carrying out most of their responsibilities in this regard. Additionally, when asked, 8(a) contractors have provided the necessary information. Further, once again we have found that although some guidance was in the partnership agreements and small business regulations, contracting officers turn to the FAR for guidance and, as of this date, their responsibilities for monitoring subcontracting limitations are not clearly set forth in procurement regulation. Until the FAR reflects these responsibilities, the 2013 statutory changes are likely to have muted effects. As the process of developing the new rules unfolds, OFPP has an opportunity to incorporate contracting officers' responsibilities into the FAR, including outlining steps that can be taken to monitor subcontracting throughout the period of contract performance.

Recommendations for Executive Action

We recommend that the Administrator of OFPP take appropriate steps to amend the FAR to include the following three requirements:

- At the time of the contract award, contracting officers shall conduct and document an assessment of the 8(a) firm's ability to comply with the subcontracting limitations;
- Contracting officers shall include monitoring and oversight provisions in all 8(a) contracts to ensure that the contractors comply with the subcontracting limitations; and
- Prime 8(a) contractors shall periodically report to the contracting officer on the percentage of subcontracted work being performed.

Agency Comments and Our Evaluation

We provided a draft of this report to OFPP, SBA, DOD, DHS, and HHS for review and comment. We also provided selected portions of the report, dealing with the subcontracting system issues, to GSA. We received an email response from OFPP and technical comments from GSA. DOD, DHS, HHS, and SBA did not have any comments on the draft report.

In its email response, a senior OFPP official stated that OFPP generally agreed with our recommendations to strengthen the monitoring and oversight of the required performance percentages for 8(a) contractors, as well as for all small businesses that receive set-aside awards. OFPP intends to ask the FAR Council to take steps to revise the FAR to address this issue to encompass the recommendations from this report, along with recommendations from our January 2012 report, and the changes to the subcontracting limitations enacted in the NDAA for Fiscal Year 2013. The official noted that OFPP will begin the process of revising the FAR when SBA finalizes its implementing regulations addressing limitations on subcontracting, adding that SBA's associated proposed rule is currently under review.

In providing technical comments, a senior GSA official stated that GSA would determine what electronic subcontracting reporting system changes are necessary once SBA issues implementing guidance for subcontracting limitations, and after any applicable FAR changes are made. The official added that GSA would ensure SBA's approval before implementation of the changes and would engage with federal agencies so they are aware of any pending changes and can take any necessary actions to prepare.

We are also sending copies of this report to other interested committees; the Director of the Office of Management and Budget; the Secretaries of Defense, Homeland Security, and Health and Human Services; and the Administrators of the Small Business Administration and General Services Administration. The report also is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have questions regarding this report, please contact me at (202) 512-4841 or MackinM@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on

the last page of this report. GAO staff who made key contributions to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink that reads "Michele Mackin". The signature is written in a cursive, flowing style.

Michele Mackin, Director
Acquisition and Sourcing Management

Appendix I: GAO Contact and Staff Acknowledgments

GAO Contact

Michele Mackin, (202) 512-4841 or MackinM@gao.gov

Staff Acknowledgments

In addition to the contact named above Tatiana Winger, Assistant Director; Justin Jaynes, Analyst in Charge; Jenny Chanley; Dani Greene; Julia Kennon; Sylvia Schatz; Jared Sippel; and Ozzy Trevino made key contributions to this report.

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