

**Congress of the United States**  
**U.S. House of Representatives**  
**Committee on Small Business**  
2361 Rayburn House Office Building  
Washington, DC 20515-6315

To: Members, Subcommittee on Contracting and the Workforce, Committee on Small Business

From: Committee Staff

Date: September 29, 2011

Re: Hearing: "Subpar Subcontracting: Challenges for Small Business Contractors"

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The Subcommittee on Contracting and the Workforce of the Committee on Small Business will meet at 10:00 a.m. on Thursday, October 6, 2011 in Room 2360 of the Rayburn House Office Building for the purposes of receiving testimony on subcontracting programs related to small business. Witnesses will include Joseph G. Jordan, Associate Administrator of Government Contracting and Business Development, Small Business Administration; Mary L. Kendall, Acting Inspector General, Department of the Interior; Jennifer Bisceglie, President, Interos, on behalf of Women Impacting Public Policy; M.L. Mackey, CEO, Beacon Interactive Systems, on behalf of the National Defense Industrial Association; and a representative from the Associated General Contractors.

Of the \$536 billion in federal prime contracts awarded in FY 2010, at least \$210 billion ultimately went to subcontractors. The hearing will address three specific subcontracting issues. First, the hearing will examine compliance and enforcement problems with the limitation on subcontracting restrictions, commonly known as pass-through contracting. Second, the hearing will examine compliance issues with small business subcontracting plans. Finally, the hearing will examine the systems used by the federal government to monitor subcontracting.

I. Pass-Through Contracts

A. Current Requirements

When a small business receives a set aside or sole source contract under the auspices of the Small Business Act contracting programs, the government has a vested interest in ensuring that the small business performs a significant portion of the work. Otherwise, the small business

could pass through the work to a large contractor. Consequently, Sections 3(p)(A)(i)(III), 8(a)(14) and 15(o) of the Small Business Act each impose restrictions on the amount of work a business may subcontract on a set-aside contract. When the set-aside is a small business contract, the Act provides:

- (1) A concern may not be awarded a contract under subsection (a) as a small business concern unless the concern agrees that—
  - (A) in the case of a contract for services (except construction), at least 50 percent of the cost of contract performance incurred for personnel shall be expended for employees of the concern; and
  - (B) in the case of a contract for procurement of supplies (other than procurement from a regular dealer in such supplies), the concern will perform work for at least 50 percent of the cost of manufacturing the supplies (not including the cost of materials).
- (2) The Administrator may change the percentage under subparagraph (A) or (B) of paragraph (1) if the Administrator determines that such change is necessary to reflect conventional industry practices among business concerns that are below the numerical size standard for businesses in that industry category.
- (3) The Administration shall establish, through public rulemaking, requirements similar to those specified in paragraph (1) to be applicable to contracts for general and specialty construction and to contracts for any other industry category not otherwise subject to the requirements of such paragraph. The percentage applicable to any such requirement shall be determined in accordance with paragraph (2).<sup>1</sup>

Section 15(o)(1)-(3).

Similar provisions apply to the 8(a), HUBZone, women-owned, and service disabled veteran-owned small business (SDVOSB) contracting programs. The only noteworthy difference is that when a firm receiving a HUBZone or SDVOSB and set-aside calculates its performance percentage, it is allowed to treat subcontracts to firms in the same programs as if they were performed by the prime contractor.<sup>2</sup>

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<sup>1</sup> Pursuant to Section 15(o)(3), The Administration has promulgated regulations addressing the limitation on subcontracting in construction, in which case the prime is required to perform at least 15 percent of the cost of the contract with its own employees (not including the costs of materials), and specialty construction, which requires the prime perform 25 percent of the cost of the contract with its own employees (not including the costs of materials). 13 C.F.R. § 125.6.

<sup>2</sup> 13 C.F.R. § 126.700; 13 C.F.R. § 125.15.

## B. Compliance Issues

For small businesses making a good faith effort to comply with the restrictions on pass-through contracting, there are two major challenges: problems with the cost-based accounting required by the Small Business Act, and classification of the contracts themselves.

First, there are the inherent challenges with cost-based accounting. Take, for example, the case of a service contract. Pursuant to Section 15(o)(1)(A) of the Small Business Act, at least 50 percent of the cost of contract performance incurred for personnel must be spent on employees of the prime contractor. However, that requires that the prime contractor have a cost-based accounting system, something that few small businesses and almost no commercial companies use. The Federal Acquisition Regulation (FAR) specifically exempts most small businesses from employing cost accounting systems, because they are considered a barrier to entry for small firms.<sup>3</sup> Even if a prime contractor has a cost accounting system, the firm must have access to each subcontractor's personnel costs if the firm is to correctly calculate 50 percent of the cost of contract performance incurred for personnel.

Unfortunately, even for cost accounting standards compliant contracts, the subcontractor is not required to give its cost information to the prime contractor, because the information is considered too sensitive. Instead, subcontractors are permitted to provide cost and pricing data in a sealed envelope that is passed to the contracting officer. However, this data pass-through will not work when examining limitation on subcontracting, as the prime contractor needs access to the cost data to track its own compliance. The small firm that wants to comply is therefore left making guesses and estimates regarding its subcontractors' costs.

The second challenge faced by small businesses is that the current statutory scheme assumes that contracts are either for goods or services. While this is sometimes the case, an increasing number of small businesses are receiving contracts as value added resellers, or for contracts that encompass the provision of goods and services. Neither the Small Business Act nor the implementing regulations give small firms guidance on how to comply in these scenarios.

## C. Issues with Fraud

Not all firms are making a good faith effort to comply with these requirements. Last year, a Washington Post exposé drew attention to some of these cases. In one instance, it was revealed that the large subcontractor, a firm called GTSI, would "lead the work and receive 99.5 percent of the revenue, even though it was a subcontractor and MultimaxArray was the 'prime.'"<sup>4</sup> In another, a large firm negotiated to receive 75 percent of the profits on over \$166 million in set-aside task orders under a Department of Homeland Security indefinite, delivery indefinite quantity (ID/IQ) contract, and SBA later found that the small business prime contractor "had

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<sup>3</sup> 48 C.F.R. § 30.0.

<sup>4</sup> Robert O'Harrow, *In Deals between Alaska Corporation and D.C. Area Contractor, a Disconnect*, WASHINGTON POST, October 1, 2010, available at <http://www.washingtonpost.com/wp-dyn/content/article/2010/09/30/AR2010093007348.html?sid=ST2010092907225>.

little to no involvement in the performance of contracts.”<sup>5</sup> Likewise, US2, a small business with only \$73,000 in revenue and run from the owner’s living room, was awarded an Army sole source contract for \$250 million.<sup>6</sup>

The appropriate agency officials have tried to respond to these cases. The Department of Interior (DOI) Office of the Inspector General (OIG) found that “US2 has been non-compliant with 8(a) subcontracting limitations for more than 2 1/2 years” but that the contracting officer “did not take effective actions to either correct the problem or terminate the contract for non-compliance.”<sup>7</sup> In the fall of 2010, SBA responded by suspending three companies from federal contracting due to violations of the limitation on subcontracting provisions.

The majority of cases where abuses of the limitation on subcontracting restrictions are discovered involved prime contractors owned by Alaska Native Corporations (ANCs) and participating in SBA’s 8(a) program. Unlike traditional 8(a) participants, whose sole source contracts are limited to \$6.5 million for manufacturing contracts and \$4 million for all other acquisitions,<sup>8</sup> ANC-owned participants have no cap on the value of a sole source award.<sup>9</sup> As these awards are larger, they are also likely to receive more scrutiny – OIGs simply do not have the resources to audit each \$2 million contract. Likewise, if contracts are sole source, as opposed to a competitive small business set-aside contract, they consequently attract more attention. However, this should not suggest that smaller sole source or larger competitive set-aside contracts are not also used to hide large business pass-throughs.

Rather, the issue is that tracking compliance with the limitation on subcontracting provisions is complicated, time consuming, and bears little advantage for the typical contracting officer (KO). If a KO wanted to track compliance, the KO would need cost data from the prime contractor and each of the subcontractors. The contracting officer would then need to calculate the applicable percentages, and repeat this process at each option, or in the case of an ID/IQ contract, every six months.<sup>10</sup> However, even if the KO determines a violation of the limitation on subcontracting

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<sup>5</sup> Letter from Michael Chodos, Suspension and Debarment Official, SBA, to Scott W. Friedlander, President and Chief Executive, GTSI Corporation (October 10, 2011) available at <http://www.govexec.com/pdfs/100510rb1b.pdf>.

<sup>6</sup> Robert O’Harrow, *Audit: Army, Interior Broke Law by Awarding Contract to Alaska Native Corporation*, WASHINGTON POST, August 17, 2011.

<sup>7</sup> DOI OIG, ACQUISITION SERVICES DIRECTORATE—SIERRA VISTA, 5 (2011) (ER-IS-NBC-0003-2011) [hereinafter ACQUISITION SERVICES]. DOI contracted with US2 on behalf of the Army.

<sup>8</sup> 48 C.F.R. § 19.805-1(a)(2).

<sup>9</sup> 13 C.F.R. § 124.506.

<sup>10</sup> 13 C.F.R. § 124.510(c). Because application of this provision is so complicated, SBA provides the following examples:

Two task orders are issued under an [ID/IQ] service contract during the first six months of the contract. If \$100,000 in personnel costs are incurred on the first task order, 90% of those costs (\$90,000) are incurred for performance by the [Prime]’s own work force, and the second task order also requires \$100,000 in personnel costs, the [Prime] would have to perform only 10 percent of the personnel costs on the second task order because it would still have performed 50 [percent] of the total personnel costs at the end of the six-month period (\$100,000 out of \$200,000). . . .

Where there is a guaranteed minimum condition in an [ID/IQ] award, the required performance of work percentage need not be met on task (cont’d)

clause present in each set-aside or 8(a) sole source contract,<sup>11</sup> the KO would need to prove that the pass through of work harmed the government before most agencies take action against the companies. However, since the KO would have already determined that the government was paying a fair and reasonable price before awarding the contract, it would be nearly impossible to prove a financial harm to the government.

## II. Compliance with Subcontracting Plans

The Executive branch has a nonstatutory goal of awarding 35.9 percent of all dollars subcontracted from federal prime contracts to small businesses.<sup>12</sup> It also has statutory goals of awarding 5 percent of subcontracted dollars to WOSB and SDB firms, and 3 percent to SDVOSB and HUBZone firms. To achieve these goals, a contract awarded to an other-than-small business for more than \$650,000 must include a subcontracting plan enumerating the opportunities for small businesses to participate as subcontractors and the plan must assign both percentage and dollar value goals to these opportunities.<sup>13</sup> The failure of an other-than-small business to make a good faith effort to comply with the subcontracting plan is supposed to result in the government collecting liquidated damages from the contractor.<sup>14</sup>

The SBA Procurement Center Representative (PCR),<sup>15</sup> when available, provides an opinion to the contracting officer on the appropriate subcontracting goals, and then the Commercial Market

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orders issued during the first six months of the contract. In such a case, however, the percentage of work that a [Prime] may further contract to other concerns during the first six months of the contract may not exceed 50 percent of the total guaranteed minimum dollar value to be provided by the contract. Once the guaranteed minimum amount is met, the general rule for indefinite quantity contracts set forth in paragraph (c)(1) of this section applies. . . .

Where a contract guarantees a minimum of \$100,000 in professional services and the first task order is for \$60,000 in such services, the [Prime] may perform as little as \$10,000 of the personnel costs for that order. In such a case, however, the [Prime] must perform all of the next task order(s) up to \$40,000 to ensure that it performs 50 [percent] of the \$100,000 guaranteed minimum (\$10,000 + \$40,000 = \$50,000 or 50 [percent] of the \$100,000).

<sup>11</sup> See, e.g., 48 C.F.R. § 52.217-1.

<sup>12</sup> SBA, GOVERNMENTWIDE 2010 SMALL BUSINESS PROCUREMENT SCORECARD (2011). Interestingly, in 2003, the goal was 40 percent, and in 1978, this Committee amended the Small Business Act to address the fact that small businesses were receiving only 37.5 percent of subcontract dollars – 1.6 percent more than the current goal. SBA, GOALING GUIDELINES FOR THE SMALL BUSINESS PREFERENCE PROGRAMS FOR PRIME AND SUBCONTRACT FEDERAL PROCUREMENT GOALS AND ACHIEVEMENTS, 6 (2003).

<sup>13</sup> 15 U.S.C. § 637(d). H.R. REP. NO. 95-949, at 5 (1978) [hereinafter, 1978 Report].

<sup>14</sup> *Id.* at (5). The damages are calculated as the actual dollar amount by which the contractor failed to achieve each subcontracting goal. 48 C.F.R. § 19.705-7.

<sup>15</sup> According to the SBA, PCRs “increase the small business share of Federal procurement awards by initiating small business set-asides, reserving procurements for competition among small business firms; providing small business sources to Federal buying activities; and counseling small firms. In addition, PCRs, advocate for the breakout of items for full and open competition to affect savings to the Federal Government.” SBA, GOVERNMENT CONTRACTING FIELD STAFF DIRECTORY (2011) [hereinafter FIELD STAFF DIRECTORY] *available at* <http://www.sba.gov/content/government-contracting-field-staff-directory>.

Representative (CMR)<sup>16</sup> and KO assume responsibility for post award compliance. Agencies and prime contractors are required to report on subcontract performance, and compliance with the subcontracting goal is reflected in past performance reports on prime contractors.<sup>17</sup> However, given the sheer number of other-than-small prime contractors and the fact that there are fewer than 35 full and part time CMRs,<sup>18</sup> it is not surprising that in FY 2006, the SBA OIG found that CMRs monitored less than half of the 2,200 largest prime contractors.<sup>19</sup> Consequently, KOs are the primary official responsible for ensuring compliance with subcontracting plans.

Specifically, the KO is responsible for “assisting in evaluating subcontracting plans, and for monitoring, evaluating, and documenting contractor performance under the clause prescribed in [48 C.F.R. §] 19.708(b) and any subcontracting plan included in the contract.”<sup>20</sup> This includes providing:

- (e) Immediate notice if, during performance, the contractor is failing to meet its commitments under the clause prescribed in [48 C.F.R §] 19.708(b) or the subcontracting plan;
- (f) Immediate notice and rationale if, during performance, the contractor is failing to comply in good faith with the subcontracting plan; and
- (g) Immediate notice that performance under a contract is complete, that the goals were or were not met, and, if not met, whether there is any indication of a lack of a good faith effort to comply with the subcontracting plan.

*Id.*

To be put on the notice contemplated by this provision, the KO is supposed to monitor the contractor’s subcontracting activities. Firms with subcontracting plans are required to submit semiannual individual contract reports, a report within 30 days of contract completion, and summary subcontracting reports annually, except that the Department of Defense (DoD) and the National Aeronautics and Space Administration (NASA) require summary reports semiannually. These reports used to be submitted on SF 294 and SF 295, but have since been replaced by the Electronic Subcontracting Reporting System (ESRS).

Since the liquidated damages penalty is triggered by failure to make a good faith effort to comply with a subcontracting plan rather than failure to achieve the goals in the plan, the important issue becomes how the SBA defines good faith efforts. A prime contractor can demonstrate that it has made a good faith effort in one of three ways: (1) by meeting its goals; (2) by overachieving in some

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<sup>16</sup> CMRs also assist small businesses seeking subcontracts through counseling and matchmaking. FIELD STAFF DIRECTORY.

<sup>17</sup> 48 C.F.R. § 19.704.

<sup>18</sup> The average CMR is responsible for 90 to 200 prime contractors. GAO, IMPROVEMENTS NEEDED TO HELP ENSURE RELIABILITY OF SBA’S PERFORMANCE DATA ON PROCUREMENT CENTER REPRESENTATIVES 2 (2011).

<sup>19</sup> SBA OIG, OFFICE OF THE INSPECTOR GENERAL, REVIEW OF SBA’S SUBCONTRACTING ASSISTANCE PROGRAM, 2007 (No. 7-33).

<sup>20</sup> 48 C.F.R. § 19.706.

categories to make up for an underachievement in other categories; or (3) by performing one of a laundry list of actions.<sup>21</sup> These other actions include:

- (i) Breaking out contract work items into economically feasible units, as appropriate, to facilitate small business participation;
- (ii) Conducting market research to identify small business subcontractors and suppliers through all reasonable means, such as performing on-line searches on the Central Contractor Registration (NCR), posting Notices of Sources Sought and/or Requests for Proposal on SBA's SUB-Net, participating in Business Matchmaking events, and attending pre-bid conferences;
- (iii) Soliciting small business concerns as early in the acquisition process as practicable to allow them sufficient time to submit a timely offer for the subcontract;
- (iv) Providing interested small businesses with adequate and timely information about the plans, specifications, and requirements for performance of the prime contract to assist them in submitting a timely offer for the subcontract;
- (v) Negotiating in good faith with interested small businesses;
- (vi) Directing small businesses that need additional assistance to SBA;
- (vii) Assisting interested small businesses in obtaining bonding, lines of credit, required insurance, necessary equipment, supplies, materials, or services;
- (viii) Utilizing the available services of small business associations; local, state, and Federal small business assistance offices; and other organizations;
- (ix) Participating in a formal mentor-protégé program with one or more small-business protégés that results in developmental assistance to the protégés.

*Id. at (b)(3).*

This list is so broad that it makes it almost impossible for a KO to issue a notice that a large prime contractor has failed to make a good faith effort to comply with its subcontracting plan. However, if such notice is issued, the KO is then responsible for “[i]nitiating action to assess liquidated damages.”<sup>22</sup>

The threat of liquidated damages is empty for many prime contractors. In nearly 30 years, there is no record of any company paying these damages, essentially neutering any deterrent the liquidated damages provision was intended to provide. Some agencies have made an effort to incentivize

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<sup>21</sup> 13 C.F.R. § 125.3(d).

<sup>22</sup> 48 C.F.R. § 19.705-6(f).

compliance. For example, some multiple award contracts use subcontracting performance on prior task orders as an evaluation factor for awarding additional task orders.<sup>23</sup> However, GAO has repeatedly found that even on the most high profile contracts, agencies fail to ensure that the ESRS reports are even filed.<sup>24</sup> Indeed, the Committee has received reports of prime contractors sponsoring agency small business conferences in order to ensure a finding of good faith – writing a check to agencies rather than writing subcontracts to small businesses.<sup>25</sup> Thus, small businesses continue to struggle to receive subcontracting opportunities.

### III. Subcontracting Systems

The federal government has two systems to track subcontracting, and one to advertise subcontracting opportunities. As previously discussed, the first, ESRS, tracks other-than-small businesses' subcontracting achievements. When a KO makes a prime contract award, the data is reported to the Federal Procurement Data System (FPDS), and if a subcontracting plan is required it populates the correct file in ESRS. While ESRS makes the calculation of the government-wide subcontracting achievements easier, the system does not readily lend itself to compliance. ESRS does not integrate into any of the other databases or systems routinely used by the KO. If a firm fails to file a report, or if its reports do not conform to the subcontracting plan, ESRS does not notify the KO, the SBA, or the agency's Office of Small and Disadvantaged Business Utilization (OSDBU) of the problem. Instead, the system remains a passive receptacle of data that once a year calculates the Administration's subcontracting achievements.

The second system is the Federal Subcontracting Reporting System (FSRS), which was created by the Federal Funding Accountability and Transparency Act (FFATA).<sup>26</sup> FFATA required that all prime contractors and prime grant award recipients report any subcontract or subgrant executed. This information is then published at [www.USASpending.gov](http://www.USASpending.gov).<sup>27</sup> However, even though FSRS collects subcontracting data, no effort is made to reconcile its data with that in ESRS, or to use that data to track compliance with limitation on subcontracting provisions. FSRS does not notify the KO, the SBA, or the agency's OSDBU if a business fails to file reports, or if the reports indicate a problem. Instead, the system remains a passive receptacle of data.

The final system is the SBA Subcontracting Network (SUB-Net). The Small Business Act requires that prime contractors publish any subcontracting opportunities over \$10,000 through a publication known as Commerce Business Daily (CBD).<sup>28</sup> At the time this provision was added, CBD also reported all prime contract opportunities. On January 1, 2002, CBD was replaced by Federal Business Opportunities (FBO) a website that provides all prime contract opportunities

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<sup>23</sup> See, e.g., General Services Administration's (GSA) National Broker Contract II.

<sup>24</sup> See, e.g., GAO, FEDERAL CONTRACTING IN THE AFTERMATH OF HURRICANES KATRINA AND RITA, (2011) (GAO-11-942T) (23 percent of contractors failed to file subcontracting reports); GAO, DOD NEEDS MEASURES FOR SMALL BUSINESS SUBCONTRACTING PROGRAM AND BETTER DATA ON FOREIGN SUBCONTRACTS (2004) (GAO-04-381) (data concerns with DOD subcontracting plans) GAO, AGENCY CONTRACTING DATA SHOULD BE MORE COMPLETE REGARDING SUBCONTRACTING OPPORTUNITIES FOR SMALL BUSINESSES (2007) (GAO-07-698T).

<sup>25</sup> Conversations with Committee staff.

<sup>26</sup> Pub. L. No. 109-282, 120 Stat. § 1186 (2006).

<sup>27</sup> This information appears to be incomplete. For example, a non-ANC 8(a) firm that received over \$120 million in prime contracts in FY 2010 does not list any subcontracts.

<sup>28</sup> 15 U.S.C. § 637(d)(8)(k).

over \$25,000 at [www.fbo.gov](http://www.fbo.gov). SBA introduced Sub-Net, which was intended to replace the subcontracting function. Unfortunately, Sub-Net has never been fully adopted. For example, on September 28, 2011, Sub-Net contained fewer than 150 small business subcontracting opportunities. In contrast, on the same day, FBO documented over 39,700 active prime contract opportunities. The FAR does not even mention SUB-Net, so it remains unclear how prime contractors would be required to use the system. The system does not communicate with FPDS, FSRS or ESRS.

#### IV. Issues Before the Subcommittee

##### A. Limitation on Subcontracting / Pass-Through Contract Issues

As previously discussed, limitation on subcontracting provisions exist to prevent a company that received a sole source or set-aside contract from then passing through the work to a company that would not have otherwise qualified for the sole source or set-aside contract. There are five issues the Subcommittee wishes to address in this area.

First, the Subcommittee questions whether FSRS could provide the government with a comprehensive tool to monitor compliance with these rules. As FSRS is already required for all businesses, it would not impose any additional reporting requirements for large or small businesses. With the data it collects, FSRS could calculate the percentage of dollars subcontracted. While it would not have the ability to account for actual costs versus price, this would at least provide KOs, SBA and OSDBUs with a warning if the reported information indicated that there could be a problem.

Second, when applying the limitation on subcontracting rules, the Subcommittee questions why some programs, such as the SVOSB program, allows work subcontracted to a similarly situated firm to count towards the prime contractor performance requirements, but other programs, such as the 8(a), WOSB and small business contracting programs, require the opposite accounting scheme. If the intent of these provisions is to ensure work is performed by businesses that meet the criteria for the set-aside, allowing subcontracting to similarly situated firms should be encouraged. This could have two benefits. It would allow combinations of small businesses to pursue larger contracts, which could help address contract bundling issues. Further, when a business outgrows the small business size standards, it's required to begin subcontracting to small businesses. This change would allow small firms to begin performing on contracts in a manner consistent with the practices that will be required as they grow.

Third, the current statutory and regulatory requirements for calculation of the limitation on subcontracting percentages are confusing and difficult to apply. This makes it harder for agencies to catch bad actors, and simultaneously more difficult for small businesses seeking to comply. The primary issue is the use of cost information rather than price when calculating prime contractor performance requirements. The Subcommittee should address whether a change from cost to price could accomplish the same goal of avoiding pass-through requirements.

Fourth, the current scheme assumes that contracts are either for goods or services. While this is sometimes the case, an increasing number of small businesses are receiving contracts as value added resellers, or for contracts that encompass the provision of goods and services. For all practical purposes, this renders the limitation on subcontracting provisions irrelevant to these contracts. The Subcommittee should consider if additional guidance is appropriate for these combination contracts.

Fifth, failure to comply with the pass-through provisions does not trigger any penalty. As previously discussed, it is very difficult to prove damages to the government in these situations, since the KO has already determined that the price paid by the government is fair and reasonable. Therefore, the Subcommittee should assess whether specific damage provisions are required.

## B. Subcontracting Plan Issues

There are six issues before the Subcommittee regarding large business subcontracting plans. The first concerns the negotiation of goals. When subcontracting goals are negotiated, PCRs and CMRs are allowed to review the goals, but only in an advisory capacity. In a recent report on the PCR program,<sup>29</sup> GAO found PCRs identified the inability to appeal subcontracting goals as one of the primary challenges faced by the program. Additionally, through its own investigations, the Committee has found that PCRs are told that a prime contract will contain a certain level of subcontracting goals in order to convince the PCR to sign off on the procurement strategy. However, the resulting contract has much lower goals than those promised to the PCR. Consequently, the Subcommittee will consider whether the PCR or CMR must be allowed to delay a procurement to see that the appropriate goals are assigned to a contract.

Second, there is the issue of noncompliance with the reporting requirements. If a firm does not file its subcontracting reports in ESRS, it is not complying with its contract, and it is a good indicator that the firm is not tracking subcontracts with small businesses. While each is a breach of the contract, it is nearly impossible to prove damages because the harm to the government is difficult to prove. The Subcommittee will consider whether compliance with these requirements could be improved if a penalty was imposed for failure to comply, or if ESRS notified the KO, SBA, or the OSDDBU if a company is failing to comply.

Third, the SBA's standard operating procedures for the subcontracting plan assumes that SBA will audit a prime contractor's compliance.<sup>30</sup> However, as previously discussed, CMRs are unable to review the vast majority of subcontracting plans. The Defense Contract Audit Agency (DCAA) currently conducts routine audits of DoD contractors with cost accounting systems. These systems require that a contractor have an auditable subcontracting process. As DCAA is already reviewing subcontracting processes, SBA should consider entering into a cooperative agreement with DCAA to review for compliance with subcontracting plans.

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<sup>29</sup> GAO, IMPROVEMENTS NEEDED TO HELP ENSURE RELIABILITY OF SBA'S PERFORMANCE DATA ON PROCUREMENT CENTER REPRESENTATIVES (2011).

<sup>30</sup> SBA, SUBCONTRACTING ASSISTANCE PROGRAM 21-31 (2003) (SOP 60 03 6).

Fourth, prime contractors are responsible for ensuring that their large subcontractors in turn subcontract with small businesses. ESRS accounts for these subcontracts, and credits the government with the dollars when calculating the government-wide subcontracting achievements. However, the prime contractor is not allowed to take credit for lower tier subcontracting. In some cases, this exclusion is warranted. For example, if the large business has a commercial type subcontracting plan, its subcontract report covers all subcontracting opportunities for the year rather than subcontracting opportunities related to the prime contract. In such cases, it would make it difficult to account for lower tier subcontracting without double counting dollars. In other cases, such as contract specific subcontracting plans, allowing the prime to receive credit for lower tier accomplishments would make the prime contractor more aggressive when monitoring its lower subcontractors, which could in turn result in more opportunities for small businesses. The Subcommittee will review whether such changes are desirable.

Fifth, requiring prime contractors to publish subcontracting opportunities on SUB-Net could lead to greater opportunities for small businesses, and would be consistent with the intention of the Small Business Act. However, it could harm small businesses that participated with the prime contractor on the successful bid. For example, a small firm might enter into a teaming agreement with a large firm to pursue a large government contract together, with the large business acting as the prime. Pursuant to the agreement, the small firm could spend months of its time helping to develop the successful offer, and be listed a proposed subcontractor in the bid. However, since teaming agreements are not usually enforceable, there are cases where the prime then awards the subcontract to a different business rather than to its teaming partner. In such cases, the Small Business Jobs Act requires the prime contractor to either use that subcontractor or justify to the KO the decision not to use the subcontractor.<sup>31</sup> If all subcontract opportunities are posted on SUB-Net, these small business team partners could be injured, so perhaps an exception to this policy is necessary for team members. The Subcommittee will consider how best to use SUB-Net to ensure that small businesses are given opportunities as subcontractors.

Finally, the Subcommittee will consider whether a statutory subcontracting goal is needed. As previously discussed, the subcontracting goals negotiated by the SBA have been declining over the past decade. In FY 2006, the subcontracting goal was 40 percent.<sup>32</sup> It is now only 35.9 percent, and actual achievements are only 35.4 percent. This means that the subcontracting goals are lower than subcontracting achievements were in 1978, when the current subcontracting program was implemented.<sup>33</sup>

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<sup>31</sup> 15 U.S.C. § 637 note.

<sup>32</sup> SBA goaling website, [http://archive.sba.gov/aboutsba/sbaprograms/goals/SBGR\\_2006\\_SCGR.html](http://archive.sba.gov/aboutsba/sbaprograms/goals/SBGR_2006_SCGR.html).

<sup>33</sup> 1978 Report at 5.

### C. System Issues

As discussed in the prior two subsections, the systems issues regarding ESRS, FSRS and SUB-Net can be distilled to two simple concepts: use and relevancy. In each case, there are issues of businesses not reporting the required information to the systems, and there are no penalties for these failures. Likewise, in each case, the KOs are not using the systems to track compliance. To make these systems relevant, the Subcommittee will consider requiring that ESRS and FSRS actively notify KOs, OSDBUs and SBA of problems, rather than passively collecting data. Additionally, the Subcommittee will consider whether all three systems are necessary, or if they are duplicative. For example, is it necessary to have two subcontracting reporting systems, or should the two be combined to save both government and industry time and effort? Likewise, should FBO, a system already used by all prime contractors, be adapted to host the functionality of SUBNet?

### V. Conclusion

Given that over \$210 billion of federal prime contract dollars is spent with subcontractors each year, the Subcommittee needs to ensure that small and large businesses alike are appropriately using the various subcontracting tools available and that the rules in place for the subcontracting programs lend themselves to compliance and enforcement. Similarly, the Subcommittee will work to verify that KOs at federal agencies are enforcing those rules, and that the systems in place support that enforcement. In doing so, the Subcommittee will support small business growth and job creation.