



December 2014

FEDERAL SUBCONTRACTING

Further Actions Needed to Improve Oversight of Pass- through Contracts

GAO Highlights

Highlights of [GAO-15-200](#), a report to congressional committees

Why GAO Did This Study

DOD, State, and USAID collectively spent approximately \$322 billion on goods and services in fiscal year 2013. Nearly two-thirds of this dollar amount was awarded to prime contractors reportedly having a plan for using subcontractors. Concerns remain that the government could overpay contractors that provide no, or little, added value for work performed by lower-tier subcontractors. Section 802 of the NDAA for fiscal year 2013, mandated DOD, State, and USAID to issue guidance and regulations as necessary to ensure that contracting officers take additional steps prior to awarding pass-through contracts.

The accompanying conference report mandated that GAO evaluate the implementation of these requirements. This report assesses the extent to which DOD, State, and USAID issued guidance and regulations consistent with Section 802. GAO reviewed policies, guidance, and regulations at the three agencies and interviewed acquisition officials.

What GAO Recommends

To help ensure contracting officers carry out Section 802 requirements, GAO recommends that DOD, State, and USAID take two actions: issue guidance to help contracting officers perform the additional steps required, and revise management review processes and guidance to verify implementation. DOD and State agreed with GAO's recommendations but USAID did not, stating that additional guidance might limit its contracting officers' discretion. GAO maintains that both recommended actions are still warranted for USAID.

View [GAO-15-200](#). For more information, contact Timothy J. DiNapoli at (202) 512-4841 or DiNapoliT@gao.gov

December 2014

FEDERAL SUBCONTRACTING

Further Actions Needed to Improve Oversight of Pass-through Contracts

What GAO Found

Congress required the Department of Defense (DOD), the Department of State (State), and the United States Agency for International Development (USAID) to issue guidance and regulations as necessary to ensure that contracting officers complete additional analyses prior to awarding pass-through contracts—contracts meeting certain criteria and in which prime contractors plan to subcontract 70 percent or more of the total cost of work to be performed—by July 2013. (See figure.)

Notification, Review, and Determination Requirements for Pass-through Contracts at the Departments of Defense, State, and U.S. Agency for International Development



Requirements of Section 802 of the National Defense Authorization Act (NDAA) for fiscal year 2013

Source: GAO analysis of FAR 15.408(n), 52.215-22, 52.215-23, and Section 802 of the NDAA for fiscal year 2013. | GAO-15-200

DOD, State, and USAID varied in their implementation of Section 802. Specifically, GAO's analysis of the agencies' policies and regulations found the following:

- USAID issued a policy directive in June 2013 restating Section 802 requirements and is updating checklists used by contracting officers.
- State issued a procurement bulletin in July 2014 that restated Section 802 requirements but has not taken further steps.
- Neither USAID nor State has provided its contracting officers additional information to help them implement these new requirements, such as by identifying how to assess alternative contracting arrangements or how to document their decisions.
- DOD has not taken any actions and is waiting for revisions to the Federal Acquisition Regulation—expected to be completed by March 2015—before deciding what, if any, changes to its guidance are needed.
- As of November 2014, none of the agencies have updated their management review processes to reflect Section 802 requirements.

Federal government internal control standards state that control activities, such as policies and procedures, help to ensure that management directives are carried out and actions are taken to address risk. The lack of guidance and updated management review processes limits the agencies' ability to minimize the potential risk of paying excessive pass-through costs.

Contents

Letter		1
	Background	2
	Guidance for Review and Justification of Pass-through Contracts Is Incomplete and Oversight Processes Are Not Updated	8
	Conclusions	12
	Recommendations for Executive Action	13
	Agency Comments and Our Evaluation	13
Appendix I	Scope and Methodology	17
Appendix II	Comments from the Department of Defense	19
Appendix III	Comments from Department of State	21
Appendix IV	Comments from the United States Agency for International Development	23
Appendix V	GAO Contact and Staff Acknowledgments	26
Figures		
	Figure 1: Example of Costs with Subcontract Layers	4
	Figure 2: Notification, Review, and Determination Requirements for Pass-through Contracts at Departments of Defense, State, and U.S. Agency for International Development	7

Abbreviations

DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DOD	Department of Defense
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System-Next Generation
NDA	National Defense Authorization Act
State	Department of State
USAID	United States Agency for International Development

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



December 22, 2014

Congressional Committees

The Department of Defense (DOD), Department of State (State), and the United States Agency for International Development (USAID) together obligated approximately \$322 billion on goods and services in fiscal year 2013. Of this amount, nearly two-thirds, or approximately \$205 billion, was obligated on contracts for which the prime contractor submitted a plan to use subcontractors to meet contract requirements. GAO and DOD audits on contracts awarded for Hurricane Katrina recovery efforts found multiple layers of subcontractors, questionable value added by contractors, increased costs, and lax oversight.¹ The National Defense Authorization Acts (NDAA) for fiscal years 2007 and 2009 contained provisions regarding excessive “pass-through” charges to the government.² Finalized in January 2011, changes to the Federal Acquisition Regulation (FAR) required a clause on limitations of pass-through charges in certain solicitations. This clause required prime contractors to provide additional information to the government when they intended to subcontract 70 percent or more of the total cost of the work to be performed under the prime contract, including the added value they would provide under these circumstances.³

More recently, Section 802 of the NDAA for fiscal year 2013 directed the Secretary of Defense, Secretary of State, and the Administrator of USAID to issue guidance and regulations as may be necessary to ensure that when an offeror notifies the contracting officer of its intent to subcontract more than 70 percent of the total cost of the work to be performed, on certain contracts or orders, their contracting officers must consider alternative contracting arrangements and make a written determination

¹ GAO, *Agency Management of Contractors Responding to Hurricanes Katrina and Rita*, [GAO-06-461R](#) (Washington, D.C.: Mar. 16, 2006) and U.S. Army Audit Agency, *Debris Removal Contracts: U.S. Army Corps of Engineers*, Audit Report: A-2007-0016-FFD (Washington, D.C.: Nov. 9, 2006).

² John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 852 (2006); Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, Pub. L. No. 110-417, § 866 (2008).

³ 75 Fed. Reg. 77741 (Dec. 13, 2010) (effective Jan. 12, 2011).

that the contracting approach selected is in the best interest of the government prior to awarding these pass-through contracts.⁴ The conference report that accompanied the act mandated GAO to report on the implementation of this provision.⁵ We assessed the extent to which DOD, State, and USAID issued guidance and regulations to address pass-through contracting issues consistent with Section 802.

To conduct our work, we compared the provisions of Section 802 to current DOD, State, and USAID acquisition policies, guidance, and regulations. Specifically, we assessed whether these agencies issued policies, guidance, and regulations to ensure that for certain solicitations when an offeror informs the agency of its intention to award subcontracts for more than 70 percent of the total cost of work to be performed, that the contracting officer (1) considers the availability of alternative contracting arrangements and the feasibility of contracting directly with a subcontractor that will perform the bulk of the work, (2) makes a written determination that the contracting approach selected is in the best interest of the government, and (3) documents the basis for such a determination. We also interviewed acquisition officials at DOD, State, and USAID to understand the actions taken or planned to be taken and how they intend to ensure compliance with Section 802.

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

Background

The government relies on contractors to provide a range of mission-critical support from operating information technology systems to battlefield logistics support. Federal regulations state that prime contractors are responsible for managing contract performance, including planning, placing, and administering subcontracts as necessary to ensure

⁴ National Defense Authorization Act for Fiscal Year 2013, Pub. L. No. 112-239, § 802.

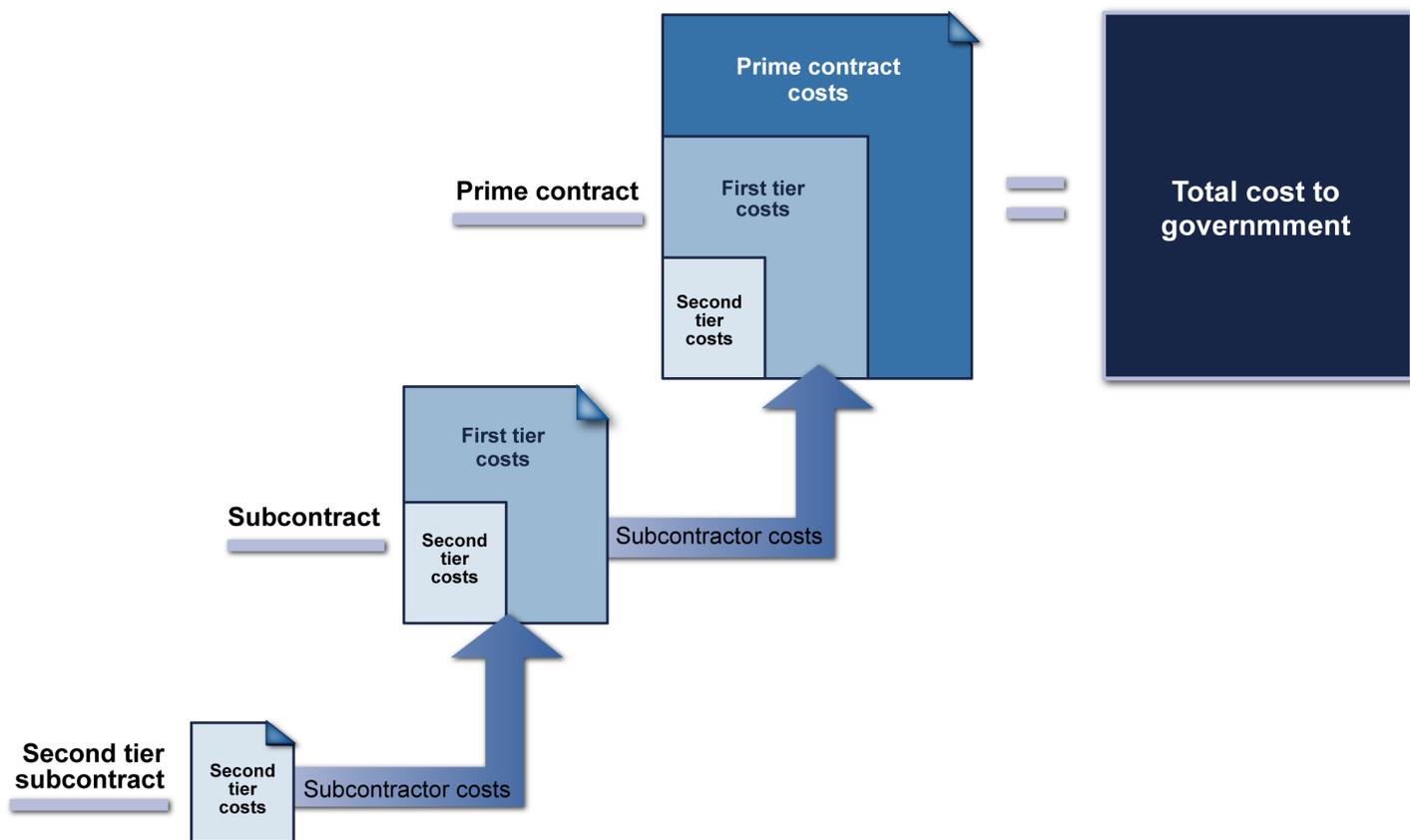
⁵ H.R. Rep. No. 112-705, at 800 (2012) (Conf. Rep.).

the lowest overall cost and technical risk to the government.⁶ Successful offerors for contracts exceeding \$650,000 that have subcontracting possibilities are required to submit a subcontracting plan which includes, among other things, a statement of the total dollars planned to be subcontracted, the principal types of supplies and services to be subcontracted, and assurances that the offeror will submit periodic reports so that the government can determine the extent to which it has complied with the plan.⁷ For cost reimbursable contracts, the government pays the contractor for allowable incurred costs, to the extent prescribed in the contract. These costs may include the costs and fees charged to the prime by its subcontractors. Figure 1 depicts how lower tier subcontractor costs become part of the higher tier's and prime contractor's overall costs.

⁶ Federal Acquisition Regulation (FAR), § 15-407-2.

⁷ FAR §§ 19.702(a) and 19.704.

Figure 1: Example of Costs^a with Subcontract Layers



Source: GAO analysis. | GAO-15-200 and GAO-08-269

^a Costs include such things as direct labor, material, overhead, and fee.

Section 852 of the NDAA for fiscal year 2007 directed the Secretary of Defense to issue regulations to ensure that pass-through charges on contracts or subcontracts (or task or delivery orders) are not excessive in relation to the cost of work performed by the contractor or subcontractor.⁸ This provision defined excessive pass-through charges as charges that occur when a contractor or subcontractor adding no, or negligible, value to a contract or subcontract charges the government for overhead and

⁸ Pub. L. No. 109-364, § 852 (2006).

profit for work performed by a lower-tier contractor or subcontractor.⁹ In response, DOD issued an interim Defense Federal Acquisition Regulation Supplement (DFARS) rule in April 2007, requiring contracting officers to include clauses in certain solicitations and contracts that provided audit rights and cost recovery should these excessive pass-through charges occur.¹⁰ The 2007 interim DFARS rule also required that an offeror identify the percentage of the effort intended to be performed by the prime contractor and the percentage expected to be performed by each of its subcontractors and describe the value added the prime contractor will provide when they intend to subcontract more than 70 percent of the total cost of the work to be performed, among other things.

In January 2008, we found that the information required by the 2007 interim rule would not, by itself, provide DOD greater insight into its supply chain and costs—key information needed to mitigate risks of excessive pass-through charges.¹¹ Further, we reported that DOD had not developed guidance to help contracting officers ensure that value added assessments were properly documented in contract files. We recommended that as DOD finalized its interim rule and developed implementing guidance, that it require its contracting officers to take into account contract risk when determining the degree of assessment needed, to document their assessments of contractor value added in contract files, and to involve the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA) in such assessments as appropriate. DOD concurred with our recommendations, but as of October 2014 has not implemented these recommendations.

⁹ This does not include charges for direct costs of managing lower-tier contracts or subcontractors and the overhead and profit based on such direct costs.

¹⁰ Excessive Pass-through Charges, 72 Fed. Reg. 20758 (Apr. 26, 2007). The rules required the inclusion of certain provisions in solicitations and contracts including task or delivery orders, with a total value that exceeds the threshold for obtaining cost or pricing data (as of October 2014 that threshold was \$700,000) in accordance with FAR §15.403-4, except when the resulting contract is expected to be (1) a firm-fixed-price contract awarded on the basis of adequate price competition, (2) a fixed-price contract with economic price adjustment awarded on the basis of adequate price competition, (3) a firm-fixed-price contract for the acquisition of a commercial item, or (4) a fixed-price contract with economic price adjustment for the acquisition of a commercial item. This rule was later updated, 73 Fed. Reg. 27464 (May 13, 2008).

¹¹ GAO, *Defense Contracting: Contract Risk a Key Factor in Assessing Excessive Pass-Through Charges*, [GAO-08-269](#) (Washington, D.C.: Jan. 25, 2008).

The NDAA for fiscal year 2009 expanded requirements related to pass-through charges to include the civilian agencies. Specifically, Section 866 required the FAR to be revised to minimize the excessive use of subcontractors that add no, or negligible, value and to ensure that neither a contractor nor a subcontractor receive payments for excessive pass-through charges for contracts exceeding the simplified acquisition threshold.¹² In January 2011, FAR changes were finalized that require contracting officers to include clauses regarding limitations on pass-through charges in certain solicitations and contracts that include provisions for the recovery of excessive pass-through charges.¹³ Specifically, civilian contracting officers are to include certain clauses in solicitations and contracts when they anticipate awarding cost reimbursement contracts or task or delivery orders and the total estimated contract or order value exceeds \$150,000. For DOD, contracting officers are to include certain clauses in solicitations and contracts or task or delivery orders when the total estimated contract or order value exceeds \$700,000, except for certain fixed price type contracts. DOD rescinded its interim DFARS rule in light of this government-wide regulation.¹⁴

Building on the previous legislation, in January 2013, Section 802 of the NDAA for fiscal year 2013 directed DOD, State, and USAID to issue guidance and regulations as may be necessary to ensure that contracting officers take additional steps when an offeror informs the agency of its intention to subcontract more than 70 percent of total costs of work to be performed for relevant contracts by July 2013.¹⁵ (See figure 2.)

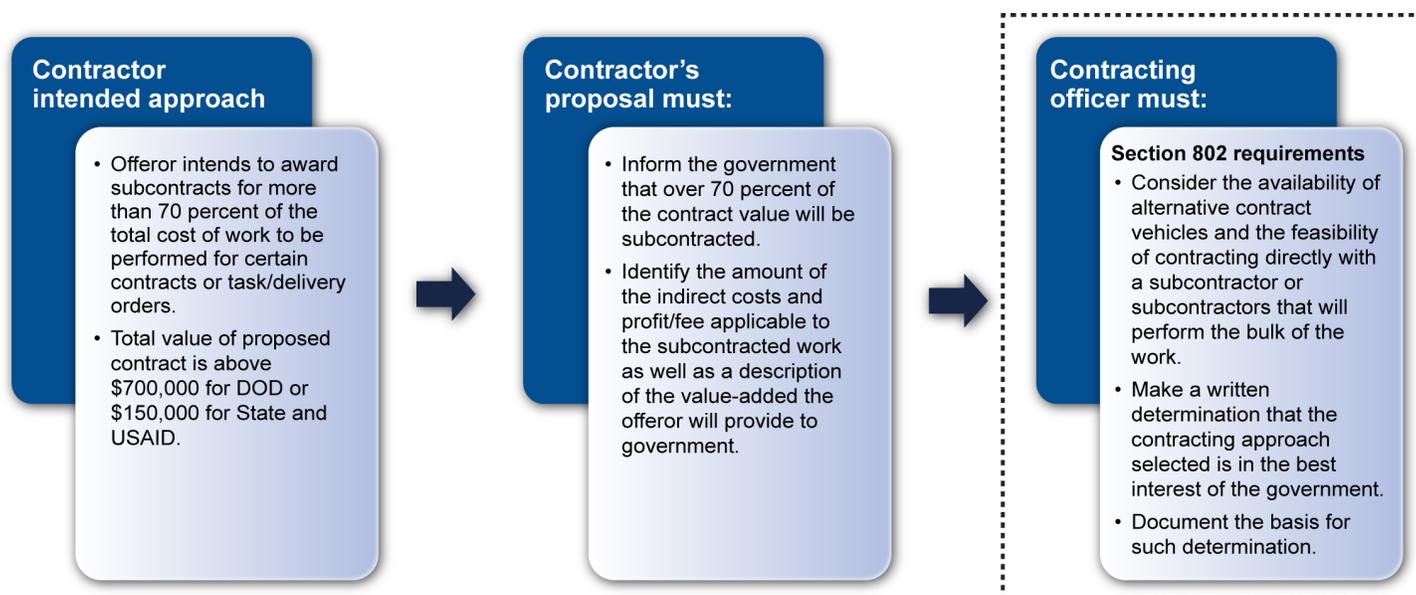
¹² Pub. L. No. 110-417, § 866 (2008). As defined in FAR § 2.101, the simplified acquisition threshold is \$150,000, except for acquisitions of supplies or services that, as determined by the head of the agency, are to be used to support a contingency operation or to facilitate defense against or recovery from nuclear, biological, chemical, or radiological attack, the term means (1) \$300,000 for any contract to be awarded and performed, or purchase to be made, inside the United States; and (2) \$1 million for any contract to be awarded and performed, or purchase to be made, outside the United States.

¹³ Limitation on Pass-Through Charges. 75 Fed. Reg. 77741 (Dec. 13, 2010) (effective Jan. 12, 2011). See FAR §15.408(n) and clauses 52.215-22 and 52.215-23.

¹⁴ 75 Fed. Reg. 48278 (Aug. 10, 2010).

¹⁵ Pub. L. No. 112-239, § 802.

Figure 2: Notification, Review, and Determination Requirements for Pass-through Contracts at Departments of Defense, State, and U.S. Agency for International Development



Requirements of Section 802 of the National Defense Authorization Act (NDAA) for fiscal year 2013
 Source: GAO analysis of FAR 15.408(n), 52.215-22, 52.215-23, and Section 802 of the NDAA for fiscal year 2013. | GAO-15-200

The FAR Council is currently developing a regulation to incorporate Section 802 requirements applicable to all executive agencies.¹⁶ According to FAR Council representatives, work to incorporate the requirements of the NDAA for fiscal year 2013 into the FAR began shortly after its enactment. These representatives noted that they also intend to incorporate an exemption for small businesses, as mandated by Section 1615 of the NDAA for the fiscal year 2014.¹⁷ A proposed rule was

¹⁶ The FAR Council was established to help direct and coordinate government-wide procurement policy and regulatory activities. Council membership consists of the Administrator for Federal Procurement Policy, the Secretary of Defense, the Administrator of National Aeronautics and Space Administration, and the Administrator of General Services. The Council is supported by teams that focus on specific acquisition areas such as finance, small business, and technology.

¹⁷ The National Defense Authorization Act for Fiscal Year 2014 included a provision that clarified the inapplicability of the requirements of Section 802 to small businesses. FAR council representatives explained that the timing of this law resulted in a delay in the issuance of the proposed FAR rule. Pub. L. No. 113-66, § 1615 (2013).

released for public comment on July 10, 2014, and a FAR Council representative estimated that the final regulation will be approved by March 2015.

Guidance for Review and Justification of Pass-through Contracts Is Incomplete and Oversight Processes Are Not Updated

USAID, State, and DOD varied in their implementation of Section 802. USAID issued a policy directive that restated Section 802 requirements in 2013 and is in the process of updating various tools to assist its contracting officers. More recently, State issued a procurement bulletin that restated Section 802 requirements, but has not taken further steps to update tools to assist its contracting officers. In contrast, DOD has not taken actions, noting that the department intends to wait until a final FAR rule is published in 2015. In general, agencies do not know the extent to which offerors proposed to subcontract 70 percent or more of the total cost of their contracts because agency specific and federal data systems do not provide such information. In lieu of creating new reporting mechanisms, each agency indicated its intent to assess contracting officers' implementation of Section 802 requirements using its existing procurement management reviews. USAID has initiated revisions of associated review guidance to incorporate these requirements, State indicated that its current review guidance is adequate, and DOD has not determined if changes to its guidance are necessary.

USAID and State Took Some Action to Implement Section 802, but None of the Agencies Revised Guidance or Regulations

USAID and State have taken some initial steps to implement Section 802, but neither have provided contracting officers with guidance on how to perform the required analysis of alternate acquisition approaches or determine the feasibility of contracting directly with proposed subcontractors, specified what documentation is necessary, or identified where the required determination should be recorded. For example,

- USAID issued a policy directive and State issued a procurement bulletin in June 2013 and July 2014, respectively, that each restate the requirements of Section 802. Specifically, both agencies require that if offerors propose to award subcontracts for more than 70 percent of the total cost of work to be performed, agency contracting officers must consider alternative contracting vehicles, make a written determination of why the contracting approach is in the best interest of the government, and document the basis for the determination. USAID's Office of Acquisition and Assistance and State's Office of Acquisition Management communicated the new requirement to its acquisition community electronically and posted the policy to its websites for future reference.

-
- USAID and State have not issued guidance or agency-specific regulations, however, to assist contracting officers in carrying out the tasks required by Section 802. USAID officials noted that the agency is currently updating checklists used by its contracting officers when performing cost and price analysis or for drafting memoranda of negotiation to include Section 802 requirements. They expect that these checklists will be revised by the end of the year. USAID officials do not anticipate the need to revise agency regulations once the FAR is updated, noting that its contracting personnel assess proposed contracting arrangements in accordance with the FAR as part of its standard acquisition processes. Officials noted that the updated checklists will remind its personnel of the Section 802 requirements to assess the feasibility of contracting directly with proposed subcontractors, and to document their determination that the accepted approach is in the government's best interests as well as the basis for that determination. However, it is unclear if checklist revisions will provide contracting officers with the information necessary to perform the analysis of alternative acquisition approaches required by Section 802. State officials do not plan to update guidance to assist contracting officers with information on how to perform the steps required by Section 802. Similar to USAID, State officials do not anticipate revising departmental regulations once the FAR rule is finalized.

DOD has not issued any policies nor has it issued guidance or regulations to implement Section 802. DOD officials explained that they are waiting for the FAR rule expected to be issued by March 2015 and did not want to issue policy, guidance, or regulations that may contradict the final FAR rule. DOD officials noted that once the FAR is revised, they will consider whether changes to DOD policy, guidance, and instruction would be necessary.

Federal government internal control standards state that control activities, such as policies and procedures, help to ensure that management directives are carried out and actions are taken to address risks.¹⁸ Further, government internal controls note that information should be recorded and communicated to enable completion of internal control and other responsibilities. The lack of additional guidance that identifies approaches for or examples of how USAID, State, and DOD contracting

¹⁸ GAO, *Internal Control: Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November, 1999).

officers may assess alternative contracting approaches, to include the feasibility of contracting directly with proposed subcontractors, or how to document their determination that the selected approach is in the best interests of the government may increase the departments' risk of not being in compliance Section 802.

Agencies Will Use Existing Mechanisms to Monitor Implementation of Section 802, but Have Not Yet Revised Applicable Processes and Guidance

USAID, State, and DOD officials stated that their contracting and financial management systems do not track the subcontracting that a contractor intends to, or has used, in performing the contracts. Further, while there have been efforts to develop government-wide information on subcontracting awards, these systems do not include data to identify all levels of subcontracting.¹⁹ In that regard, in June 2014, we found subcontract data contained in USASpending.gov to be unverifiable because agencies frequently did not maintain the records necessary to verify the information reported by the awardees.²⁰

Our analysis found that in fiscal year 2013 DOD reported obligating approximately \$129.5 billion on contracts which were of the type of contract and dollar value that would potentially be subject to Section 802, and that had a subcontracting plan, while USAID and State reported obligating approximately \$817 million and \$222 million, respectively, for contracts that would be subject to the criteria applicable to those agencies. USAID, State, and DOD officials believe that few of the prime contractors subcontract 70 percent or more of the total cost of work performed on the types of contracts subject to Section 802. For example, State acquisition officials believe that such a high level of subcontracting is more likely to be found on State's contracts for construction, which often use fixed-priced contracts and, therefore, would not be subject to the requirements of Section 802.

¹⁹ GAO, *Data Transparency: Oversight Needed to Address Underreporting and Inconsistencies on Federal Award Website*, [GAO-14-476](#) (Washington, D.C.: June 30, 2014) and GAO, *8(a) Subcontracting Limitations: Continued Noncompliance with Monitoring Requirements Signals Need for Regulatory Change*, [GAO-14-706](#) (Washington, D.C.: Sept. 16, 2014).

²⁰ [GAO-14-476](#). USASpending.gov is intended to provide the public with the ability to track where and how federal funds are spent. It receives prime contract data from the Federal Procurement Data System—Next Generation (FPDS-NG) and subcontract data from the Federal Funding Accountability and Transparency Subaward Reporting System (FSRS). FSRS provides information on the extent subcontracting was performed under federal awards, but does not capture all subcontract awards.

In lieu of developing new data or reporting requirements to assess whether its acquisition personnel are properly implementing Section 802, USAID acquisition officials noted that they will rely on routine, on-site procurement system and contract reviews to evaluate contracting offices' compliance with Section 802.²¹ An official from USAID's Office of Acquisition and Assistance, Evaluation Division stated that they completed three procurement management reviews at international locations in October 2014 during which pass-through contracts were discussed, but were not found to be an issue. USAID officials noted that they intend to revise their guidance governing procurement system reviews by the end of 2014. Similarly, both State and DOD officials indicated that they intend to rely on procurement management reviews to determine if contracting officers are properly implementing Section 802, but noted that associated review guidance has not been updated. At the same time, our review of current USAID, State, and DOD procurement management review instructions and checklists found that they do not reflect all Section 802 requirements. State officials believe that pass-through contracting issues will be addressed because its officials use the department's domestic contract file table of contents as a checklist, which includes sections on solicitation and pre-award documentation, to conduct contract file reviews. State does not currently plan to revise the guidance to specifically reflect Section 802 requirements. DOD acquisition officials noted that they have not yet determined what changes to guidance, if any, would be required.

As previously noted, federal internal control standards state that control activities, such as policies, procedures, and other mechanisms, help to ensure that management directives are carried out and actions are taken to address risks.²² Though agencies have identified a process to monitor contracting officer implementation of Section 802 requirements, without

²¹ All three agencies conduct procurement management reviews. Generally, a procurement management review is an agency internal assessment of its procedures for acquiring goods and services. DOD procurement management review teams examine the effectiveness of contracting functions, analyze problem areas, and identify best practices. State reviews are conducted for acquisitions over the simplified acquisition threshold. State reviews include the verification of correct contracting documentation and that contracting officers met regulation requirements. USAID's procurement system reviews score contracting offices on compliance with an array of issues related to solicitation; contract negotiation, award, and administration; and adherence to rules for other specific contracting areas.

²² [GAO/AIMD-00-21.3.1](#).

specifically incorporating these requirements into review guidance, agencies may not effectively oversee compliance.

Conclusions

Over the past 8 years, a number of legislative and regulatory changes have been enacted to enhance the government's insight into the billions of dollars that prime contractors award to subcontractors. Initially, the focus of these changes had been on requiring prime contractors to notify contracting officers when they intend to rely largely on subcontractors. Section 802 changed that paradigm by requiring contracting officers to consider alternative arrangements, such as directly contracting with subcontractors and to make a written determination that the accepted approach is in the best interest of the government, and to document the basis for such a determination when they receive such a notification. Neither USAID nor State has provided its contracting officers additional guidance to help them implement these new requirements. DOD, having the highest level of obligations for contracts that may be potentially subject to Section 802 requirements, has not taken any actions and is waiting for the issuance of a final FAR rule before deciding what, if any, revisions to its guidance are needed. USAID, State, and DOD intend to use procurement management reviews to monitor implementation of Section 802, but have not updated the related review processes and guidance. Without data on the extent to which agencies make use of contracts that rely largely on subcontractors, it is essential that agencies provide guidance to assist their contracting officers in implementing legislative requirements and develop oversight processes to assess their agencies' compliance. DOD's decision to wait until the FAR is revised next year rather than proactively initiating actions has increased the risk that its contracting personnel are not currently acting in compliance with the law and may also have missed opportunities to establish more beneficial contracting arrangements. While State and USAID obligate less for contracts that may be subject to Section 802, their more limited exposure does not obviate the need to provide guidance or management oversight. Federal internal control standards highlight the need for agencies to establish processes and procedures to ensure compliance with statutory provisions.

Recommendations for Executive Action

We recommend that the Secretary of Defense, Secretary of State, and Administrator of USAID take the following two actions to help ensure contracting officers carry out the requirements of Section 802:

- issue guidance to assist contracting officers by identifying approaches for or examples of how to assess alternative contracting approaches to include the feasibility of contracting directly with proposed subcontractors, and documenting a determination that the approach selected is in the best interests of the government; and
- revise the processes and guidance governing management reviews of procurements to ensure that such reviews assess whether contracting officers are complying with the provisions of Section 802.

Agency Comments and Our Evaluation

We provided a draft of this report to DOD, State, and USAID for comment. DOD and State concurred with our recommendations, but USAID did not agree that additional guidance was necessary to assist contracting officers when assessing alternative contracting approaches and noted current management reviews would be used to identify subcontracting issues. The agencies' comments are summarized below. Written comments from DOD, State, and USAID are reproduced in appendixes II, III, and IV respectively.

In response to the recommendation to identify approaches for, or examples of, how to assess alternative contracting approaches, and document a determination that the approach selected is in the best interests of the government, DOD and State concurred. DOD, by way of explaining its delay in issuing guidance, noted it was required to adhere to the regulatory rulemaking process and noted that the final FAR rule to implement Section 802 is expected to be issued in March 2015. Section 802 provided flexibility for DOD to issue guidance and regulations as may be necessary to ensure contracting officers take specific actions for certain solicitations and we continue to believe DOD should do so expeditiously. State noted that it will issue guidance to assist contracting officer to assess alternative contracting approaches and document the determination that the approach selected is in the best interest of the government. USAID did not believe it was necessary to issue additional guidance, stating that the FAR has provided specific actions for a contracting officer to follow to ensure that they identify and adequately reconsider proposed contracts and that to provide additional guidance may limit its contracting officers' discretion. As we noted in the report, USAID has restated these actions in a policy directive, but it has not provided contracting officers with guidance on how to perform these new

requirements. Specifically, USAID has not provided examples of how to conduct an analysis of alternate acquisition approaches or determine the feasibility of contracting directly with proposed subcontractors, described what documentation is necessary, or identified where the required contracting officer's determination should be recorded. Rather than limit a contracting officer's discretion, we believe that more specific guidance will help contracting officer's comply with these new requirements, improve oversight, and align more closely with federal internal control standards.

DOD and State concurred with our recommendation to revise their processes and guidance governing management reviews of procurements to ensure that such reviews assess whether contracting officers are complying with the provisions of Section 802. DOD indicated it will provide or revise and update guidance governing management reviews to ensure that such reviews assess whether contracting officers are complying with the provisions of Section 802. In addition, once the final FAR rule is issued, DOD noted it will assess whether it needs to include supplemental information in its Procedures, Guidance, and Information to ensure compliance. State noted that it will also revise its management review guidance to include compliance with Section 802. USAID did not specifically state whether it concurred with the recommendation, noting that it will be reviewing random files during procurement system reviews to see if contracting officers are taking appropriate steps in instances where an offeror proposes to award subcontracts for more than 70 percent of the total award. We agree that such an approach could be an appropriate step when conducting a procurement management review, but, as noted in the report, USAID has not revised the processes and guidance governing management reviews of procurements to do so. Federal internal control standards state that guidance helps to ensure that management directives are carried out and actions are taken to address risks and, accordingly, we continue to believe that USAID should revise its procurement management guidance.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Defense, the Secretary of State, and the Administrator, USAID, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-4841 or DinapoliT@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.



Timothy J. DiNapoli
Director
Acquisition and Sourcing Management

List of Committees

The Honorable Carl Levin
Chairman
The Honorable James M. Inhofe
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Richard J. Durbin
Chairman
The Honorable Thad Cochran
Ranking Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Howard P. "Buck" McKeon
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

The Honorable Rodney Frelinghuysen
Chairman
The Honorable Pete Visclosky
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Appendix I: Scope and Methodology

Section 802 of the National Defense Authorization Act (NDAA) for Fiscal Year 2013 directed the Secretary of Defense, Secretary of State, and the Administrator of the United States Agency for International Development (USAID) to issue guidance and regulations as may be necessary to ensure that when an offeror notifies the contracting officer of its intent to subcontract more than 70 percent of the total cost of the work to be performed on certain contracts or orders, contracting officers consider alternative contracting arrangements and make a written determination that the contracting approach selected is in the best interest of the government and document the basis for the determination.¹ The conference report that accompanied the act mandated GAO to report on the implementation of this provision.² We assessed the extent to which the Department of Defense (DOD), Department of State (State), and USAID revised their guidance and regulations to address pass-through contracting issues consistent with Section 802.

To conduct our work, we compared the provisions of Section 802 to current DOD, State and USAID acquisition policies, guidance, and regulations. Specifically, we assessed whether these agencies issued policies, guidance, and regulations to ensure for certain solicitations when an offeror informs the agency of its intention to award subcontracts for more than 70 percent of the total cost of work to be performed that the contracting officer (1) considers the availability of alternative contracting arrangements and the feasibility of contracting directly with a subcontractor that will perform the bulk of the work, (2) makes a written determination that the contracting approach selected is in the best interest of the government, and (3) documents the basis for such determination. We interviewed acquisition officials at DOD's Office of Defense Procurement and Acquisition Policy, the military departments, Defense Contract Management Agency (DCMA), and Defense Contract Audit Agency (DCAA); State's Offices of Acquisition Management and Office of the Procurement Executive; and USAID's Office of Acquisitions and Assistance in Washington, D.C. and Kabul, Afghanistan, to understand the steps taken and future plans for completing the required guidance and regulation. We also interviewed Federal Acquisition Regulation Council representatives to understand content and timeframes

¹ National Defense Authorization Act for Fiscal Year 2013, Pub. L. No. 112-239, § 802.

² H.R. Rep. No. 112-705, at 800 (2012) (Conf. Rep.).

for a government-wide regulation being developed in response to the Section 802 statutory requirements.

To determine how agencies identify or monitor pass-through contracts, we interviewed acquisition officials at DOD, State, and USAID and reviewed guidance available to contracting officers and supporting agencies, such as DCAA and DCMA. We used the government's procurement database—Federal Procurement Data System-Next Generation (FPDS-NG)—to identify DOD, State, and USAID total obligations for fiscal year 2013 on contracts that by type and value could be subject to Section 802 requirements and reported having a plan to use subcontractors. For DOD, these are contracts where obligations exceed \$700,000 and exclude certain fixed-price contracts. For State and USAID, contracts include those where obligations exceeded \$150,000 and are cost-type contracts. To assess the reliability of FPDS-NG's data, we (1) performed electronic testing for obvious errors in accuracy and completeness; and (2) reviewed related documentation. We found the prime contract obligation data sufficiently reliable for the purposes of this report. We were unable to use subaward information in USASpending.gov to reliably identify whether these obligations were made to contractors whose subcontracting costs comprised over 70 percent of the total costs of the contract. As noted in our June 2014 report, federal reporting systems used to populate USASpending.gov do not identify all contract awards and that the information is largely inconsistent with agency records or unverifiable.³

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

³ GAO, *Data Transparency: Oversight Needed to Address Underreporting and Inconsistencies on Federal Award Website*, [GAO-14-476](#) (Washington, D.C.: June 30, 2014).

Appendix II: Comments from the Department of Defense



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

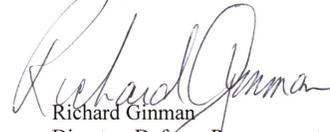
DEC 15 2014

Mr. Timothy J. DiNapoli
Director, Acquisition and Sourcing Management
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. DiNapoli:

This is the Department of Defense (DoD) response to the GAO Draft Report, GAO-15-200, "FEDERAL SUBCONTRACTING: Further Actions Needed to Improve Oversight of Pass-through Contracts" dated November 26, 2014 (GAO Code 121228). Detailed comments on the report recommendations are enclosed.

Sincerely,


Richard Ginman
Director, Defense Procurement
and Acquisition Policy

Enclosure:
As stated

GAO Draft Report Dated December 2014
GAO-15-200 (GAO CODE 121228)

“FEDERAL SUBCONTRACTING: Further Actions Needed to Improve Oversight of
Pass-through Contracts”

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION

RECOMMENDATION 1: The GAO recommend that the Secretary of Defense, Secretary of State, and Administrator of USAID issue guidance to assist contracting officers by identifying approaches for, or examples of, how to assess alternative contracting approaches to include the feasibility of contracting directly with proposed subcontractors, and documenting a determination that the approach selected is in the best interests of the government.

DoD RESPONSE: Concur. FAR Case 2013-012, Review and Justification of Pass-Through Contracts, was established to implement the requirements of Section 802 of the FY 2013 NDAA into the FAR. Since implementation of the requirements of Section 802, as amended by Section 1615 of the 2014 NDAA, (1) relates to the expenditure of appropriated funds; and (2) has a significant effect beyond the internal operating procedures of the agency issuing the policy, regulation, procedure, or form, and has a significant cost or administrative impact on contractors or offerors, DoD was required by statute to adhere to the regulatory rulemaking process and revise the FAR to implement the statutory requirements (in accordance with 41 U.S.C. 1707). As indicated in the GAO report, work to incorporate the requirements of Section 802 into the FAR began shortly after its enactment. However, publication of the FAR revision in the Federal Register was delayed due to objections raised by SBA, and the subsequent incorporation of the amended requirements set forth under Section 1615 of the FY 2014 NDAA to exclude small business offerors from the requirements in Section 802. The revised proposed FAR rule was published in the Federal Register and public comments were received and considered in the drafting of the final rule. The Final FAR rule is estimated to be issued in March 2015.

RECOMMENDATION 2: The GAO recommend that the Secretary of Defense, Secretary of State, and Administrator of USAID revise the processes and guidance governing management reviews of procurements to ensure that such reviews assess whether contracting officers are complying with the provisions of Section 802.

DoD RESPONSE: Concur. We will provide or revise and update guidance governing management reviews of procurements to ensure that such reviews assess whether contracting officers are complying with the provisions of Section 802 as implemented in the FAR. When the final FAR rule is issued, DPAP will submit to the DAR Council for consideration any supplemental information that might be considered for the Procedures, Guidance and Information to assist contracting officers in documenting and the acquisition community to review and ensure compliance.

Appendix III: Comments from Department of State



United States Department of State
Comptroller
P.O. Box 150008
Charleston, SC 29415-5008

DEC 04 2014

Dr. Loren Yager
Managing Director
International Affairs and Trade
Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548-0001

Dear Dr. Yager:

We appreciate the opportunity to review your draft report, "FEDERAL SUBCONTRACTING: Further Actions Needed to Improve Oversight of Pass-through Contracts" GAO Job Code 121228.

The enclosed Department of State comments are provided for incorporation with this letter as an appendix to the final report.

If you have any questions concerning this response, please contact Eric Moore, Director, Office of the Procurement Executive, Bureau of Administration at (703) 875-4079.

Sincerely,


Christopher H. Flaggs

Enclosure:
As stated.

cc: GAO – Timothy DiNapoli
A– Joyce A. Barr
State/OIG – Norman Brown

Department of State Comments to GAO Draft Report

Federal Contracting: Further Actions Needed to Improve Oversight of Pass-Through Contracts
(GAO-15-200, GAO Code 121228)

The Department of State appreciates the opportunity to comment on GAO's draft report "*Federal Contracting: Further Actions Needed to Improve Oversight of Pass-Through Contracts*".

GAO Recommendations:

- 1) Issue guidance to assist contracting officers by identifying approaches for or examples of how to assess alternative contracting approaches to include the feasibility of contracting directly with proposed subcontractors, and documenting a determination that the approach selected is in the best interests of the government.

Department Response: Concur- The Department of State will issue guidance to assist contracting officers on how to make and document the determination.

- 2) Revise the processes and guidance governing management reviews of procurements to ensure that such reviews assess whether contracting officers are complying with the provisions of NDAA Section 802.

Department Response: Concur- The Department of State will revise guidance governing management reviews of procurements to include compliance with NDAA Section 802.

Appendix IV: Comments from the United States Agency for International Development



Timothy DiNapoli
Director, Acquisition and Sourcing Management
U.S. Government Accountability Office
Washington, DC 20548

DEC 15 2014

Dear Mr. DiNapoli:

I am pleased to provide USAID's formal response to the Government Accountability Office (GAO) draft report entitled, "FEDERAL SUBCONTRACTING: Further Actions Needed to Improve Oversight of Pass-through Contracts" (GAO-15-200).

This letter, together with the enclosed USAID comments, is provided for incorporation as an appendix to the final report.

Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this audit review.

Sincerely,

A handwritten signature in blue ink, appearing to read "Angelique M. Crumbly".

Angelique M. Crumbly
Assistant Administrator
Bureau for Management
U.S. Agency for International Development

Enclosure: a/s

- 2 -

USAID COMMENTS ON GAO DRAFT REPORT
No. GAO-15-200

We recommend that the Secretary of Defense, Secretary of State, and Administrator of USAID take action to help ensure contracting officers carry out the requirements of Section 802:

Recommendation 1: We recommend that the Secretary of Defense, Secretary of State, and Administrator of USAID issue guidance to assist Contracting Officers by identifying approaches for or examples of how to assess alternative contracting approaches to include the feasibility of contracting directly with proposed subcontractors, and documenting a determination that the approach selected is in the best interests of the government.

Response: FAR case 2013-012, "Review and Justification of Pass-Through Contracts," provides steps for contracting officers (COs) to take in the instance where an offeror proposes to award subcontracts for more than 70 percent of the total award. This was mandated by Section 802 of the 2013 NDAA.

In those instances, the CO is required to: (1) consider the availability of alternative contract vehicles and the feasibility of contracting directly with a subcontractor or subcontractors that will perform the bulk of the work; (2) make a written determination that the contracting approach selected is in the best interest of the Government; and (3) document the basis for such determination.

Given that the FAR has provided such specific steps for a CO to follow, we do not believe it is necessary for USAID to issue additional guidance. The FAR gives COs the discretion to make this determination, and by providing examples, we may limit the COs discretion.

Recommendation 2: We recommend that the Secretary of Defense, Secretary of State, and Administrator of USAID revise the processes and guidance governing management reviews of procurements to ensure that such reviews assess whether contracting officers are complying with the provisions of Section 802.

Response: USAID has a number of steps in place where subcontracting will be reviewed and documented as part of the cost analysis.

The initial review of subcontracting levels would occur during the proposal submission and review phase. Offerors that submit proposals indicating that they intend to subcontract more than 70% of the total cost of work to be performed, would have their proposals reviewed in accordance with FAR 15.408(n), FAR 52.215-22, and FAR 52.215-23. The issue of subcontracting would also be reviewed during any request for subcontract consent, per applicable FAR provisions, including FAR 44.201 and FAR 44.202.

In addition, M/OAA's Evaluation Division (M/OAA/E) does a worldwide (Washington and the field) review to ensure and maintain the integrity of the Agency's procurement system. Executive order 129311 ensures effective and efficient spending of public funds through

- 3 -

fundamental reforms by making procurement more effective in support of mission accomplishment. M/OAA/E uses a Scorecard Risk Assessment and reviews subcontracting issues during review of the Negotiation Memorandum to ensure there is adequate documentation that fully supports award decisions.

In addition, given that the FAR is providing specific steps that a CO must follow, USAID will be reviewing random files during procurement system reviews to see if COs are taking appropriate steps in instances where an offeror proposes to award subcontracts for more than 70 percent of the total award.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Timothy J. DiNapoli, (202) 512-4841 or dinapolit@gao.gov

Staff Acknowledgments

In addition to the contact named above, Penny Berrier (Assistant Director), Marycella Cortes, Thomas Twambly, Julia Kennon, Alyssa Weir, Danielle Greene, and Jena Sinkfield made key contributions to this report.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's website (<http://www.gao.gov>). Each weekday afternoon, GAO posts on its website newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to <http://www.gao.gov> and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's website, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

Connect with GAO

Connect with GAO on [Facebook](#), [Flickr](#), [Twitter](#), and [YouTube](#). Subscribe to our [RSS Feeds](#) or [E-mail Updates](#). Listen to our [Podcasts](#). Visit GAO on the web at www.gao.gov.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Website: <http://www.gao.gov/fraudnet/fraudnet.htm>

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Katherine Siggerud, Managing Director, siggerudk@gao.gov, (202) 512-4400, U.S. Government Accountability Office, 441 G Street NW, Room 7125, Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800 U.S. Government Accountability Office, 441 G Street NW, Room 7149 Washington, DC 20548

