

GAO

Report to the Honorable  
Kweisi Mfume,  
House of Representatives

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September 1995

# SMALL BUSINESS

## Monitoring of Subcontracting to Small Disadvantaged Businesses







United States  
General Accounting Office  
Washington, D.C. 20548

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Resources, Community, and  
Economic Development Division

B-265826

September 22, 1995

The Honorable Kweisi Mfume  
House of Representatives

Dear Mr. Mfume:

This report responds to your request that we review federal efforts to monitor the progress made by federal agencies' contractors in providing maximum subcontracting opportunities for small businesses owned and controlled by socially and economically disadvantaged individuals. As requested by your office, our review included the Defense Logistics Agency (DLA), the National Aeronautics and Space Administration (NASA), the Department of Energy (DOE), and the General Services Administration (GSA). Specifically, we determined (1) how these agencies monitor contractors' progress in subcontracting to small disadvantaged businesses (SDB); (2) whether agencies have assessed monetary damages, known as liquidated damages,<sup>1</sup> against contractors who did not make a good faith effort to subcontract to SDBs; and (3) what initiatives are being considered to change the monitoring process.

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## Results in Brief

Each of the four agencies has established procedures to monitor contractors, including (1) reports from contractors on their subcontracting activities and, at some offices, (2) on-site reviews of contractors' subcontracting programs. Many officials told us that this monitoring has increased the subcontracting dollars awarded to small disadvantaged businesses. On the basis of contractors' reports, the agencies have generally met or exceeded annual subcontracting goals to small disadvantaged businesses since fiscal year 1988. DOD, however, met its subcontracting goal for the first time in fiscal year 1994. Despite these achievements, we found certain shortcomings in the monitoring processes. For example, the agencies often do not closely review or act on contractor-submitted reports on subcontracting activities, and they do not verify subcontracting data reported by the contractors to ensure the information's accuracy. Some officials questioned the need for additional monitoring procedures because, as in other small business programs, they rely on contractors to self-certify their progress.

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<sup>1</sup>Liquidated damages, authorized by the Business Opportunity Development Reform Act of 1988, may be assessed when the contractor fails to make a good faith effort to comply with the subcontracting program's requirements. The amount of liquidated damages is the dollar amount by which the contractor failed to achieve its subcontracting goals.

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Contracting staff we spoke with knew of no instances in which their agencies had assessed liquidated damages against contractors. Nevertheless, some staff believe that the threat of such action encourages compliance with subcontracting goals. Others disagree that liquidated damages is a deterrent, believing that the regulation's definition of a lack of good faith effort is vague and questioning whether an assessment of liquidated damages would be upheld in court.

Various initiatives are under way or planned that may affect the agencies' monitoring process. These include streamlined reports, contractorwide subcontracting plans, and electronic data reporting. Certain of these initiatives have grown out of efforts to reform and streamline the federal procurement process. These initiatives would reduce the amount of data collected and, therefore, the amount of information available for monitoring.

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## Background

In 1978, the Congress revised the Small Business Act, requiring that large businesses prepare subcontracting plans for federal contract actions in excess of \$500,000 (\$1 million for construction contracts). These plans must document the actions that contractors plan to take to provide small businesses and SDBs with the maximum practicable opportunity to participate in subcontracting and must contain specific goals for subcontracting to both groups.

In 1988, the Congress again amended the Small Business Act to authorize agencies to assess liquidated damages against contractors that did not make good faith efforts to meet subcontracting goals. The Congress also established an annual, governmentwide goal of targeting 5 percent of total federal subcontracting funds to SDBs.<sup>2</sup> To help achieve this goal, the Small Business Administration (SBA) negotiates annual goals with individual federal agencies, which may be above or below the 5-percent mark. The Department of Defense (DOD), however, has a 5-percent goal.

Since 1988, the agencies included in our review have reported generally upward trends in their percentages of subcontracting dollars going to SDBs. NASA, DOE, and GSA generally met or exceeded the goals negotiated with SBA. DOD met its mandated goal for the first time in fiscal year 1994, reporting that 5 percent of its subcontracting dollars went to SDBs. That same fiscal year, NASA reported SDB subcontracting at 9.7 percent, and DOE

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<sup>2</sup>The law requires a 5-percent SDB goal for prime contracts and subcontracts. The Office of Federal Procurement Policy, which provides governmentwide procurement policy, has interpreted this provision to require two 5-percent goals for SDBs—one for prime contracts and one for subcontracts.

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reported 8.7 percent. GSA reported falling back from 5.6 percent in fiscal year 1993 to 3.8 percent in fiscal year 1994, citing delays in construction contracts and delinquent contractor reports as causes. (App. I contains more information on the SDB subcontracting program, including the agencies' goals and the results of subcontracting to SDBs in fiscal years 1990-94.)

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## How Agencies Monitor the SDB Subcontracting Program

Agency staff rely primarily on (1) periodic reports from contractors on their subcontracting activities and (2) agencies' reviews of contractors' subcontracting programs to monitor contractors' progress in subcontracting to SDBs. However, we found shortcomings in the agencies' monitoring processes.

Regulations require contractors to periodically submit information on their subcontracting activities. The Form 294 report—required every 6 months for each contract that has a subcontracting plan—provides information such as the contract amount, subcontracting goals for small businesses and SDBs, and actual subcontracting dollars awarded to both groups. The Form 295 report—required annually (quarterly for DOD contracts)—summarizes information for all of the contractors' federal contracts, including the total amounts subcontracted to small businesses and SDBs. Only one Form 295 report is provided to each agency, no matter how many federal contracts a contractor may have with the agency.

In addition to the Form 294 and 295 reports, the agencies assess contractors' subcontracting programs through reviews conducted at contractors' facilities. DLA small business specialists perform annual compliance reviews of subcontracting programs at contractors' facilities. GSA initiated a program in 1993 for small business specialists to conduct similar reviews. While NASA and DOE staff do not perform such reviews, staff at both agencies pointed out that the Contractors' Purchasing Systems Reviews (CPSR) include a section on the subcontracting program. CPSRs are to be conducted every 3 years for contractors with annual federal sales of at least \$10 million. SBA also periodically reviews contractors' subcontracting programs; however, limited resources permit such reviews primarily for the largest contractors. According to SBA officials, the frequency of reviews varies, and some contractors have never been reviewed. (App. II contains a more detailed discussion of how the agencies monitor contractors' subcontracting programs.)

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## Shortcomings in the Monitoring Process

Agencies do not always closely monitor subcontracting reports and therefore do not always identify missing or erroneous reports. Of the 378 Form 294 reports that were due during fiscal years 1993 and 1994 for the contracts we reviewed, about 14 percent were not received or were missing from files. Although many agency staff told us that they review the subcontracting reports, about 83 percent of the Form 294 reports that were received showed no documentation of a review. About one-third of the reports received contained errors, some minor and some significant, that suggested a lack of attention to the reports by both the contractor and agency staffs. Finally, about 6 percent of the Form 294 reports were on obsolete forms or were substitute reports that did not provide all of the required information.

The reviews that the agencies perform to assess subcontracting programs at contractors' facilities do not routinely verify the subcontracting data reported by contractors. Rather, the reviews emphasize processes and procedures, such as ensuring that contractors have procedures in place for contacting SDBs about potential subcontracting opportunities and for documenting that firms qualify as SDBs. Furthermore, the reviews do not cover all contractors or their subcontracting plans.

Despite these monitoring shortcomings, many officials told us that in the absence of monitoring, fewer subcontracting dollars would be awarded to SDBs. Some officials question the need for additional monitoring procedures because in this program, like other small business programs, agencies rely on contractors to self-certify their progress. Furthermore, they indicated that the current process, when combined with other activities of the agencies' small business specialists—such as counseling small businesses, helping large firms to locate small business subcontractors, and participating in conferences and trade shows—generally encourages contractors to make the most of subcontracting opportunities for SDBs and comply with SDB subcontracting requirements. (App. III discusses in detail the shortcomings in the agencies' current subcontracting processes.)

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## Liquidated Damages Not Assessed

No staff we spoke to were able to identify any instance in which their agency had assessed liquidated damages against a contractor. However, some staff believed that the threat of being required to pay liquidated damages is enough to secure compliance because the consequences to contractors of being assessed damages, such as delays in being awarded

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future contracts, are so severe. Other staff disagreed that the law is effective in securing compliance.

While contractors are required to make good faith efforts to provide maximum practicable subcontracting opportunities for small businesses and SDBS, the failure to achieve subcontracting goals does not in itself constitute a failure to make a good faith effort. Regulations state that the failure to take certain actions, such as not maintaining records to support compliance with the program, are indications of failure to make a good faith effort.

Some of the agencies' contracting staff believe the definition of a lack of good faith effort is vague and question whether an assessment of liquidated damages would be upheld in court. They believe that the government would have to prove that the contractor had intentionally excluded SDBS from subcontracting opportunities and that to avoid damages, the contractor would only have to show evidence that it had contacted such firms or awarded even a small contract. (App. IV contains further details on liquidated damages.)

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## Initiatives May Change Program Monitoring

Various initiatives are under way or planned that could affect the agencies' processes for monitoring subcontracting. These include streamlining Forms 294 and 295 reports to reduce the amount of subcontracting information reported by contractors; requiring contractorwide subcontracting plans, thereby eliminating the Form 294 report; and allowing contractors to electronically report subcontracting data.

The Federal Acquisition Streamlining Act's (FASA) small business task force has proposed changes to Forms 294 and 295. In preparing regulations to implement FASA, the small business task force proposed to revise Forms 294 and 295 to include information about contractors' subcontracting to women-owned businesses. In response to comments received on these changes and in conjunction with changes being considered by DOD, the task force has proposed changes that would significantly reduce the type of information on subcontracting reports. The Form 294 would include only the current subcontracting goal and the cumulative subcontracting amount for the contract. The report would no longer include information on the contract amount and period, original estimates of revised subcontracting amounts and goals, or separate subcontracting data for the 6-month reporting period. Similarly, the Form 295 would include only cumulative subcontracting data for the year. The

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task force also has proposed reducing to twice a year the frequency of the Form 295s for DOD contracts. While DOD and SBA officials told us that the information being omitted is not useful for monitoring, small business program officials at NASA, DOE, and GSA disagreed and preferred to keep the information on the current forms.

A DOD test has allowed a small number of large contractors to use a contractorwide plan rather than provide a plan for each contract. This test, which was mandated by the Congress in 1989, sets contractorwide or divisionwide goals, eliminating the need for individual plans for each contract and Form 294 reports. The initial results reported by DOD in 1994 were favorable, as both agency and contractor staffs noted that their administrative burdens were reduced and resources were available for other small business activities. However, DOD was not confident of the results because of several factors that affected the test, such as the small number of contractors involved and the declining amount of DOD contract dollars. The test has been extended to 1998.

In fiscal year 1993, DLA began developing electronic reporting by contractors of the information on Form 294 and Form 295 reports. Testing of electronic reporting of the Form 295 report is being done at several contracting offices in DLA's Western District. DLA plans that all of its offices will allow contractors to electronically report Form 295 data in 1996, and the Western District's associate director for small business estimates that the computer application will cost each contractor about \$50. DOD officials are considering a similar, compatible system for electronically reporting Form 294 data. Five DLA offices are also testing an electronic database of Form 294 data.

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## Scope and Methodology

To develop information on the agencies' monitoring processes, we interviewed procurement and other officials at DLA, NASA, DOE, and GSA headquarters and field office locations. At 15 field office locations for the four agencies, we reviewed in detail contract files for 105 judgmentally selected contracts that had active subcontracting plans as of September 1994 to determine how the agencies carried out their monitoring tasks. In addition, we discussed the agencies' use of liquidated damages and its deterrent effects with procurement officials at each of the four agencies. Finally, for information on initiatives under way or on planned changes to the agencies' monitoring processes, we interviewed DOD and GSA officials and reviewed pertinent documents, including proposed changes to the Federal Acquisition Regulations.

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Because our sample of plans was small and not statistically representative, our review does not generalize to all plans at either an agency or an office we visited. However, agency staff generally agreed that the shortcomings in the monitoring processes that we observed were not limited to the contracts we reviewed. (App. V contains further details of our scope and methodology.)

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## Agency Comments

We provided DOD, NASA, DOE, GSA, and SBA with a draft of this report. We met with officials of DOD, including the Deputy Director, Office of Small and Disadvantaged Business Utilization, Office of the Secretary of Defense; officials of NASA, including the program analyst, Contract Management Division, Office of Procurement; officials of DOE, including the Director, Office of Special Projects and Management Systems, Office of the Deputy Assistant Secretary for Procurement and Assistance Management; and officials of GSA, including the Deputy Director, Small and Disadvantaged Business Utilization.

These officials generally agreed with the facts presented in the report, but they expressed concern about the overall tone. DOD and DOE officials, in particular, said that the shortcomings we have cited are less significant than the increases made in SDB subcontracting during the past several years. We believe the shortcomings are of concern because they could have an impact on the levels of subcontracting performance reported by the agencies. However, we agree that the increases in subcontracting to SDBs are noteworthy, and we have included information on these achievements in the report. The officials also provided technical clarifications and updated information, which we have incorporated into the report as appropriate.

Although we did not meet with SBA officials, we received a copy of an internal memorandum on the draft report from SBA's Manager for the Subcontracting Assistance Program. Among other comments, the memorandum stated that SBA staff perform some degree of verification on every compliance review. We agree that SBA staff review samples of contractors' purchase orders, and as we have noted in appendix II, the SBA reports and guidance that we saw appeared to have more depth and documentation than those of other agencies. However, SBA's review guidance does not require verifying reported data back to contractors' source documents. Instead, it directs reviewers to study the contractors' methodologies in preparing the reports and to compare reported data to

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contractors' summary reports. We have incorporated other comments from SBA's memorandum into the report as appropriate.

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We are sending copies of this report to appropriate congressional committees; the Secretary of Defense; the Secretary of Energy; the Administrator of NASA; the Administrator of GSA; and the Administrator of SBA. We will also make copies available to others on request.

Please call me at (202) 512-7631 if you or your staff have any questions about this report. Major contributors to this report are listed in appendix VI.

Sincerely yours,

A handwritten signature in black ink that reads "Judy A. England-Joseph". The signature is written in a cursive style with a large initial "J" and "A".

Judy A. England-Joseph  
Director, Housing and Community  
Development Issues

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**Abbreviations**

ACO	administrative contracting officer
CPSR	Contractors' Purchasing Systems Reviews
DOD	Department of Defense
DOE	Department of Energy
DLA	Defense Logistics Agency
FASA	Federal Acquisition Streamlining Act
GSA	General Services Administration
NASA	National Aeronautics and Space Administration
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget
OSDBU	Office of Small and Disadvantaged Business Utilization
SBA	Small Business Administration
SDB	small disadvantaged business

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# History of the Small Disadvantaged Business Subcontracting Program

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The federal subcontracting program was established in 1961 by an amendment to the Small Business Act. The amendment mandated the Department of Defense (DOD), the General Services Administration (GSA), and the Small Business Administration (SBA) to develop a federal program to ensure that federal contractors consider small businesses when awarding subcontracts. The amendment required that large businesses with federal contracts of \$1 million or more establish and conduct their own subcontracting programs to assist small businesses. Contractors did not have to set goals for subcontracting to small businesses, but agencies were required to periodically review contractors' programs.

Despite the program, in 1978 the Senate Committee on Small Business found that the level of subcontracting to small businesses still depended "solely upon the voluntary 'good effort' of Federal prime contractors." At the same time, the House Committee on Small Business found that small and, in particular, small disadvantaged businesses (SDB)<sup>1</sup> had not been fairly considered as subcontractors. SDBs were not addressed in the 1961 legislation, and DOD reported that subcontracting to SDBs was less than 1 percent in the mid-1970s.

In October 1978, the Congress enacted P.L. 95-507, an amendment to the Small Business Act. The amendment required that large businesses develop subcontracting plans for each federal contract action of \$500,000 or more (\$1 million for construction contracts), including goals for both small businesses and SDBs. The plans must document what actions contractors will take to provide both small businesses and SDBs with the maximum practicable opportunities to participate in subcontracting.

According to regulations, the plans must include goals for (1) estimated dollar amounts that will be subcontracted to small businesses and SDBs and (2) the percentage of these amounts in relation to the contractor's total estimated subcontracting dollars. In addition, federal regulations require that plans include such information as (1) the contractor official who will oversee the program, (2) the type of work to be subcontracted, (3) a description of efforts the contractor will make to subcontract to small businesses and SDBs, (4) the types of records the contractor will

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<sup>1</sup>A small disadvantaged business is a small business, as defined in SBA's size standards, that is at least 51 percent owned and controlled by one or more individuals who are socially and economically disadvantaged. Certain individuals, such as Black Americans, Hispanic Americans, and Asian-Pacific Americans, are presumed to be socially and economically disadvantaged. The economically disadvantaged are socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired because of diminished capital and credit opportunities, as compared to others in the same or similar line of business.

maintain to demonstrate compliance with the program, and (5) an agreement to submit prescribed subcontracting activity reports.

The law permits contractors with more than one subcontracting plan to obtain approval from an agency to use a master subcontracting plan. When the contractor receives a new contract, only information that will vary from contract to contract needs to be added, such as goals and the types of goods or services to be subcontracted.

Ten years after Congress mandated subcontracting plans, subcontracting to SDBs remained relatively low—1.9 percent for DOD contracts and 2.8 percent for GSA's. In 1988, we reported that no punitive or remedial action had been taken against a contractor that failed to meet a subcontracting goal and that had not demonstrated a good faith effort to do so.<sup>2</sup> As a result, the Business Opportunity Development Reform Act of 1988 (P.L. 100-656) was enacted in 1988. In this law, the Congress attempted to strengthen the program by allowing agencies to assess liquidated damages against any contractor that did not make a good faith effort to carry out its subcontracting plan and to comply with subcontracting program regulations. The law also included a governmentwide goal of 5 percent of total subcontracting dollars to SDBs.<sup>3</sup>

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## **Agencies Set SDB Subcontracting Goals Annually**

The 5-percent SDB subcontracting goal is a governmentwide goal and does not apply individually to each agency. SBA annually negotiates several socio-economic procurement goals with federal agencies, one of which is for subcontracting to SDBs. If agency and SBA officials cannot agree on a goal, the Office of Federal Procurement Policy (OFPP) mediates the differences. Table I.1 shows the goals associated with subcontracting to SDBs for each agency included in our review, as well as the combined governmentwide goal.

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<sup>2</sup>Compliance with Subcontracting Requirements at GSA, Energy, and Navy (GAO/GGD-88-83, May 1988).

<sup>3</sup>The law states that there will be a 5-percent goal for prime contracts and subcontracts. The Office of Federal Procurement Policy has interpreted this to mean that there are two 5-percent goals, one for prime contracts and one for subcontracts.

**Appendix I  
History of the Small Disadvantaged Business  
Subcontracting Program**

**Table I.1: Goals for Subcontracting to SDBs, Fiscal Years 1990-94**

Dollars in millions					
	1990	1991	1992	1993	1994
All agencies	\$3,453 4.9%	\$3,232 5.2%	\$2,957 5.1%	\$2,864 5.2%	\$2,907 5.7%
DOD	\$2,897 5.0%	\$2,601 5.0%	\$2,393 5.0%	\$2,283 5.0%	\$2,020 5.0%
NASA	\$110 2.2%	\$300 6.2%	\$266 5.9%	\$223 7.2%	\$436 12.5%
DOE	\$275 5.5%	\$20 <sup>a</sup> 5.0%	\$20 5.0%	\$43 5.0%	\$43 8.6%
GSA	\$50 4.9%	\$130 5.2%	\$100 5.0%	\$104 5.2%	\$165 5.5%

<sup>a</sup>The decline in DOE dollars is due to a change in reporting. (See section on DOE in this appendix.)

Note: Dollar amounts are rounded. The percentages are the amount of subcontracting to SDBs compared to total subcontracting.

Source: The State of Small Business: A Report of the President (fiscal years 1990-93 data), and SBA's Office of Government Contracting (fiscal year 1994 data).

## Subcontracting to SDBs Has Grown Over the Past Several Years

Since fiscal year 1988, the agencies included in our review have reported generally upward trends in percentages of subcontracting dollars going to SDBs. The National Aeronautics and Space Administration (NASA), the Department of Energy (DOE), and GSA have generally met or exceeded the goals set by SBA. However, DOD first met its goal in fiscal year 1994, reporting that 5 percent of subcontracting dollars went to SDBs in that year. For that same fiscal year, NASA reported SDB subcontracting at 9.7 percent, and DOE reported 8.7 percent. GSA's SDB subcontracting declined from 5.6 percent in fiscal year 1993 to 3.8 percent in fiscal year 1994; the agency cited delays in construction contracts and delinquent contractor reports as causes. Table I.2 shows the reported subcontracting to SDBs for each agency.

**Appendix I  
History of the Small Disadvantaged Business  
Subcontracting Program**

**Table I.2: Agencies' Reported Subcontracting to SDBs, Fiscal Years 1990-94**

Dollars in millions					
	1990	1991	1992	1993	1994 <sup>a</sup>
All agencies	\$2,448 3.6%	\$2,167 3.2%	\$2,502 4.3%	\$2,757 4.9%	\$3,155 5.5%
DOD	\$1,575 2.9%	\$1,549 2.7%	\$1,777 3.8%	\$1,914 4.3%	\$2,253 5.0%
NASA	\$286 6.6%	\$267 5.8%	\$341 6.7%	\$373 8.3%	\$417 9.7%
DOE	\$364 6.4%	\$41 <sup>b</sup> 5.0%	\$23 4.8%	\$40 5.0%	\$77 8.7%
GSA	\$109 6.0%	\$115 5.6%	\$146 6.2%	\$130 5.6%	\$107 3.8%

<sup>a</sup>Unpublished SBA figures as of August 1995.

<sup>b</sup>The decline in DOE dollars is due to a change in reporting. (See section on DOE in this appendix.)

Note: Dollar amounts are rounded. The percentages are the amounts of subcontracting to SDBs compared to total subcontracting.

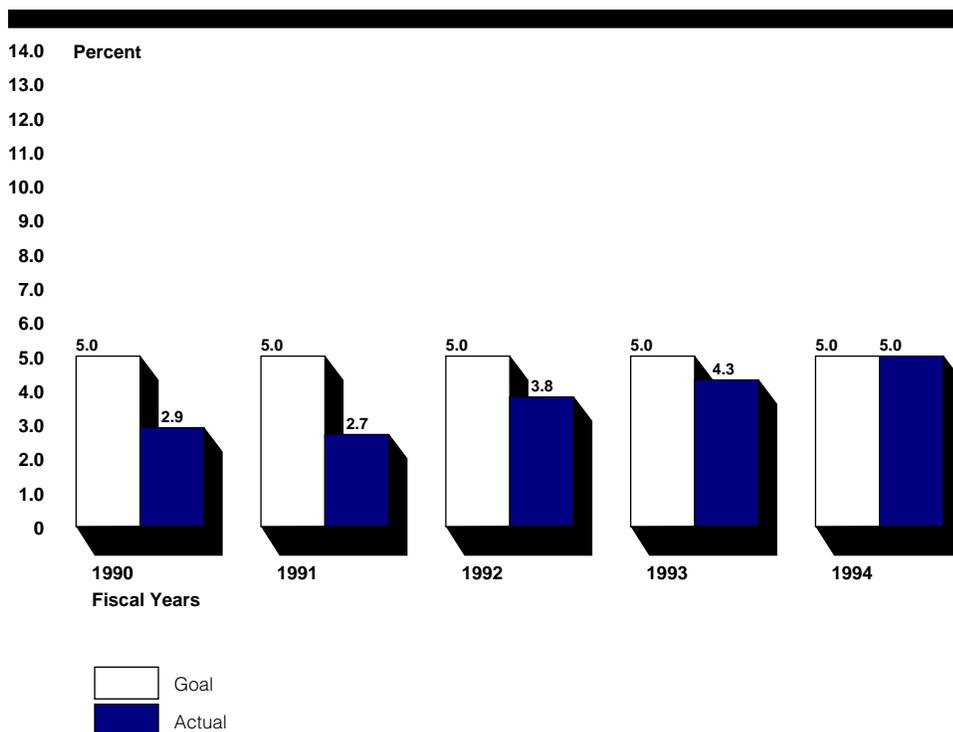
Source: The State of Small Business: A Report of the President (fiscal years 1990-93 data), and SBA's Office of Government Contracting (fiscal year 1994 data).

**DOD's Goals and Reported Performance**

DOD's goal has been 5 percent since fiscal year 1988, but it attained that goal for the first time in fiscal year 1994 when DOD reported that about \$2.25 billion worth of subcontracts went to SDBs. This amount included about \$1.9 billion from contracts administered by the Defense Logistics Agency (DLA), which represented about 4.7 percent of all subcontracting dollars awarded by those contracts. The remainder of subcontract dollars is from contracts that were administered by other military services. Overall, DOD reached its 5-percent goal because these other military services reported that they met or exceeded the DOD goal: Air Force, 10.5 percent; Army, 8.7 percent; and Navy, 5 percent. DOD officials said that the DLA figure does not reflect a poor performance by DLA. They pointed out that the DLA staff do not approve the subcontracting goals for the contracts they administer and that they handle the largest and most complex military contracts, such as large weapons systems, for which contractors have difficulty in finding SDBs that can take on significant amounts of subcontracting. Figure I.1 shows DOD's goals and reported performance.

**Appendix I  
History of the Small Disadvantaged Business  
Subcontracting Program**

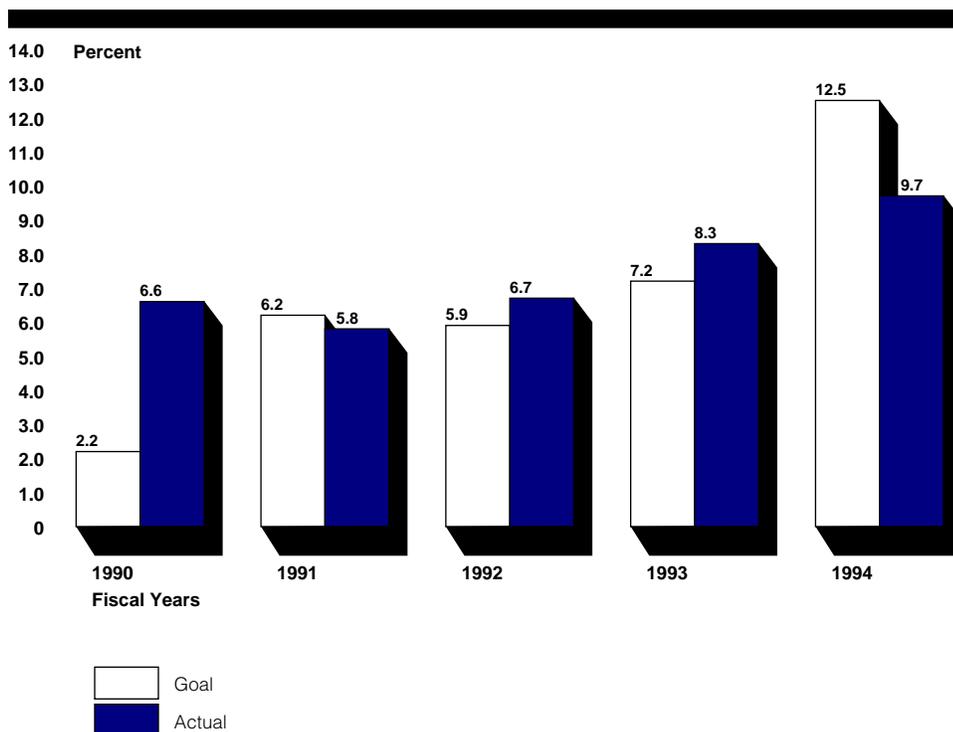
**Figure I.1: DOD's SDB Subcontracting Goals and Reported Performance, Fiscal Years 1990-94**



**NASA's Goals and Reported Performance**

Since fiscal year 1990, NASA has generally reported that it met or exceeded its goals, always above the governmentwide goal of 5 percent. Notably, NASA's goals and achievements have risen gradually during the past several years. Although NASA did not reach its 12.5-percent goal in fiscal year 1994, NASA's Associate Administrator, Office of Small and Disadvantaged Business Utilization (OSDBU), stated that NASA officials erroneously included all women-owned businesses when negotiating the SDB goal with SBA. In addition to NASA's SDB subcontracting goal, the Congress has mandated that a separate 8-percent goal of all NASA contract dollars be contracted or subcontracted to SDBs and women-owned businesses; NASA reported meeting this goal for fiscal year 1993. Procurement staff at NASA offices we visited attributed much of NASA's success in subcontracting to SDBs to the emphasis placed on the program by the current NASA Administrator. Figure I.2 shows NASA's goals and reported performance.

Figure I.2: NASA's SDB  
 Subcontracting Goals and Reported  
 Performance, Fiscal Years 1990-94



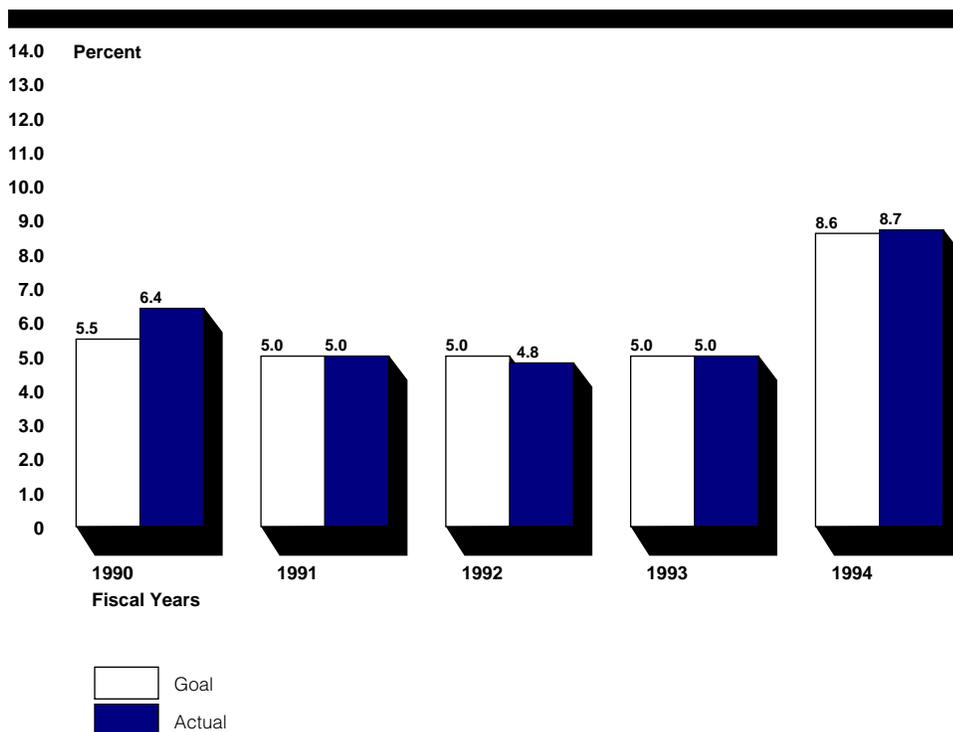
### DOE's Goals and Reported Performance

DOE has generally reported that it met or exceeded its goals for each fiscal year except 1992. Notably, DOE's goals and achievements jumped more than 70 percent for fiscal year 1994. Figure I.3 shows DOE goals and reported performance.

The decline in DOE's subcontracting dollars between fiscal years 1990 and 1991 (see table I.2) was caused by a change in reporting. OFPP ruled that subcontracts awarded by prime contractors that operate and maintain large DOE facilities should be categorized by DOE as prime contracts and not subcontracts. According to DOE officials, these contractors account for a substantial amount of the agencies' contract dollars—76 percent in fiscal year 1994. According to SBA, DOE is the only agency following this procedure.

**Appendix I  
History of the Small Disadvantaged Business  
Subcontracting Program**

**Figure I.3: DOE's SDB Subcontracting Goals and Reported Performance, Fiscal Years 1990-94**

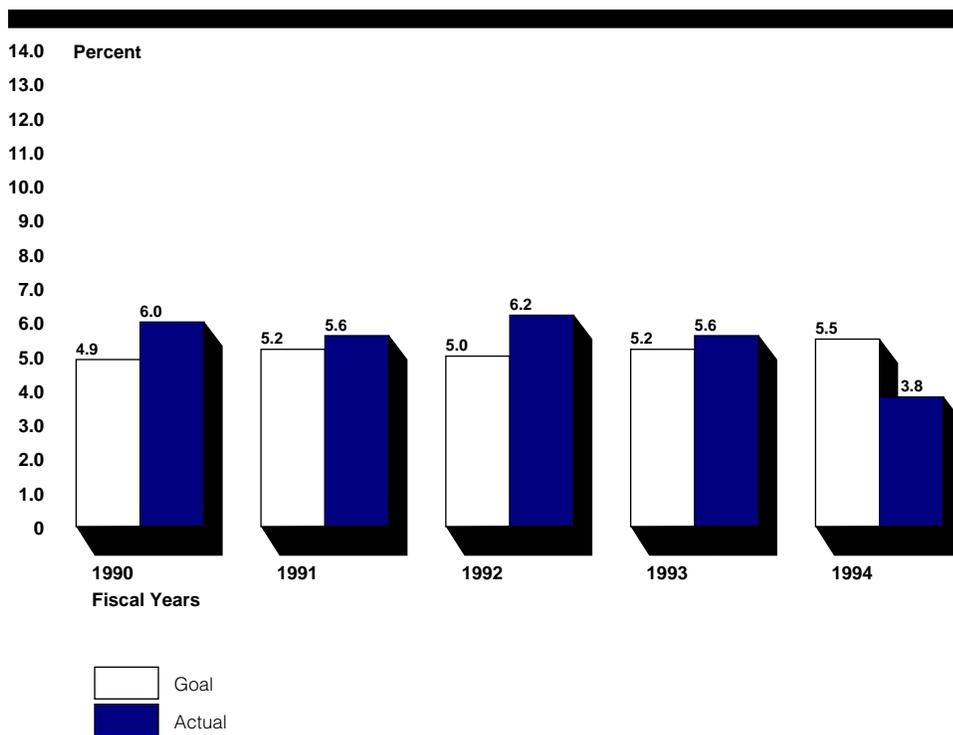


**GSA's Goals and Reported Performance**

For fiscal years 1990 through 1993, GSA reported that it met or exceeded its goals and the governmentwide goal of 5 percent. However, for fiscal year 1994, GSA reported that its SDB subcontracting was 3.8 percent, as compared to a 5.5-percent goal for the year. The GSA subcontracting program manager told us that the agency missed its fiscal year 1994 goal because of delays in construction contracts, which historically have high participation by SDBs, and a high rate of delinquent reports from contractors. She stated that the delays were due to reviews requested by the Congress of planned construction projects. Figure I.4 shows GSA's goals and reported performance.

Appendix I  
History of the Small Disadvantaged Business  
Subcontracting Program

Figure I.4: GSA's SDB Subcontracting  
Goals and Reported Performance,  
Fiscal Years 1990-94



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# Primary Monitoring Methods of DLA and Civilian Agencies

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Each agency we reviewed has established some type of procedures for monitoring contractors' progress in subcontracting to small disadvantaged businesses (SDB). Federal regulations require administrative contracting officers (ACO) to monitor contractors' performance under the subcontracting program. Each agency has assigned small business specialists at or near its major contracting offices to help ACOS carry out monitoring tasks. Agency staff rely primarily on contractors' periodic reports and review of contractor subcontracting programs to carry out the agencies' monitoring responsibilities.

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## Agencies' Program Regulations and Guidance Vary

Federal regulations do not include specific monitoring procedures but instead state that ACOS are responsible for "monitoring, evaluating, and documenting" contractors' performances relating to their subcontracting plans. GSA has provided more specific procedural guidance for its small business specialists in a draft supplement to the regulations, and DLA has issued a manual for small business specialists that includes procedures for monitoring contractors' subcontracting. NASA and DOE have not provided similar consolidated agencywide guidance, but both agencies have provided guidance in documents such as position descriptions, local procedural guidance, and agencies' newsletters. Also, both NASA and DOE have developed automated systems to record and summarize subcontracting data reported by contractors on a contract-by-contract basis.

In addition, regulations require SBA to assist agencies in monitoring the program. An SBA manual on its subcontracting assistance program describes how SBA staff are to support the agencies and requires periodic visits to contractors' facilities to review their subcontracting programs.

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## ACOs and Small Business Specialists Share Monitoring Duties

DLA has delegated virtually all monitoring tasks to small business specialists at its 33 contract administration offices. These offices report to DLA's three district offices, where associate directors for small business provide overall guidance and summarize reported subcontracting activity. At five of the six DLA offices at which we performed detailed work, small business specialists told us they spend most of their time on duties related to the subcontracting program. Staff at the remaining office estimated that they spent about one-third of their time on such duties.

At the DOE, GSA, and NASA offices that we visited, ACOS and their staff have retained most subcontract monitoring functions, and small business

specialists assist with such duties as reviewing proposed subcontracting plans and tracking and summarizing contractors' reports of subcontracting activities. These specialists are located in contracting offices at NASA's 12 centers and at 24 DOE sites. At GSA, these specialists are located at each of the agency's 11 regional business service centers and at each of the three major procurement services at headquarters. Most small business specialists at the offices we visited estimated that they spend 15 or 20 percent of their time on the subcontracting program.

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## Agencies' Staff Rely on Contractors' Reports of Subcontracting Activities

Regulations require that contractors periodically submit information on their subcontracting activities for each contract that has a subcontracting plan. Two one-page forms are used to collect and report information on subcontracting activities—Form 294 and Form 295.

Subcontracting activities on each contract are to be submitted every 6 months on Standard Form 294, which shows such information as contract amount, performance period, subcontracting goals, and actual subcontracting achievements. Some contractors have one hundred or more contracts and are required to submit a separate report for each contract. In some instances, offices have required this reporting more often. The Office of Management and Budget (OMB) has estimated that it takes a contractor about 5.7 hours to complete a Form 294.

Regulations also require contractors to submit summarized information for all of their federal contracts quarterly for DOD contracts and once a year for other agencies' contracts.<sup>1</sup> This information is submitted on Standard Form 295, which shows total subcontracting achievements for all contracts, including amounts subcontracted to small businesses and SDBs. The report also includes summary information on contracts that have subcontracting plans. No matter how many federal contracts a contractor may have, it is required to submit only one 295 report to each agency with which it contracts. OMB has estimated that it takes a contractor about 16.2 hours to complete a Form 295.

Each of the four agencies we reviewed has created an automated system to record and summarize information from the contractors' Form 295 reports. Information in these systems is used by the agencies to report to SBA on the extent to which the agencies are achieving their SDB

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<sup>1</sup>To help monitor the congressionally mandated subcontracting goal of 8 percent for SDBs and women-owned businesses, NASA has required contractors to submit Form 295 reports quarterly since fiscal year 1993. Officials plan to reduce the reporting frequency to semi-annually in fiscal year 1996.

subcontracting goals and the other procurement goals that the agencies negotiated with SBA.

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## Agencies Perform Various Reviews of Contractors' Subcontracting Programs

Agencies perform several types of reviews that assess contractors' subcontracting programs. These include reviews by the agencies and SBA that are directed solely at the subcontracting program and broader reviews that assess contractors' overall purchasing systems.

DLA's procedures require small business specialists to annually review each contractor's subcontracting program. Of the 60 contracts we reviewed at DLA, small business specialists had reviewed 33 contractors in both fiscal years 1993 and 1994 and another 23 contractors in 1 of the 2 fiscal years. These reviews sometimes last a day or less, but specialists told us they can take up to 4 days for the largest contractors. DLA's review guidance includes a series of questions that are related largely to compliance issues, such as whether the business has a written policy to support the program, trains its buyers on contracting with SDBS, and maintains evidence that it has made efforts to reach out to SDBS. GSA's Office of Small and Disadvantaged Business Utilization established a program in 1993 for the agency's small business specialists to conduct such reviews. Although the program has not been fully implemented by all GSA offices, specialists at GSA in fiscal year 1993 or 1994 reviewed 4 of the 15 contractors included in our review.

Although NASA and DOE have no review programs and generally do not perform such reviews, several staff pointed out to us that the Contractors' Purchasing Systems Reviews (CPSR) include a section on subcontracting plan activities. Federal regulations require that CPSRs be conducted every 3 years at businesses with annual government sales of \$10 million or more. More limited interim reviews may be performed. The guidance that we observed for these reviews is significantly less detailed than that for the DLA reviews.

DLA staff have performed many of these reviews, both for military contracts and for contracts awarded by other agencies, including NASA. Several DLA staff informed us that CPSRs do not sufficiently assess a contractor's subcontracting program. They said that reports by DLA often reiterate results of the small business specialists' compliance reviews and summarize data from contractors' Form 295 reports.

In addition to the agencies' reviews, SBA performs periodic compliance reviews of contractors' subcontracting programs. According to SBA officials, SBA conducted more than 300 of these reviews in fiscal year 1994. Unlike reviews by other agencies, SBA assesses activity under all of a contractor's federal subcontracting plans, rather than just those related to one agency. SBA's guidance is more detailed and requires more in-depth and documented work than DLA's.

According to SBA officials, because SBA has only 17 full-time staff to do these reviews, SBA has been able to review primarily only the largest contractors. In addition, the frequency of the reviews can vary significantly from one SBA region to another; contractors in one SBA district we visited are reviewed only every 3 or 4 years. Some contractors have never been reviewed. During fiscal years 1993 and 1994, SBA conducted reviews of contractors for 27 of the 105 contracts that we reviewed.

NASA and DOE staff also pointed out that performance evaluations may assess contractors' subcontracting programs for award fee contracts. Despite these various types of reviews, agencies did not review contractors' subcontracting programs during fiscal years 1993 and 1994 for 21 of the 105 contracts that we reviewed.

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## **Small Business Specialists Perform Related Tasks That May Increase SDB Subcontracting**

At all of the offices we visited, small business specialists said that they are involved in many other activities that may increase SDB subcontracting. These activities are performed under the guidance of each agency's Office of Small and Disadvantaged Business Utilization (OSDBU). They included

- counseling small business owners seeking federal contracts or subcontracts,
- assisting large businesses attempting to find small business subcontractors,
- participating in conferences and trade shows,
- training contractors' small business staff and agencies' contracting officers,
- reviewing contract solicitations to ensure that agencies are providing opportunities to small businesses,
- developing offices' small business goals, and
- determining nonmonetary awards to agency or contractor staff that have performed exceptionally well in assisting small businesses to obtain federal contracts or subcontracts.

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**Appendix II  
Primary Monitoring Methods of DLA and  
Civilian Agencies**

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Certain of these activities assist the agencies in monitoring subcontracting and helping to provide the maximum amount of subcontracting to SDBs. GSA officials specifically cited recent enhancements in these activities directed at SDB subcontracting. These changes include (1) intensified outreach for major construction and telecommunication projects and (2) a computerized training program for contracting staff and small business specialists. GSA sponsors conferences prior to awarding contracts for major projects, allowing SDBs to meet with agency staff and large contractors.

In addition, NASA's Associate Administrator, OSDBU, told us that his office has frequent contacts with the larger SDBs and that such contacts would undoubtedly disclose any problems that the SDBs may have with subcontracts on NASA contracts. Several other small business and procurement staff we spoke with expressed similar opinions.

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# Shortcomings of the Current Monitoring Processes

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We observed some shortcomings with the monitoring process. Agencies often do not closely review and act on Form 294 reports upon receipt, and subcontracting data reported by contractors are not verified by the agencies.

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## Agencies Do Not Always Closely Monitor Form 294 Reports

In our review of 105 contracts, we noted that agencies did not always closely monitor the Form 294 reports that are submitted by contractors. For the 105 contracts, a total of 378 Form 294 reports were due from the contractors during fiscal years 1993 and 1994.

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## Reports Were Missing From Files

In some cases, reports were missing from the agencies' files—they either had been lost or were never received. Of the 378 Form 294 reports that were due, 52—about 14 percent—were not in either the administrative contracting officers' or small business specialists' files. We rarely found any indication that staff had followed up to obtain missing reports. Staff at one DLA office we visited had recently reviewed a contractor with over 500 active subcontracting plans as of September 1994 and reported that DLA had not received 68 of the Form 294 reports due in 1994.

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## Reviews Lacked Documentation

While many staff said they reviewed reports, most reports we reviewed had no indication that anyone had reviewed them. Of the 326 Form 294 reports received by agencies for the 105 contracts we reviewed, 269, or about 83 percent, had no documentation of a review. For those that had evidence of documentation, some offices had created a form to assist in reviewing the reports; staff at other offices had documented their review on the report itself. Small business specialists at some DLA offices informed us that they have too many subcontracting plans to review all reports. One office we visited had about 725 subcontracting plans, but only one specialist was assigned to monitor the plans at the time of our visit. Staff at several DLA offices said that they check reports when they conduct annual compliance reviews, but we rarely found documented evidence to support this.

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## Reports Often Include Errors With No Documented Follow-Up

Many reports we reviewed included obvious errors with no documented follow-up. In reviewing the 326 Form 294 reports received, we noted that about one-third had errors that suggested a lack of attention to the reports by both the contractor and agency staffs. For example, we found reports

that omitted contract amounts or performance periods, included cumulative amounts that did not agree with prior reports, and reported obviously incorrect dollars or percentages. Some errors were more significant. For example, after reporting a cumulative total of \$20.85 million in subcontracting for a contract as of March 1993, one contractor reported that subcontracting had increased to \$266.8 million 6 months later. In September 1994, the contractor reduced the figure to \$20.76 million. The reports did not explain the differences, and agency staff noted only that they were aware of discrepancies in the contractor's reports. Moreover, SDB goals on about one-third of the reports we reviewed did not agree with the subcontracting plans in the agencies' files.

While we did not review Form 295 reports, a DLA district associate director for small business told us that about half of the Form 295 reports received include erroneous or missing information that must be corrected before her staff can record data in DOD's automated database.

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### **Agencies Accepted Obsolete Forms or Incomplete Substitutes**

In a few cases, we found that agencies accepted obsolete forms or substitute reports with incomplete information. For 20 of the 326 reports we reviewed—about 6 percent—agency staff had allowed some contractors to use old versions of the Form 294 and computer reports that did not include all of the information required on the current Form 294. For example, some computer reports showed only cumulative subcontracting activity, without separate data on activities that had occurred during the reporting period.

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### **SDB Subcontracting Data Reported by Contractors Generally Are Not Verified**

While agency staff pointed out various types of reviews that assess contractors' efforts in the subcontracting program, these reviews do not emphasize verification of reported data. Instead, guidance directs reviewers to assess contractors' overall subcontracting programs, concentrating on administrative and compliance issues. For example, guidance directs reviewers to determine if the contractor has established necessary procedures, provided training to its employees, maintained necessary records, and used appropriate methods of making the most of subcontracting opportunities for SDBs.

The reports and written support for reviews that we analyzed included little documentation that agency staff had verified data. Rather, reports commonly noted how the contractor obtained its data or stated that a sample of purchase orders was reviewed. We found little information on

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**Appendix III**  
**Shortcomings of the Current Monitoring**  
**Processes**

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such samples, and where we did, they were usually used to determine whether contractors' files included evidence that SDBs had been solicited for subcontracts and certifications required to confirm the status of subcontractors identified as small businesses and SDBs.

Although agencies do not routinely verify reported data, we did not visit contractors to determine whether the data are accurate and have no basis to assess their accuracy. DLA staff in Twin Cities, Minnesota, verified data in 1995 for an \$801,000 incentive fee<sup>1</sup> claimed by a contractor and found no significant errors. The staff said that the amount of the fee was unusually high. They believed that because this was a multiyear contract, the contracting officer should have periodically adjusted the fee to take into consideration the contractor's subcontracting accomplishments on the contract. On the other hand, a December 1994 audit report by the DOE Office of Inspector General found that data reported by three of five large contractors were either incorrect or unsupported and that one contractor underreported SDB contracting by about \$23 million.<sup>2</sup> DLA's Western District is currently planning to test verification at eight large contractors, but several staff we spoke with are concerned about the resources that such an effort may require.

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<sup>1</sup>Contracts sometimes include provisions to pay incentive fees to contractors who exceed their small business or SDB subcontracting goals.

<sup>2</sup>Audit of Administration of the Department of Energy's Small Disadvantaged Business Program (DOE/IG-0364, Dec. 1994).

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# Agencies' Program Staffs' Perceptions Differ on Efficacy of Liquidated Damages to Enforce Compliance

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The Small Business Act authorizes the assessment of liquidated damages as the primary means for the government to act against contractors that do not make appropriate efforts to subcontract to SDBs. No staff we spoke to were able to identify any instance in which liquidated damages had been assessed against a contractor. Most, however, believed that the law is at least somewhat effective.

Federal Acquisition Regulations require contractors to make good faith efforts to provide maximum practicable subcontracting opportunities for small businesses and SDBs. The regulations state that the failure to make a good faith effort means a willful or intentional (1) failure to perform in accordance with the subcontracting plan or (2) action to frustrate the plan. The regulations also state that the indications of failure to make a good faith effort include not assigning an official to administer the program, not identifying or contacting small businesses or SDBs, not maintaining records to support compliance with the program, or adopting policies or procedures that prevent the program from succeeding. A failure to achieve goals does not in itself constitute a failure to make a good faith effort because various factors may prevent a contractor from reaching a goal. In commenting on our draft report, the Manager, SBA's Subcontracting Assistance Program, stated that agencies other than DLA, NASA, DOE, and GSA have assessed liquidated damages.

Although agency staff were unable to identify any instance in which their agency has assessed liquidated damages, staff at most of the offices we visited viewed the law as at least somewhat effective in increasing SDB subcontracting. Some believe that the threat of liquidated damages is enough to secure compliance because the consequences to prime contractors of being assessed damages, such as delays in being awarded future contracts, are so severe. As a result, they said, contractors generally demonstrate enough of a good faith effort to protect themselves from such agency actions.

Some staff disagreed that the law is effective. They believe the definition of good faith effort is vague and "lacks teeth," and several questioned whether assessment of liquidated damages would be upheld in court. They believed that the government would have to prove that the contractor had willfully and intentionally excluded SDBs from subcontracting opportunities and that to avoid the assessment of damages, the contractor would only have to show evidence that it had contacted such firms or awarded even a small contract to an SDB. Some also said that contractors know the government will not use the law and that some contractors are

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**Appendix IV  
Agencies' Program Staffs' Perceptions Differ  
on Efficacy of Liquidated Damages to  
Enforce Compliance**

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unaware of the law. In explaining the difficulty in using liquidated damages, a small business specialist at DLA cited a list of actions that he feels are necessary to lead up to assessing damages: an unsatisfactory mark on a compliance review, disapproval of the contractor's purchasing system, direct contact with the contractor by the contracting office's commander, and placement on DOD's contractor alert list.

GSA small business specialists believed that the term "liquidated damages" brings the law into question, because the term usually indicates there has been damage to the federal government. It is doubtful, they said, that insufficient efforts to subcontract to SDBs would damage the government.

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# Objectives, Scope, and Methodology

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As requested, our work focused on efforts of the Defense Logistics Agency, the Department of Energy, the General Services Administration, and the National Aeronautics and Space Administration to monitor the progress made by the agencies' contractors in providing maximum subcontracting opportunities for SDBs and achieving the SDB program's goals in subcontracting plans. Specifically, we determined (1) how these agencies monitor contractors' progress in subcontracting to small disadvantaged businesses, (2) whether agencies have assessed monetary damages, known as liquidated damages, against contractors who did not make a good faith effort to subcontract to SDBs, and (3) what initiatives are being considered to change the monitoring process. We conducted our review from January through August 1995 in accordance with generally accepted auditing standards.

In performing our work, we interviewed procurement and other officials at headquarters and field office locations for each of the four agencies. We discussed how the agencies have implemented their monitoring processes, the staff involved in the monitoring processes, and the specific monitoring tasks the staff perform. We also discussed the agencies' use of liquidated damages against contractors that failed to achieve their goals, the deterrent effects of this assessment, and the agencies' use of other penalties or incentives to encourage subcontracting with SDBs. Finally, we discussed what initiatives the individual agencies or the federal government has under way or planned to change monitoring processes. We also reviewed guidance issued by the agencies on subcontract monitoring and documents describing proposed or planned changes to the monitoring processes, including a change to the Federal Acquisition Regulations that would, among other things, reduce the information required on subcontracting reports submitted by contractors.

To determine how the agencies actually carried out monitoring tasks, whether the monitoring processes help to ensure that contractors comply with their plans and accurately report subcontracting result, and whether the agencies had assessed liquidated damages, we reviewed agencies' files for 105 contracts at the following 15 field office locations.

- DLA: Atlanta, Georgia; Boston, Massachusetts; Dallas, Texas; Philadelphia, Pennsylvania; St. Louis, Missouri;<sup>1</sup> and Van Nays, California.
- NASA: Greenbelt, Maryland; Huntsville, Alabama; and Houston, Texas.

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<sup>1</sup>Because of the high concentration of contracts with one contractor at the St. Louis office, we reviewed only 7 contracts at this location. We completed our sample of 105 contracts by reviewing 3 contracts at the DLA office in Baltimore, Maryland.

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- DOE: Albuquerque, New Mexico; Chicago, Illinois; and Oak Ridge, Tennessee.
  - GSA: Chicago, Illinois; District of Columbia; San Francisco, California.

The contracts, representing 99 contractors, were selected on a judgmental basis from contracts with active subcontracting plans as of September 1994.

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