



September 2018

VETERANS FIRST PROGRAM

VA Needs to Address Implementation Challenges and Strengthen Oversight of Subcontracting Limitations

Accessible Version

GAO Highlights

Highlights of [GAO-18-648](#), a report to congressional requesters

Why GAO Did This Study

VA spends billions every year to procure goods and services and is required to give preference to veteran-owned small businesses when awarding contracts—a program known as Veterans First. In turn, those firms must comply with limitations on the use of subcontracting. A 2006 statute established Veterans First, and a 2016 Supreme Court decision clarified conflicting interpretations, resulting in changes to how VA must now implement the program.

GAO was asked to review VA's implementation of Veterans First since the Supreme Court decision. Among other things, this report assesses the extent to which (1) changes occurred in procurement obligations to veteran-owned small businesses from fiscal years 2014 through 2017; (2) VA has encountered any challenges in implementing Veterans First policies; and (3) VA has mechanisms to oversee contractor compliance with subcontracting limitations.

GAO analyzed VA regulations, policies, and contracting data; conducted three site visits; and reviewed a non-generalizable sample, selected based on factors such as high dollar value, of 35 contracts and orders, 29 of which VA awarded under Veterans First.

What GAO Recommends

GAO is making six recommendations, including that VA provide more targeted training for contracting officers, assess whether training should be mandatory, ensure required clauses are included in contracts, and improve oversight of compliance with subcontracting limitations. VA agreed with GAO's recommendations.

View [GAO-18-648](#). For more information, contact Shelby S. Oakley at (202) 512-4841 or oakleys@gao.gov.

September 2018

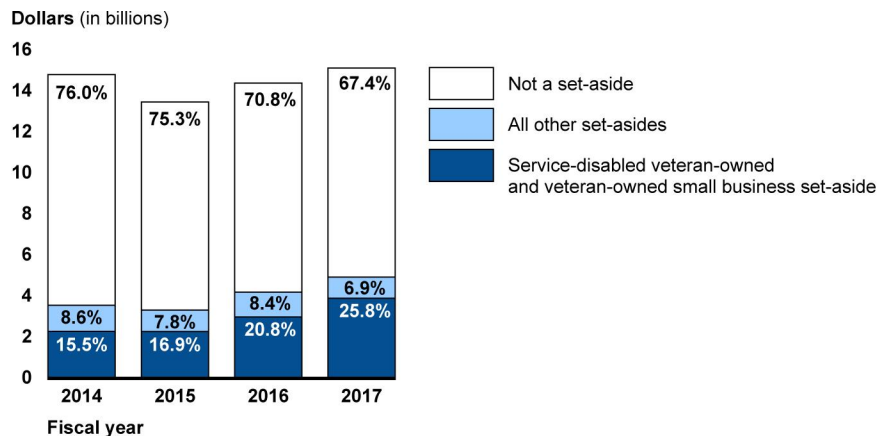
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What GAO Found

GAO found that the percentage of Department of Veterans Affairs (VA) obligations set aside for veteran-owned small businesses under its Veterans First program was higher in 2017—the first full year following the 2016 Supreme Court decision—than in previous years. In its decision, the court clarified that VA contract competitions must be restricted to these businesses if they meet two criteria: (1) the contracting officer reasonably expects that at least two such businesses will submit offers, and (2) the award can be made at a fair and reasonable price and best value to the government. This has become known as the “VA Rule of Two.” VA created a new policy for implementing Veterans First following the 2016 decision. The percentage of obligations set aside for veteran-owned small businesses increased from fiscal years 2014 to 2017 (see figure).

VA Contract Obligations for Set-Asides and Non-Set-Asides, Fiscal Years 2014 through 2017



Source: GAO analysis of Veterans Affairs (VA) Electronic Contract Management System data. | GAO-18-648

Contracting officers face challenges implementing aspects of Veterans First, some of which VA has addressed through policy and optional training. However, 12 of the 30 contracting officers GAO interviewed cited difficulty in assessing the second criterion of the VA Rule of Two when making a set-aside decision. Eight of them stated that they sometimes lacked confidence in their fair and reasonable price determinations. VA's training, however, does not fully address these more challenging aspects of implementing the Veterans First policy. More targeted training would provide VA with greater assurance that its contracting officers have the knowledge and skills necessary to implement the policy. Additionally, assessing whether training on this policy should be mandatory would allow VA to determine if it would be beneficial for all contracting officers.

GAO found that VA conducts limited oversight of contractor compliance with limitations on subcontracting and has few mechanisms for ensuring compliance. For example, GAO found that the required clause for ensuring that veteran-owned small business contractors perform the required portion of work was either missing entirely or an outdated version was used in 11 of the 29 set-aside contract actions GAO reviewed. Without better oversight, VA is limited in its ability to detect violations and ensure that the goal of Veterans First—to promote opportunities for veteran-owned small businesses—is not undermined.

Contents

Letter		1
	Background	5
	Obligations to and Number of SD/VOSBs Receiving Awards Were Higher Following the Supreme Court Decision	10
	VA Updated Policy for the Veterans First Program and Provided Training to Contracting Officers to Address Confusion	19
	Contracting Officers Face Several Challenges in Applying Aspects of the Veterans First Policy	27
	VA Conducts Limited Oversight of Compliance with Subcontracting Limitations	36
	Conclusions	47
	Recommendations for Executive Action	49
	Agency Comments	50
<hr/>		
Appendix I: Objectives, Scope, and Methodology		51
Appendix II: Comments from the Department of Veterans Affairs		57
Appendix III: GAO Contact and Staff Acknowledgments		61
Appendix IV: Accessible Data		62
	Data Tables	62
	Agency Comment Letter	65
<hr/>		
Tables		
	Table 1: Small Business Administration Subcontracting Limitations (May 2016)	9
	Table 2: Key Differences between VA Veterans First Program Policies in 2007 and after the <i>Kingdomware Technologies, Inc. v. United States</i> Supreme Court Decision	23
<hr/>		
Figures		
	Figure 1: Organizational Structure of the Department of Veterans Affairs (VA) Procurement Function	6

Figure 2: VA Obligations for SD/VOSB Set-Asides and Other Categories, Fiscal Years 2014 through 2017	12
Figure 3: VA Awards Set Aside for SD/VOSBs and Other Categories, Fiscal Years 2014 through 2017	13
Figure 4: VA Obligations for Construction and Non-Construction Set-Asides for SD/VOSBs, Fiscal Years 2014 through 2017	15
Figure 5: Percentage of Obligations for SD/VOSB Set-Asides in VISN Contracting Offices, Fiscal Year 2017	16
Figure 6: Obligations on SD/VOSB Set-Aside and Non-SD/VOSB-Set-Aside Contracts and Orders in Fiscal Years 2014 through 2017 for VA's National Acquisition Center (NAC), Strategic Acquisition Center (SAC), and Technology Acquisition Center (TAC)	17
Figure 7: Number of SD/VOSB Certified Firms in VA Vendor Information Pages (VIP) Database, and Number of SD/VOSBs Receiving Set-Aside Awards, Fiscal Years 2014 through 2017	19
Figure 8: Overview of Process for Applying VA Rule of Two	21
Figure 9: Timeline of Training Provided to Contracting Officers on Veterans First Program after the Supreme Court Decision	24
Figure 10: Number of Selected VA Contract Actions Where the Service-Disabled/Veteran-Owned Small Business Set-Aside Clause Was Outdated, Missing, or Included	39
Accessible Data for VA Contract Obligations for Set-Asides and Non-Set-Asides, Fiscal Years 2014 through 2017	62
Accessible Data for Figure 2: VA Obligations for SD/VOSB Set-Asides and Other Categories, Fiscal Years 2014 through 2017	62
Accessible Data for Figure 3: VA Awards Set Aside for SD/VOSBs and Other Categories, Fiscal Years 2014 through 2017	62
Accessible Data for Figure 4: VA Obligations for Construction and Non-Construction Set-Asides for SD/VOSBs, Fiscal Years 2014 through 2017	63
Accessible Data for Figure 5: Percentage of Obligations for SD/VOSB Set-Asides in VISN Contracting Offices, Fiscal Year 2017	63
Accessible Data for Figure 6: Obligations on SD/VOSB Set-Aside and Non-SD/VOSB-Set-Aside Contracts and Orders in Fiscal Years 2014 through 2017 for VA's National Acquisition Center (NAC), Strategic Acquisition Center (SAC), and Technology Acquisition Center (TAC)	64

Accessible Data for Figure 7: Number of SD/VOSB Certified Firms in VA Vendor Information Pages (VIP) Database, and Number of SD/VOSBs Receiving Set-Aside Awards, Fiscal Years 2014 through 2017	64
Accessible Data for Figure 10: Number of Selected VA Contract Actions Where the Service-Disabled/Veteran-Owned Small Business Set-Aside Clause Was Outdated, Missing, or Included	65

Abbreviations

COR	contracting officer's representative
eCMS	Electronic Contract Management System
FAR	Federal Acquisition Regulation
FSS	Federal Supply Schedule
NAC	National Acquisition Center
OSDBU	Office of Small and Disadvantaged Business Utilization
RMCS	Risk Management and Compliance Service
SAC	Strategic Acquisition Center
SBA	Small Business Administration
SCRP	Subcontracting Compliance Review Program
SDVOSB	Service-Disabled Veteran-Owned Small Business
SD/VOSB	Service-Disabled Veteran-Owned Small Business or Veteran-Owned Small Business
TAC	Technology Acquisition Center
VA	Department of Veterans Affairs
VHA	Veterans Health Administration
VIP	Vendor Information Pages
VISN	Veterans Integrated Service Network
VOSB	Veteran-Owned Small Business

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September 24, 2018

The Honorable Steve Chabot
Chairman
Committee on Small Business
House of Representatives

The Honorable Phil Roe
Chairman
Committee on Veterans' Affairs
House of Representatives

The Honorable Ann McLane Kuster
Ranking Member
Subcommittee on Oversight and Investigations
Committee on Veterans' Affairs
House of Representatives

The Department of Veterans Affairs (VA) spent \$26.2 billion in fiscal year 2017 to procure a wide range of goods and services—including construction, information technology, medical supplies, and many others—to meet veterans' needs. In 2006, in order to increase opportunities for veterans to do business with VA, Congress directed the department to apply a preference to Veteran-Owned Small Businesses (VOSB) and Service-Disabled Veteran-Owned Small Businesses (SDVOSB) before awarding competitive contracts. VA created what it calls its Veterans First Contracting Program (referred to in this report as Veterans First) to implement the statute.¹

In June 2016, the Supreme Court's decision in *Kingdomware Technologies, Inc. v. United States* clarified conflicting interpretations of the requirement for the preference, concluding that VA must restrict competition to veteran-owned small businesses if the contracting officer reasonably expects that at least two such businesses will submit offers and the award can be made at a fair and reasonable price that offers best

¹The Veterans Benefits, Health Care, and Information Technology Act of 2006, Pub. L. No. 109-461, § 502(a), 120 Stat. 3403, 3431 (2016) (codified as amended at 38 U.S.C. § 8127).

value to the United States.² VA's prior practice had been to consider this preference mandatory only until it met its annual goals for contracting with veteran-owned small businesses. Prior VA practice was also not to apply it to orders placed against the Federal Supply Schedules (FSS).³ The Court held that VA must apply the preference—often referred to as a “set-aside”—before contracting under competitive procedures, regardless of whether VA has met goals, and to orders placed against FSS. In response, VA made a number of changes to the policies and regulations implementing its Veterans First program to ensure appropriate application across all of the department's contracts. Firms that receive contracts through this preference must also comply with a number of requirements, which generally includes the Small Business Administration's (SBA) Limitations on Subcontracting requirement. The purpose of the subcontracting limitations is to ensure that firms that receive awards on a set-aside basis perform a material portion of the contract themselves, rather than subcontracting a majority of the work to firms that would have been ineligible for the award.

You requested that we examine changes to how VA implements the Veterans First program as a result of the Supreme Court's decision. This report assesses: (1) how VA procurement obligations to veteran-owned small businesses changed in the period from fiscal years 2014 through 2017; (2) what actions VA has taken to update Veterans First policies and regulations and provide training following the Supreme Court's decision; (3) what challenges, if any, VA is encountering in applying Veterans First policies; and (4) the extent to which VA has mechanisms in place to monitor compliance with subcontracting limitations by veteran-owned small businesses, and the effectiveness of such mechanisms.

To assess how VA procurement obligations to veteran-owned small businesses changed in the period from fiscal years 2014 through 2017, we obtained data from VA's Electronic Contract Management System

²See *Kingdomware Technologies, Inc. v. United States*, 579 U.S. ___, 136 S. Ct. 1969 (2016).

³The Federal Supply Schedules program, managed by the General Services Administration, provides federal agencies a simplified method of purchasing commercial products and services at prices associated with volume buying. A schedule is a set of contracts awarded to multiple vendors that provide similar products and services. The General Services Administration has delegated authority to VA to manage schedules for health-care-related supplies and services. VA is the largest user of these categories of goods and services.

(eCMS) on all contracts from fiscal years 2014 through 2017, chosen to provide data before and after the Supreme Court decision. We analyzed these data to determine changes in the use of set-asides for SDVOSB and VOSB firms relative to overall VA contracting obligations during this period, to identify patterns across VA contracting organizations, and to determine the number of individual SDVOSB and VOSB firms that received awards for set-aside contracts from fiscal years 2014 through 2017. We analyzed VA's Office of Small and Disadvantaged Business Utilization's (OSDBU) Vendor Information Pages (VIP) database to determine the change in the total number of businesses that were certified during this same period. To assess the reliability of the data, we reviewed documentation and interviewed officials responsible for maintaining eCMS data to gather information on processes, accuracy, and completeness of the data; we chose to exclude actions reported in Express Reports—summaries of multiple orders placed on existing contracts—from our analysis because they were only consistently reported in eCMS starting in 2017. We determined that the eCMS and VIP data were sufficiently reliable for the purposes of this reporting objective.

To assess what actions VA has taken to update Veterans First policies and regulations following the Supreme Court's decision, we analyzed policies, regulations, guidance, and training materials related to the program, and compared these to what VA had in place prior to the decision. We met with leadership at VA's national contracting organizations to discuss the implementation of the Veterans First policy within their organizations, and interviewed senior officials in VA's Office of Acquisition and Logistics, OSDBU, Office of General Counsel, and Veterans Health Administration's (VHA) Procurement and Logistics Office regarding the program.

To assess what challenges, if any, VA is encountering in applying the Veterans First policy, we gathered documentation from six contracting organizations across the VA. We conducted site visits at a non-generalizable selection of three VHA regional offices, known as Veterans Integrated Service Networks (VISN). We focused our site visits on VHA because it is the largest contracting organization in the Department. We selected these VISNs primarily based on changes in total contract obligations to SDVOSBs and VOSBs from fiscal year 2015 to fiscal year 2017—the first full fiscal years before and after the Supreme Court decision—selecting two with among the largest percentage changes, and one with the lowest. At the selected VISNs, we interviewed leadership at their respective Network Contracting Offices, and selected a non-

generalizable sample of 35 total contracts and orders—29 of which were set aside for SDVOSBs or VOSBs—selected based on high dollar value, and for procurements of construction, services, or supplies. For each of the selected contracts and orders, we reviewed the contract files and interviewed both the contracting officer and the customer—in most cases the contracting officer’s representative. We held roundtable discussions of Veterans First implementation, training, and other matters with 8 to 11 contracting officers at each location, randomly selected from the construction, services, and supply teams. We also interviewed leaders at three VA national contracting organizations—the National Acquisition Center, the Technology Acquisition Center, and the Strategic Acquisition Center.

To assess the extent to which VA has mechanisms in place to monitor compliance with subcontracting limitations, we analyzed VA and SBA policies and regulations. To assess the effectiveness of VA’s mechanisms, we evaluated the extent to which VA applied these mechanisms in the 29 selected contracts set aside for SDVOSBs and VOSBs. We reviewed the internal policies of VA’s Subcontracting Compliance Review Program and analyzed the program’s audit results. We interviewed senior VA procurement officials responsible for developing and/or implementing these mechanisms. We also reviewed our prior work and SBA and VA Inspector General reports on VA and other agencies’ compliance with subcontracting limitations.⁴ See appendix I for a more detailed scope and methodology.

We conducted this performance audit from October 2017 to September 2018 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.

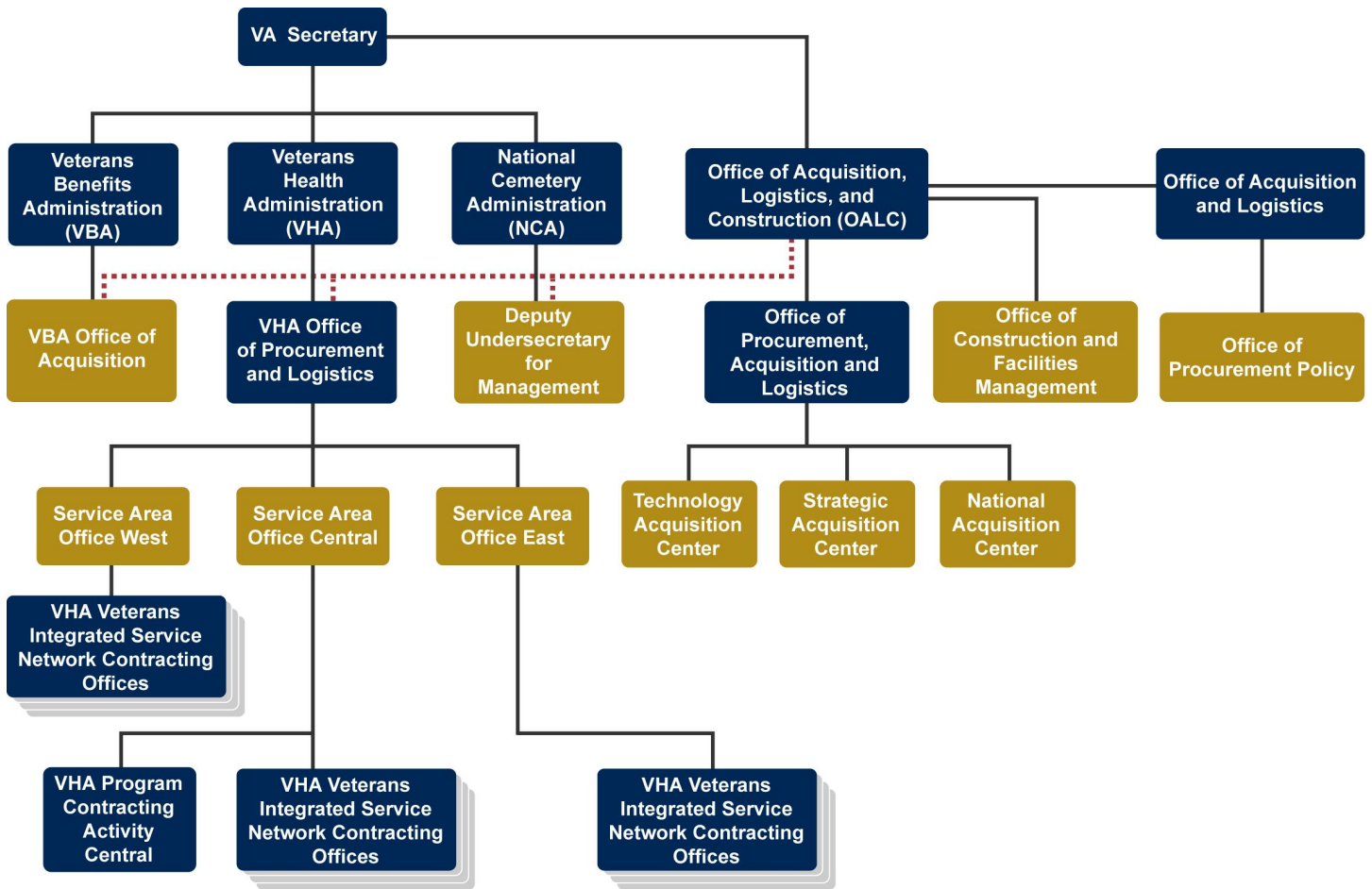
⁴SBA, *Surveillance Review Report, VA VISN 19, Glendale, CO* (Washington, D.C.: Sept. 19, 2016); and Department of Veterans Affairs Inspector General, *Audit of Veteran-Owned and Service-Disabled Veteran-Owned Small Business Programs*, 10-02436-234 (Washington, D.C.: July 25, 2011).

Background

VA Contracting Organizational Structure

VA serves veterans of the U.S. armed forces and provides health, pension, burial, and other benefits. The department's three operational administrations—VHA, Veterans Benefits Administration, and National Cemetery Administration—operate largely independently from one another. Each has its own contracting organization, though all three administrations also work with national contracting offices under the Office of Acquisition, Logistics, and Construction for certain types of purchases, such as medical equipment and information technology. VHA, which provides medical care to about 9 million veterans at 172 medical centers, is by far the largest of the three administrations and, as such, is the primary focus of our review. These VHA medical centers are organized into 18 VISNs, organizations that manage medical centers and associated clinics across a given geographic area. Each VISN is served by a corresponding Network Contracting Office, which awards contracts for goods and services needed by the VISN. VA's Office of Procurement Policy and Warrant Management (referred to in this report as the Office of Procurement Policy), within the Office of Acquisition and Logistics, is responsible for all procurement policy matters at the VA. Figure 1 shows the organizational structure of the procurement function at VA.

Figure 1: Organizational Structure of the Department of Veterans Affairs (VA) Procurement Function



..... OALC's oversight of the acquisition function in each Administration.

■ Heads of contracting activity (HCA)

Source: GAO analysis of Veterans Affairs organizational charts and policies. | GAO-18-648

Preferences for Veteran-Owned Small Businesses in Awards of VA Contracts

The 2006 Veterans Benefits, Health Care, and Information Technology Act established a requirement that VA contract competitions must be restricted to SDVOSBs and VOSBs if: 1) the contracting officer reasonably expects that at least two such businesses will submit offers, and 2) the award can be made at a fair and reasonable price that offers

the best value to the government. (In this report, we refer to these two elements of the law as criteria.) This determination is known as the “VA Rule of Two.” The statute also establishes an order of priority for the contracting preferences, with the highest preference for SDVOSBs, followed by VOSBs. (In this report, we refer to these businesses collectively as SD/VOSBs.)

There are a number of socio-economic programs implemented in the Federal Acquisition Regulation (FAR) that provide contracting preferences or special contracting authorities for specific groups. These include contracting preferences for small businesses overall as well as more targeted preferences such as SBA’s 8(a) Business Development Program, which assists disadvantaged small businesses. Unlike these other socioeconomic preference programs that generally apply to agencies across the federal government, the 2006 statute created a preference for SD/VOSBs that applies only to VA.⁵

In June 2016, the Supreme Court decision in *Kingdomware Technologies, Inc. v. United States* found that the manner in which VA had been applying the preference for SD/VOSBs was not consistent with the 2006 statute. This case arose because VA was not applying the statute’s preference in competitions for orders under the FSS, which VA uses to order medical supplies, among other things. The Supreme Court ruled that VA’s FSS orders are subject to the 2006 statute, and that the VA Rule of Two must be applied because the statute mandates its use before contracting under competitive procedures.

Previously, VA considered FSS a mandatory source of supplies and services that must be used when possible, but did not require that contracting officers apply the Rule of Two when placing FSS orders. An example of a mandatory source used across the federal government is the AbilityOne procurement list. AbilityOne is a program to employ the blind and people with severe disabilities to provide supplies and services

⁵Separate and prior legislation—the Veterans Benefit Act of 2003, codified at 15 U.S.C. § 657f—created a procurement program for SDVOSBs that applies government-wide. This program was implemented through Federal Acquisition Regulation subpart 19.14 and SBA regulations.

to federal customers.⁶ Federal agencies that need the specific products and services on AbilityOne's procurement list are generally required to purchase them through the program.

Contracting officers, who are authorized to commit the government to contracts, are ultimately responsible for awarding and administering contracts, including ensuring compliance with the VA Rule of Two. Within the VA contracting organizations we reviewed, the contracting officer typically designates a representative of the customer office—the organization that has requested the purchase of a good or service for its use—as the contracting officer's representative. This individual assists with tasks that support the work of the contracting officer, such as market research, developing independent government cost estimates, and monitoring contractor performance.

Verification of SD/VOSBs

The 2006 statute also required VA to maintain a database of verified SD/VOSBs, and required that only firms appearing in the database may qualify for VA awards set aside for SD/VOSBs. VA's Office of Small and Disadvantaged Business Utilization (OSDBU) maintains this database through its Center for Verification and Evaluation, which assesses whether small businesses meet the criteria for being veteran-owned and controlled by verifying self-certifications provided by the SD/VOSBs. A separate federal agency, SBA, is responsible for setting size standards (by revenue and employees) for what constitutes a small business; the threshold varies by industry. Certified SD/VOSBs—which VA has verified as owned and controlled by veterans—are listed in VA's Vendor Information Pages (VIP). This is an online database accessible to VA's contracting workforce and the public that includes basic information about each firm.⁷ Firms listed in this database select numerical codes based on the North American Industry Classification System to identify the types of

⁶In 1938, Congress established a program under the Wagner-O'Day Act that created employment opportunities for the blind. People employed under the program manufactured and sold certain products, such as brooms and mops, to the federal government. In 1971, Congress expanded the program under the Javits-Wagner-O'Day Act to employ people with other severe disabilities and provide services (in addition to products) to federal customers.

⁷GAO, *Department of Veterans Affairs: Agency Has Exceeded Contracting Goals for Veteran-Owned Small Businesses, but It Faces Challenges with Its Verification Program*, [GAO-10-458](#) (Washington, D.C.: May 28, 2010).

goods and services they seek to provide to the VA; firms can do business under a variety of these codes.

Subcontracting Limitations

While SD/VOSBs that receive awards through set-asides may subcontract with firms that do not have small business status, the SD/VOSBs generally must perform a certain percentage of the work on a contract themselves. The SBA establishes regulations that govern these subcontracting limitations, which were most recently revised in May 2016.⁸ These regulations place limits on the percentage of the overall contract value that firms in particular socio-economic categories, including SD/VOSBs, may pay to subcontractors that do not belong to the same category.

The purpose of the subcontracting limitations is to ensure that firms that receive awards on a set-aside basis perform a material portion of the contract themselves, rather than subcontracting a majority of the work to firms that would have been ineligible for the award. Under SBA's revised regulations, subcontracted work performed by "similarly situated" entities—those in the same socio-economic category as the firm awarded the set-aside contract—does not count against the subcontracting limitation. Table 1 lists the maximum percentage a firm that is awarded a set-aside contract may subcontract to firms that are not in the same socio-economic category under SBA's 2016 Subcontracting Limitations regulations.

Table 1: Small Business Administration Subcontracting Limitations (May 2016)

Category of contract	Maximum percentage of work service-disabled veteran-owned small businesses may subcontract to firms without that status on a set-aside contract
Services (excluding construction services)	50 percent of the amount paid by the government
Supplies	50 percent of the amount paid by the government. ^{a, b}
General construction	85 percent of the amount paid by the government. ^b
Specialty construction	75 percent of the amount paid by the government. ^b

Source: GAO analysis of Small Business Administration Regulations (13 CFR § 125.6). | GAO-18-648

⁸The May 2016 revision was to implement provisions in the fiscal year 2013 National Defense Authorization Act related to subcontracting limitations. 81 Fed. Reg. 34,243, 34,244 (May 31, 2016).

^aIn the case of a contract for supplies from a nonmanufacturer, the firm must supply the product of a domestic small business manufacturer, unless a waiver is granted. This is known as the “nonmanufacturer rule.” See 13. C.F.R. § 121.406

^bThe cost of materials are excluded and not considered to be subcontracted.

If a firm violates the subcontracting limitations, SBA’s subcontracting limitation regulation would allow the government to impose a penalty of \$500,000 or, if it is greater, the dollar amount spent on subcontracted work in excess of the permitted level.⁹ Contracting officers are responsible for ensuring compliance with the terms of the contract, and, as discussed in more detail below, the terms of a contract may include a requirement to comply with SBA’s limitations on subcontracting regulation. In addition, we have reported that contracting officers were not clear who was responsible for the monitoring, and uncertain about how to conduct the monitoring.¹⁰ The VA’s Inspector General and SBA compliance reviews have reported similar findings.¹¹

Obligations to and Number of SD/VOSBs Receiving Awards Were Higher Following the Supreme Court Decision

VA’s set-asides to SD/VOSBs increased following the 2016 Supreme Court decision, particularly among non-construction contract actions. The change in percentage of obligations made under set-aside contracts varied across VA contracting organizations, in part because of differences in the types of goods and services they bought. The number of SD/VOSBs certified by VA also increased, as did the number of those firms that received contract awards.

⁹For example, if only \$5 million of work was allowed to be subcontracted but the actual amount of subcontracted work was valued at \$6 million, the penalty could be up to \$1 million.

¹⁰GAO, *8(a) Subcontracting Limitations: Continued Noncompliance with Monitoring Requirements Signals Need for Regulatory Change*, [GAO-14-706](#) (Washington, D.C.: September 16, 2014).

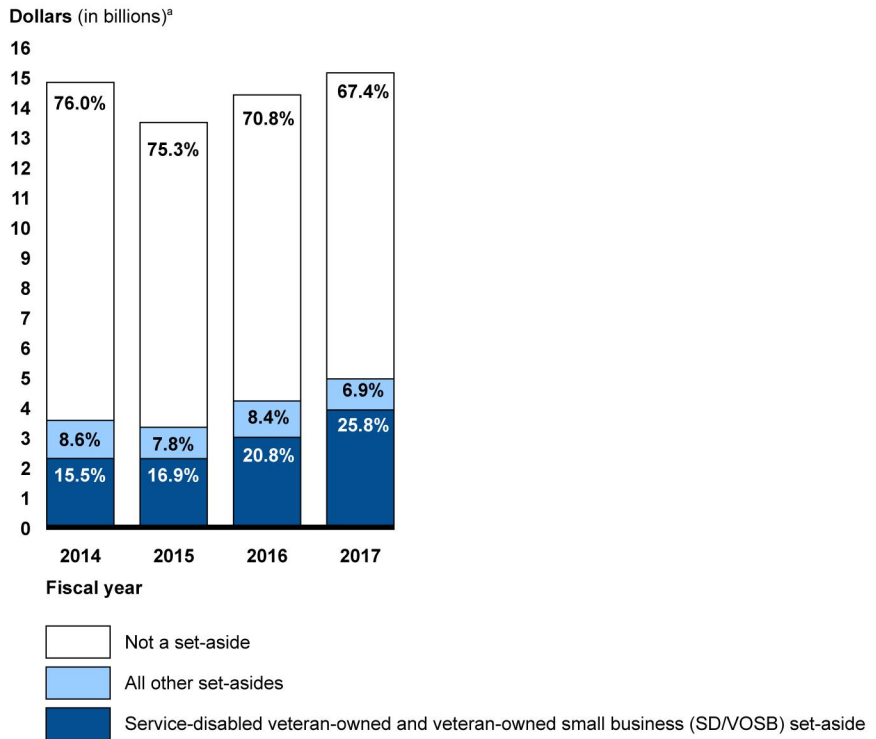
¹¹Department of Veterans Affairs Inspector General, *Audit of Veteran-Owned and Service-Disabled Veteran-Owned Small Business Programs*, 10-02436-234 (Washington, D.C.: July 25, 2011); and SBA, *Surveillance Review Report, VA VISN 19, Glendale, CO* (Washington, D.C.: Sept. 19, 2016).

Obligations and Awards to SD/VOSBs Increased Since the Supreme Court Decision

VA obligations and awards for SD/VOSB set-asides increased in fiscal years 2016 and 2017, particularly fiscal year 2017, which was the first full fiscal year following the 2016 Supreme Court decision.¹² VA obligations for SD/VOSB set-asides have increased as a percentage of total VA obligations over this period, while the percentage of obligations through other set-aside types—mostly non-veteran-owned small business set-asides—remained almost steady. VA obligated about \$3.9 billion through SD/VOSB set-asides in fiscal year 2017, and VA's overall obligations also increased. Figure 2 depicts this information.

¹²Our comparison of VA obligations and awards excluded orders included in Express Reports (summary reports of multiple orders placed on existing contracts, such as for nursing home care) because these orders were not consistently reported to the Veterans Affairs Electronic Contract Management System until after fiscal year 2016, and they include few set-asides for SD/VOSBs.

Figure 2: VA Obligations for SD/VOSB Set-Asides and Other Categories, Fiscal Years 2014 through 2017

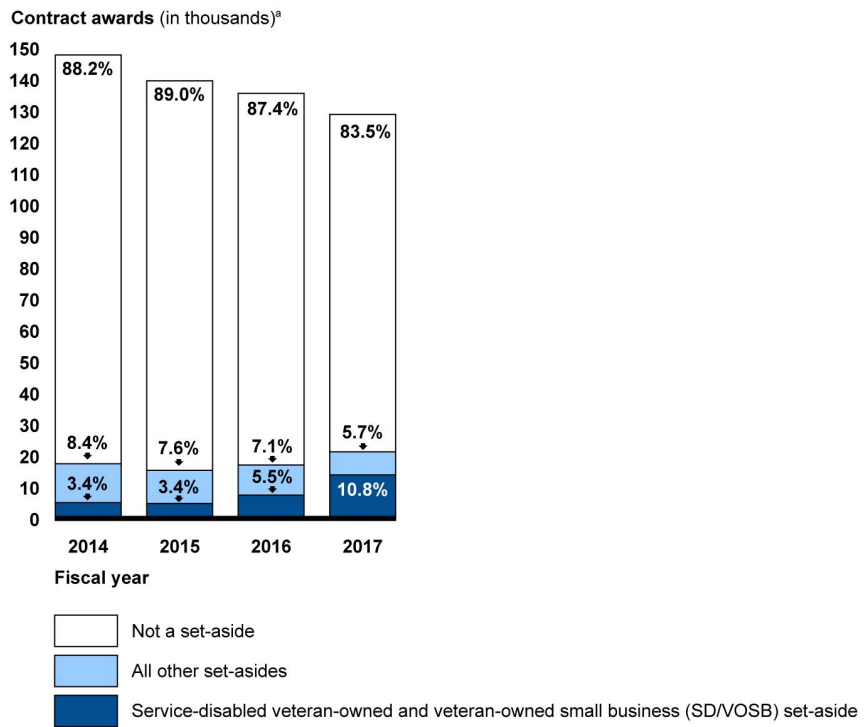


Source: GAO analysis of Veterans Affairs (VA) Electronic Contract Management System data. | GAO-18-648

^aObligations exclude orders included in Express Reports (summary reports of multiple orders placed on existing contracts, such as for nursing home care), because these data were not consistently reported to eCMS until fiscal year 2017, and include relatively few SD/VOSB set-asides. As a result, these figures do not represent total VA contract obligations in these fiscal years. Totals include all obligations in each year under contracts and orders that were set aside for SD/VOSBs, even if the original award occurred in a prior year. All data are in constant fiscal year 2017 dollars adjusted for inflation using fiscal year gross domestic price index.

The number of individual awards—new contracts and orders—made by VA through SD/VOSB set-asides has also increased as a percentage of total VA awards from fiscal years 2014 through 2017, particularly in fiscal year 2017 following the Supreme Court decision, as shown in figure 3.¹³

Figure 3: VA Awards Set Aside for SD/VOSBs and Other Categories, Fiscal Years 2014 through 2017



Source: GAO analysis of Veterans Affairs (VA) Electronic Contract Management System data. | GAO-18-648

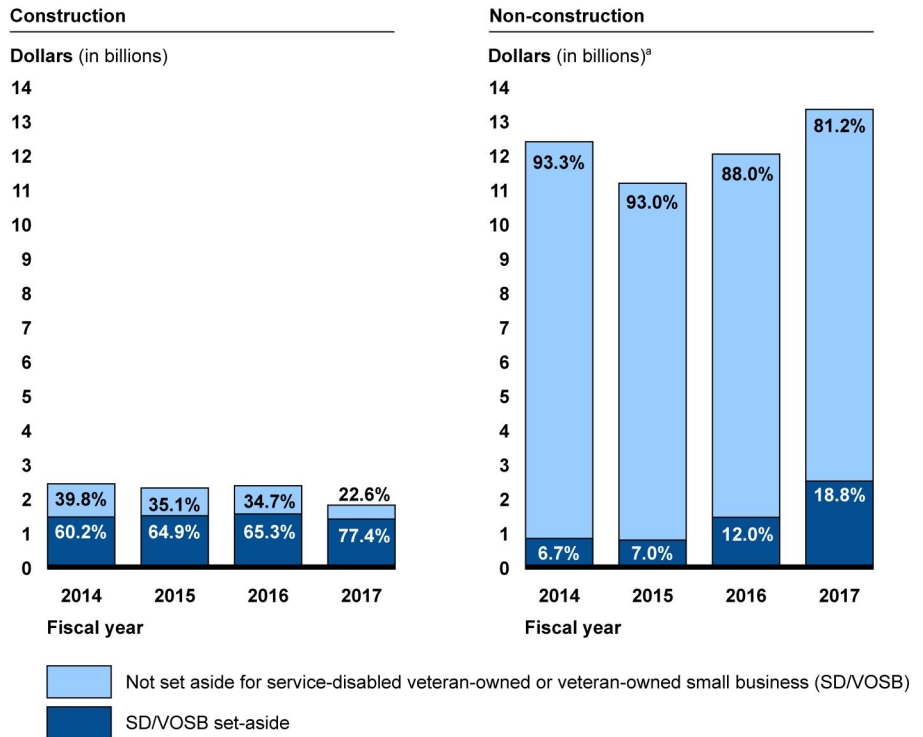
^aThis analysis excludes orders included in Express Reports (summary reports of multiple orders placed on existing contracts, such as for nursing home care), because these data were not consistently reported to eCMS until fiscal year 2017 and include relatively few SD/VOSB set-asides. As a result, these figures do not represent all VA contract actions in these fiscal years.

¹³For the purposes of this report, “orders” refers to orders are placed under indefinite delivery contracts, which do not specify a firm quantity (other than a minimum or maximum) and provide for the issuance of orders during the contract period. FAR §§ 16.501-1, 16.504.

SD/VOSB Non-Construction Set Asides Increased

VA has consistently set aside a much greater percentage of construction contracts and orders for SD/VOSBs than for other types of goods and services, according to our analysis of VA eCMS data from fiscal years 2014 through 2017. Construction accounted for about 51 percent of obligations under SD/VOSB set-asides, despite construction representing only about 15 percent of VA's overall contract obligations during this period. VA contracting officials we spoke with stated that the market for firms performing construction services generally has a greater percentage of capable SD/VOSBs than the market for firms providing non-construction goods and services. VA contracting officers working on construction contracts told us that they experienced little effect from the policy changes related to the 2016 Supreme Court decision because they had already been setting aside most construction contract actions for SD/VOSBs. Nonetheless, there was an increase in the percentage of total obligations for construction set-asides to SD/VOSBs in fiscal year 2017, while total obligations for construction contracts declined. Figure 4 shows total and set-aside obligations for construction and non-construction contract actions in fiscal years 2014 through 2017.

Figure 4: VA Obligations for Construction and Non-Construction Set-Asides for SD/VOSBs, Fiscal Years 2014 through 2017



Source: GAO analysis of Veterans Affairs (VA) Electronic Contract Management System data. | GAO-18-648

^aObligations exclude orders included in Express Reports (summary reports of multiple orders placed on existing contracts, such as for nursing home care), because these data were not consistently reported to eCMS until fiscal year 2017 and include relatively few SD/VOSB set-asides. As a result, these figures do not represent total VA contract obligations in these fiscal years. Totals here include all obligations in each year under contract actions that were set aside for SD/VOSBs, even if the original award occurred in a prior year. All data are in constant fiscal year 2017 dollars adjusted for inflation using fiscal year gross domestic price index.

As depicted in figure 4, obligations for non-construction SD/VOSB set-asides increased in fiscal year 2017 both in total dollars and as a percentage of total obligations. Among obligations for non-construction SD/VOSB set-asides, the top five categories of goods and services by obligations across fiscal years 2014 through 2017 included:

1. Automatic data processing and telecommunications.
2. Information technology equipment, software, supplies, and support equipment.
3. Medical/dental equipment and supplies.
4. Professional services.

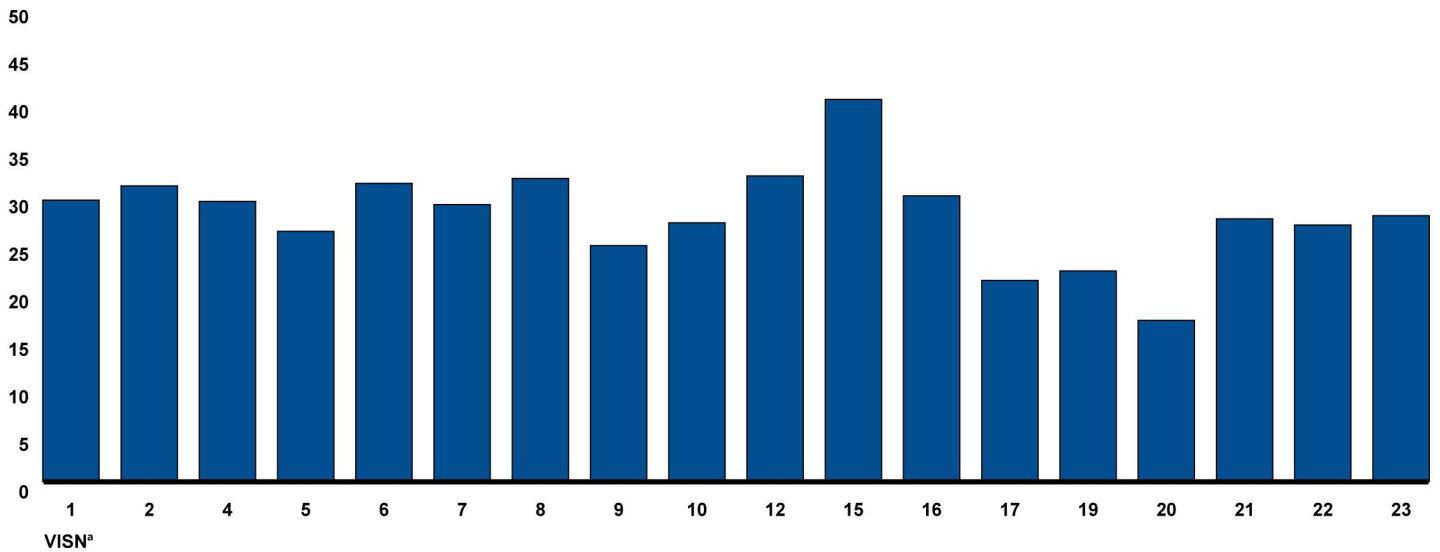
5. Housekeeping services.

Obligations for SD/VOSB Set-Asides Varied across VA Contracting Organizations

The percentage of obligations for SD/VOSB set-asides varied across VA contracting organizations. Among the contracting offices for VHA's 18 VISNs—which together accounted for about 47 percent of total obligations—the percentage for SD/VOSB set-asides ranged from approximately 17 percent to 40 percent in fiscal year 2017, as shown in figure 5.

Figure 5: Percentage of Obligations for SD/VOSB Set-Asides in VISN Contracting Offices, Fiscal Year 2017

2017 percent of obligations to SD/VOSB set-asides



VISN = Veterans Integrated Service Network
 SD/VOSB = Service-disabled veteran-owned and veteran-owned small business

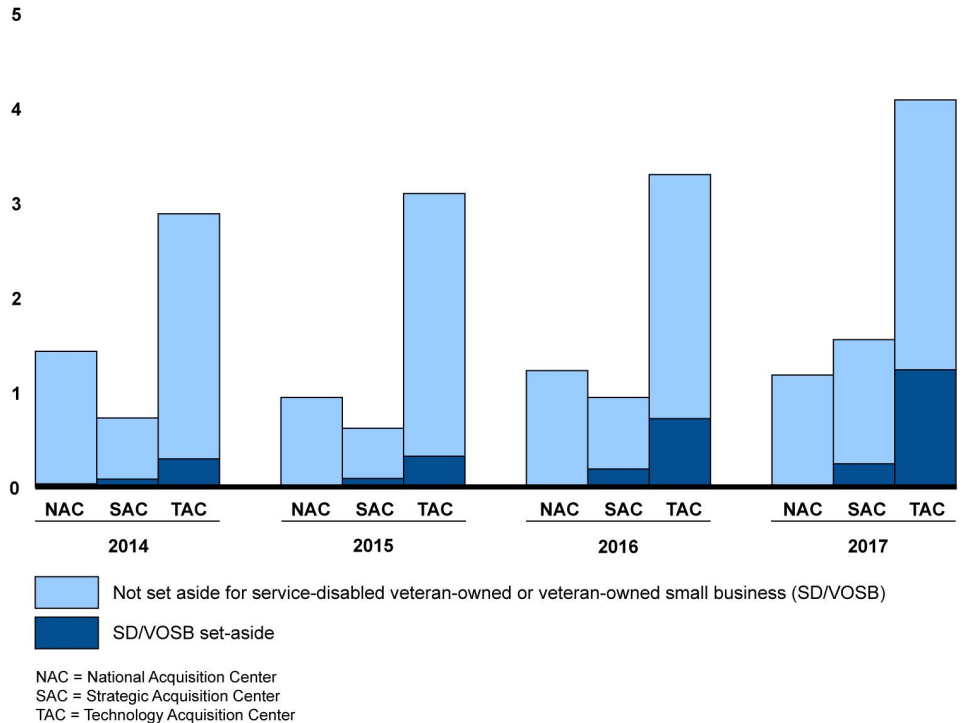
Source: GAO analysis of Veterans Affairs (VA) Electronic Contract Management System data. | GAO-18-648

^aSome VISNs have been consolidated over time. In fiscal year 2017, there were 18 VISNs in total. Total obligations and SD/VOSB set-aside obligations also varied across VA's three national contracting offices—the National Acquisition Center, Strategic Acquisition Center, and Technology Acquisition Center—in part because of differences in the types of goods and services they procure. The Technology Acquisition Center had a larger increase in SD/VOSB set-aside obligations than other contracting organizations in fiscal year 2017. This increase is consistent with our finding that IT-related categories were among the types of goods and services that had the

highest increase in SD/VOSB obligations following the Supreme Court decision. The National Acquisition Center consistently had the lowest volume and percentage of obligations for SD/VOSB set-asides; officials noted that its areas of focus in pharmaceuticals and high tech medical equipment are markets that have little participation from small businesses and SD/VOSBs. Figure 6 shows obligations on set-aside and non-set-aside contracts and orders in these three national contracting offices over fiscal years 2014 through 2017.

Figure 6: Obligations on SD/VOSB Set-Aside and Non-SD/VOSB-Set-Aside Contracts and Orders in Fiscal Years 2014 through 2017 for VA's National Acquisition Center (NAC), Strategic Acquisition Center (SAC), and Technology Acquisition Center (TAC)

Dollars (in billions)^a



Source: GAO analysis of Veterans Affairs (VA) Electronic Contract Management System data. | GAO-18-648

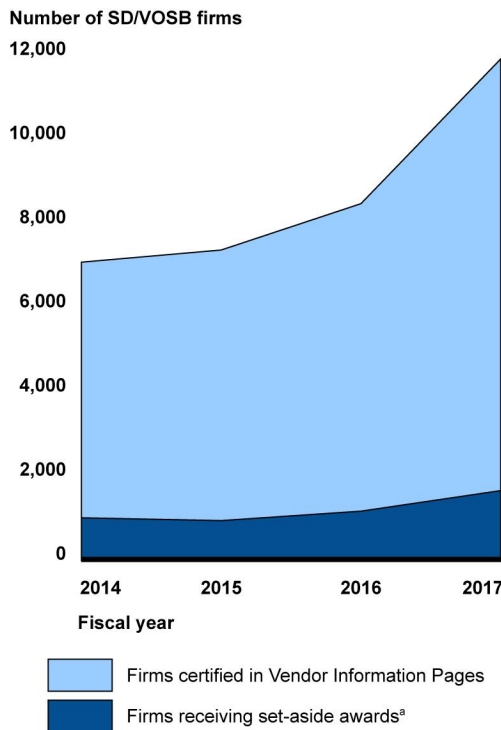
^aObligations exclude orders included in Express Reports (summary reports of multiple orders placed on existing contracts, such as for nursing home care), because these data were not consistently reported to eCMS until fiscal year 2017, and include relatively few SD/VOSB set-asides. As a result, these figures do not represent total VA contract obligations in these fiscal years. Totals shown here include all obligations in each year under contract actions that were set aside for SD/VOSBs, even if the original award occurred in a prior year. All data are in constant fiscal year 2017 dollars adjusted for inflation using fiscal year gross domestic price index.

The Number of Veteran-Owned Small Businesses Receiving Set-Aside Awards Has Increased Since the Supreme Court Decision

Data from VA's OSDBU shows consistent increases over the last several years in the number of certified firms listed in its VIP database, with a noticeable spike following the Supreme Court decision. While the number of certified SD/VOSBs in VIP increased annually from fiscal years 2014 through 2017, the largest increase—from 8,925 to 11,926 firms—occurred in the last year of this time frame.

The number of SD/VOSBs that received set-aside contracts or orders also increased over fiscal years 2015 through 2017. The largest year-to-year increase during this period was in the last year of this time frame, when the number increased from 1,174 to 1,663, as shown in figure 7.

Figure 7: Number of SD/VOSB Certified Firms in VA Vendor Information Pages (VIP) Database, and Number of SD/VOSBs Receiving Set-Aside Awards, Fiscal Years 2014 through 2017



SD/VOSB = Service-disabled veteran-owned and veteran-owned small business

Source: GAO analysis of Veterans Affairs (VA) Electronic Contract Management System and Vendor Information Pages (VIP) data. | GAO-18-648

^aAnalysis includes firms receiving obligations in each fiscal year under contract actions that were set aside for SD/VOSBs, even if the award occurred in a prior fiscal year.

VA Updated Policy for the Veterans First Program and Provided Training to Contracting Officers to Address Confusion

VA Updated Veterans First Program Policy

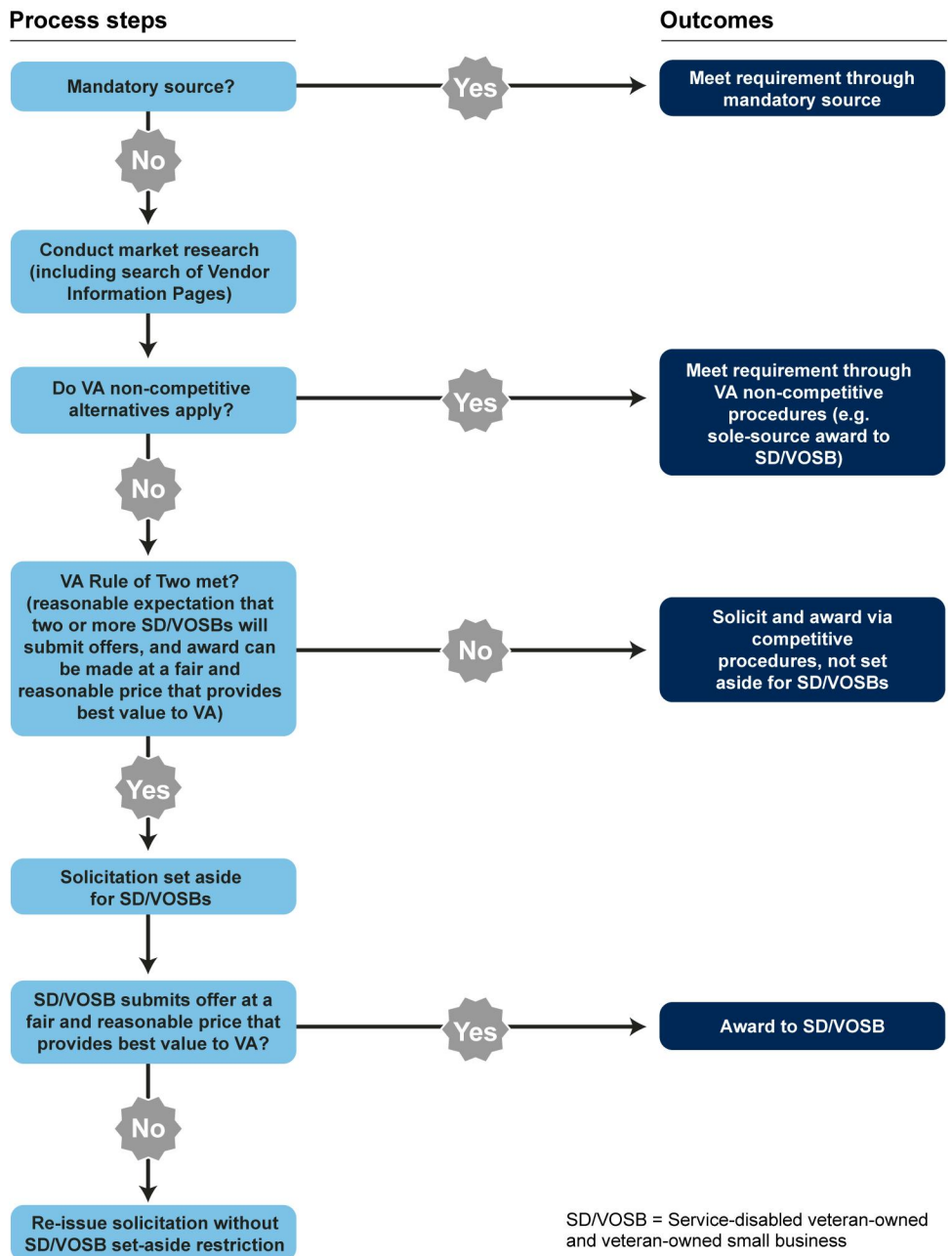
In response to the Supreme Court's 2016 decision in the case of *Kingdomware Technologies, Inc. v. United States*, VA released a July

2016 policy for the Veterans First program, a revision to its 2007 policy.¹⁴ To develop this revised policy, officials from VA's Office of Procurement Policy said they created an integrated project team that consisted of representatives from VA procurement leadership, the Office of General Counsel, OSDDBU, and others. VA's Office of Procurement Policy also subsequently issued a "class deviation" to the VA Acquisition Regulation to implement changes VA viewed as necessary for consistency with the Supreme Court's decision. VA's Deputy Senior Procurement Executive issues class deviations when necessary to allow VA's contracting organizations to deviate from the FAR or VA Acquisition Regulation.¹⁵ According to VA officials, these deviations effectively replace existing policy. The Office of Procurement Policy also issued guidance to provide clarifications on certain issues. Among the guidance VA issued was a decision tree that summarized how to apply the VA Rule of Two under the new 2016 Veterans First policy. Figure 8 presents our analysis of VA's process.

¹⁴VA also issued regulations in 2009 to incorporate the approach outlined in the 2007 policy memorandum into the VA Acquisition Regulation. See 74 Fed. Reg. 64,619 (Dec. 8, 2009) (final rule revising numerous sections of the VA Acquisition Regulation to implement portions of the Veterans Benefits, Health Care, and Information Technology Act of 2006 by providing opportunities for SD/VOSBs to increase their federal contracting and subcontracting).

¹⁵A class deviation is a deviation from the FAR (or agency acquisition regulation, such as the VA Acquisition Regulation) that revises how the regulations are applied to specified categories of contract actions. See FAR § 1.404.

Figure 8: Overview of Process for Applying VA Rule of Two



Source: GAO analysis of Veterans Affairs (VA) policies and guidance. | GAO-18-648

VA's Office of Acquisition and Logistics had issued an Information Letter in June 2007 that established procedures for the Veterans First program, to comply with the 2006 federal statute that directed VA to prioritize

SD/VOSBs in their contracting decisions.¹⁶ While the basic principle of the VA Rule of Two was the same across the 2007 and 2016 policies, the 2007 policy did not provide contracting officers as many details for applying the VA Rule of Two. In contrast, the 2016 policy provides more detail on how contracting officers must implement set-asides for SD/VOSBs across different types of procurements and various steps in the contracting process, including market research and use of existing contract vehicles—such as FSS and agency-wide indefinite delivery contracts. These changes had implications for how VA contracting officers make contracting decisions and document their work. Table 2 summarizes key differences in emphasis between the 2007 and 2016 policies and the work that contracting officers must perform.

¹⁶At the time this Information Letter was issued, the organization was known as the Office of Acquisition and Materiel Management. As we found in September 2016, Information Letters were meant to be temporary in nature, and VA's Office of Procurement Policy has been working to replace all such documents with Procurement Policy Memoranda. See GAO, *Veterans Affairs Contracting: Improvements in Policies and Processes Could Yield Cost Savings and Efficiency*, [GAO-16-810](#) (Washington, D.C.: Sept. 16, 2016).

Table 2: Key Differences between VA Veterans First Program Policies in 2007 and after the *Kingdomware Technologies, Inc. v. United States* Supreme Court Decision

Topics	Veterans First Policy in 2007 ^a <i>Veterans First policy, June 19, 2007</i>	Veterans First Policy after Supreme Court decision ^b <i>Veterans First policy, July 25, 2016</i>
Market research	<ul style="list-style-type: none"> No mention of requirements for conducting market research. No mention of documentation of market research.^c 	<ul style="list-style-type: none"> Contracting officers must perform market research to determine whether the VA Rule of Two is met. Contracting officers must thoroughly document market research in the contract file.
Vendor Information Pages (VIP) database	<ul style="list-style-type: none"> Contracting officers must use VIP as a source to confirm a vendor's status as a service-disabled veteran-owned or veteran-owned small business (SD/VOSB) at the time of award. 	<ul style="list-style-type: none"> Contracting officers must use VIP as the first step in market research to identify SD/VOSBs capable of performing work. Contracting officers must use VIP as a source to confirm a vendor's SD/VOSB status at the time of award. Contracting officers must document VIP queries in the contract file.
Existing contract vehicles and mandatory sources	<ul style="list-style-type: none"> Rules for use of Federal Supply Schedules (FSS) and AbilityOne are unchanged. 	<ul style="list-style-type: none"> Rules for use of AbilityOne are unchanged, except that the VA Rule of Two must be applied before adding a new requirement to the AbilityOne procurement list. Rules for use of FSS and VA national contract vehicles are revised to require application of the VA Rule of Two before the purchase.

Source: GAO analysis of VA policies. | GAO-18-648

^aIn addition to the Veterans First Information Letter issued on June 19, 2007, VA later revised numerous sections of the VA Acquisition Regulation in 2009 to implement the SD/VOSB contracting preferences established in the Veterans Benefits, Health Care, and Information Technology Act of 2006.

^bIn addition to the Veterans First Procurement Policy Memo issued on July 25, 2016, VA issued deviations to the VA Acquisition Regulation in 2016, 2017, and 2018 to implement changes related to the Supreme Court's decision.

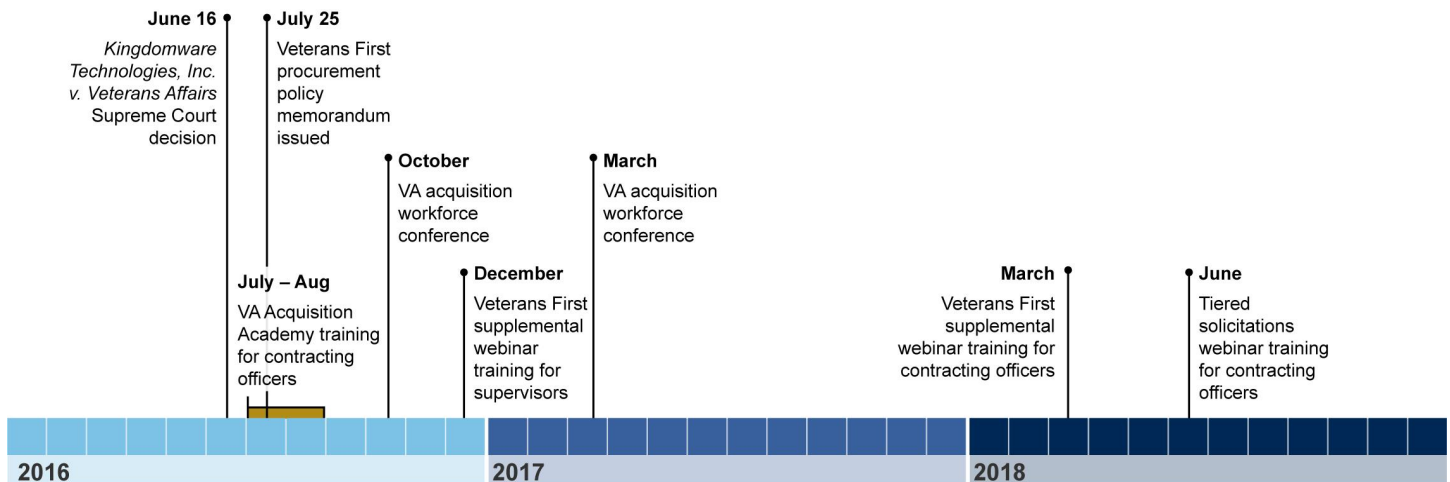
^cWhile market research was not addressed in the 2007 Veterans First policy, market research and documentation of market research were addressed in VA's 2009 revision to the VA Acquisition Regulation. Further, the Federal Acquisition Regulation generally requires agencies to conduct market research appropriate to the circumstances.

VA Provided Training on Updated Veterans First Program Policy

VA has conducted training for its workforce on the 2016 Veterans First policy and subsequent updates and guidance. VA's Office of Procurement Policy collaborated with the VA Acquisition Academy to provide several

installments of online training to contracting officers. The academy offered initial training to contracting officers in July 2016, just after the policy was issued. Supplemental training was offered to supervisors in December 2016. In March 2018, the academy offered follow-up training for all contracting officers to provide further clarification on the Veterans First policy. These trainings focused on specific areas of frequent questions that the Office of Procurement Policy received from contracting officers, including market research, fair and reasonable price determinations, and limitations on subcontracting, among other things. These trainings were highly encouraged but not mandatory. Figure 9 details the training provided to contracting officers.

Figure 9: Timeline of Training Provided to Contracting Officers on Veterans First Program after the Supreme Court Decision



Source: GAO analysis of Veterans Affairs (VA) information and documents. | GAO-18-648

VA Took Steps to Clarify Certain Aspects of Veterans First Policy to Help Address Contracting Officer Confusion and Concerns

VA’s Office of Procurement Policy addressed some aspects of the 2016 Veterans First policy that had caused confusion and concerns among contracting officers by providing additional guidance and policy. Contracting officers we met with told us of their initial uncertainty about whether they could use existing contract vehicles and whether they must apply the VA Rule of Two before using these vehicles under the Veterans First policy. In response to such concerns, the Office of Procurement Policy gathered frequently asked questions, and created guidance by

posting answers on its website as another mechanism for providing clarification to contracting officers.

VA also issued new policy and guidance to address contracting officers' concerns about the additional work and delays associated with cases where they set-aside a solicitation for SD/VOSBs but did not receive any offers. Specifically, 28 of the contracting officers we interviewed individually and in roundtable discussions told us they sometimes had to cancel SD/VOSB solicitations for this reason and then reopen procurements without the SD/VOSB set-aside, resulting in delays in the contract award process. Other contracting officials we spoke with told us that since the implementation of the 2016 Veterans First policy, individual contract actions take longer to award on average due to the need to re-solicit in cases where they set aside solicitations for SD/VOSBs but do not receive acceptable offers, as well as due to expectations for increased documentation of the rationale for issuing a solicitation without an SD/VOSB set-aside restriction. For instance, a contracting officer at one of the VISN contracting offices we visited stated that a majority of his contract actions have involved multiple rounds of solicitations, which has increased his workload and procurement lead times.

In response to such concerns, VA's Office of Procurement Policy provided informal guidance in early 2017, followed by policy in February 2018 that contracting officers could use "tiered" or "cascading" solicitations. Under VA's current policy, VA issues a solicitation that requests offers from multiple types of firms, or "tiers," including SD/VOSBs, other small business types, and, potentially, large businesses. The solicitation establishes an order of preference among the different tiers. The contracting officer separates the offers based on the firms' size or socioeconomic status, and then evaluates them in the order of preference established by the solicitation. If the award cannot be made

at the first tier, the evaluation moves to the succeeding tier or tiers until an award can be made.¹⁷

¹⁷In the context of the Veterans First program, a contracting officer would award to an SD/VOSB firm if, upon evaluation of the offers submitted by SD/VOSB concerns, the contracting officer determines at least one offer would result in award at a fair and reasonable price that offers best value to the VA. If no offers were submitted by SD/VOSBs, or if the contracting officer determines that none of the SD/VOSB offers would result in award at a fair and reasonable price that offers best value to the VA, then the contracting officer would withdraw the SD/VOSB set-aside, and proceed to the set-aside for the subsequent tier—for example, a small business—and proceed with the same evaluation process until the contracting officer determines that award can be made at a fair and reasonable price that offers best value to the VA. Otherwise, the contracting officer could cancel the tiered solicitation and resolicit as an unrestricted procurement.

Contracting Officers Face Several Challenges in Applying Aspects of the Veterans First Policy

Applying the 2016 Veterans First policy has presented challenges for contracting officers. First, the VA system that contracting officers are required to use for the initial step of market research was not designed for this purpose, and contracting officers we interviewed expressed dissatisfaction with it. Second, contracting officers we spoke with expressed confusion about conducting market research and applying the VA Rule of Two criteria—determining whether there is a reasonable expectation that two or more SD/VOSBs will submit offers and that award can be made at a fair and reasonable price that offers best value to the government. Further, contracting officers also expressed confusion on how to determine whether the prices offered by SD/VOSBs in response to a set-aside solicitation are fair and reasonable. Finally, continuing workload issues, real and perceived pressure to set aside contracts, and training not reaching all VA contracting officers are other factors that continue to contribute to the challenges.

Contracting Officers Cited Barriers in Using VA's Vendor Information Pages System to Conduct Market Research

VA's 2016 Veterans First policy requires contracting officers to use VIP as the first step in market research to identify SD/VOSBs capable of performing the work. While the use of VIP and documentation of its use had been required by the VA Acquisition Regulation since 2009, presenting it as the first step for all market research was a key change in how contracting officers use this system. Forty-one out of 60 contracting officers we interviewed individually and in roundtable discussions expressed dissatisfaction with VIP as the starting point for market research, citing difficulty in using it and lack of usefulness to conduct market research. Specifically, several of these contracting officers stated that while VIP can be used to determine whether firms are certified as SD/VOSBs, it does not contain much information to help them determine whether these SD/VOSBs will be capable of performing the contract. They also stated, and OSDBU officials confirmed, that each SD/VOSB self-selects the codes that indicate the types of goods and services it can provide, and many list a large number. As a result, a search can return hundreds of results. Twenty-six contracting officers we interviewed—either individually or in roundtable discussions—stated that they have had instances where they issued an SD/VOSB set-aside solicitation based on

a VIP search returning a high number of SD/VOSB contractors that provide the desired goods or services, but no SD/VOSBs submitted offers. Many of these contracting officers stated that, because they feel they cannot rely on the VIP results, they have taken subsequent steps such as using public “sources sought” notices to gauge interest from SD/VOSBs. While this step requires additional time, they said they found it to be a better source of information for making a VA Rule of Two decision.

VA OSDBU officials stated that they would like to provide contracting officers with enhanced utility for conducting and documenting market research. They acknowledged that VIP is not designed to be used as a market research tool and that the challenges contracting officers noted were not surprising. The director of OSDBU stated that VA is planning to make some improvements to its VIP database to provide better information on SD/VOSB capability, but, according to these officials, these improvements are not yet available for use.

The 2016 Veterans First policy requires contracting officers to document their VIP searches in the contract file, but this requirement is being implemented inconsistently. Specifically, 29 of the 35 contract files we reviewed did not contain such documentation. The cognizant contracting officers for most of these contracts told us they conducted the VIP searches; some stated they forgot to print and attach the results to the contract file, while others stated they had difficulty printing the results. According to VA’s Veterans First policy, documenting the results of the VIP search is required to establish the contracting officer’s basis for the VA Rule of Two decision, regardless of whether the contract is set aside or not. Documenting this information in the case files, as required, provides VA with assurance that contracting officers have performed this search to support their overall market research efforts.

Contracting Officers Face Challenges in Determining Whether to Set Aside for SD/VOSBs Under VA Rule of Two

There are a large number of certified SD/VOSBs offering various goods and services—about 12,000 as of fiscal year 2017, according to VIP data provided by the OSDBU. A number of contracting officers we met with stated that this can result in VIP searches that return a lengthy list of SD/VOSBs. As a result, the decision of whether to set aside a solicitation is often based on the second criterion of the VA Rule of Two—whether

there is a reasonable expectation that the award can be made at a price that is fair and reasonable and offers the best value to VA. To meet this criterion, the contracting officer combines research and professional judgment to make a decision whether to set aside or not, according to VA officials.

While these VA Rule of Two criteria have not changed since 2007, contracting officers told us that their perception of the rule's application has changed following the Supreme Court decision and VA's 2016 Veterans First policy. Several contracting officers we met with stated that sometimes, when they identified that there were two or more SD/VOSBs that they expected to submit offers, they set aside a solicitation without providing full consideration of this second criterion. These contracting officers told us it is difficult in some cases to make a prospective determination that they can reasonably expect to be able to make an award at a fair and reasonable price without any actual offers in-hand. Contracting officers told us that prior to the Supreme Court decision their understanding was that they had the option to set aside contract actions for SD/VOSBs when they expected that the price would be fair and reasonable. They stated that after the decision, management relayed an expectation that contracting officers must set aside contract actions to SD/VOSBs unless they can prove that they cannot reasonably expect to make an award at a fair and reasonable price.

Contracting officers also told us of instances where they identified multiple SD/VOSBs likely to submit proposals, but, based on their market research, it was unlikely that an award could be made at a fair and reasonable price that offered best value to VA. Many of these contracting officers stated that, despite those findings, they focused only on the number of SD/VOSBs, in part because they felt pressure to do so from local or headquarters' management, OSD/BU, or feared protests from SD/VOSBs, which would delay the award.

In two specific areas of contracting we found examples of differing approaches to addressing the challenges faced by contracting officers when applying the VA Rule of Two criteria. Prior to the Supreme Court decision, there was little use of SD/VOSB set-asides in real property leasing or for high-tech medical equipment, according to officials from contracting offices responsible for these procurements. After the decision, there was uncertainty about whether and how to apply the Veterans First policy to these areas of contracting. As illustrated in the examples below, real property officials continue to face challenges applying the VA Rule of Two to leasing, whereas high-tech medical equipment contracting officials

addressed this challenge by preparing a business case and used it to apply the VA Rule of Two consistently across their contracts:

- Officials in VA's headquarters Construction and Facilities Management office—responsible for planning, designing, and constructing VA facilities—told us that prior to the Supreme Court decision they did not apply the VA Rule of Two to its real property leases. These officials stated that they have found the Rule of Two to be difficult to apply. According to the officials, VHA facilities have requirements for specific size, space, and location, and there are few SD/VOSBs in this industry, so it is rare that an SD/VOSB can meet these requirements. These officials further told us that, since the Supreme Court decision, they have often set aside lease solicitations for SD/VOSBs as long as there were two firms available despite uncertainty that these firms could compete for the work at a fair and reasonable price at best value to the VA.

According to these VA officials, based on guidance they received from OGC and others, they felt compelled to conduct the procurements as SD/VOSB set-asides even when they were unsure that the second criterion of the VA Rule of Two would be met. These officials stated they are often unable to make awards to those firms—either because their proposals were not acceptable, or the SD/VOSBs did not submit proposals at all. They expressed concern that the Veterans First program is being applied to leasing when, from their perspective, it is impractical to do so. They stated that these challenges in applying VA's Rule of Two criteria have added an average of 3 to 6 months to the process of awarding a new lease, resulting in delays in developing new facilities. Similarly, officials responsible for awarding leases at one VISN contracting office we visited told us they set aside a solicitation to an SDVOSB even though only one SDVOSB responded to a sources sought notice. This action was taken, according to the contracting officials, because they were concerned that their decision would be challenged by OSDDBU if they did not set it aside. They stated they had been without a broker—a firm that helps to negotiate leases—for more than a year due to challenges in applying the VA Rule of Two, making it difficult for them to move forward with any new leases.

In both cases, VA officials stated that they decided to solicit on an SD/VOSB set-aside basis even though they lacked confidence that there was a reasonable expectation that two or more SD/VOSBs would submit offers and that award could be made at a fair and reasonable price that offered the best value to the government. Also,

in both cases, VA had to reissue solicitations without the SD/VOSB set-aside restriction, which lengthened the time that VA procurement staff were required to spend on the acquisition and delayed the fulfillment of VA's leasing requirements.

- In contrast, another VA contracting organization determined that SD/VOSB set-asides were not feasible because there was no reasonable expectation that two or more SD/VOSBs would submit offers and that award could be made at a fair and reasonable price. The National Acquisition Center's program to procure high-tech medical equipment—such as magnetic resonance imaging and X-ray machines—historically had little participation from SD/VOSBs. Following the release of the 2016 Veterans First policy, contracting officials responsible for the program halted all non-emergency purchases for over a year while they conducted an analysis of how to apply the VA Rule of Two to purchases of high-tech medical equipment.¹⁸ These officials analyzed the marketplace and concluded that no SD/VOSBs manufacture such equipment, and that purchasing this equipment from SD/VOSB resellers would greatly increase costs and not present the best value to VA.

The results of this analysis were summarized in an internal report that was used as documentation to support the contracting officers' decision not to set-aside high-tech medical equipment purchases for SD/VOSBs. As a result, they continued to meet medical centers' equipment needs through existing purchasing arrangements. The contracting officers told us they also periodically revisit their analysis to identify any opportunities to set aside specific solicitations for SD/VOSBs.

Determining Whether the Price Offered by an SD/VOSB Is Fair and Reasonable Poses Challenges for Contracting Officers

Contracting officers must determine whether the price proposed by an SD/VOSB is fair and reasonable and offers the best value to VA before awarding the contract. The 2016 Veterans First policy did not change this requirement, and contracting officers are generally required to make this determination for every contract award. However, we found that many of

¹⁸VA officials stated that this amount of time was required due to the size and complexity of the high-tech medical equipment program.

the contracting officers we interviewed were uncertain how to balance the Veterans First preference with the determination of fair and reasonable price when lower prices were available on the open market. Twelve of the 30 contracting officers we interviewed for selected contract actions stated that it is difficult to assess whether the SD/VOSB's offered price is fair and reasonable, and 8 stated that, in some cases, they lacked confidence in their determinations that prices were fair and reasonable. In many of these cases, contracting officers told us that they determined that a higher price was fair and reasonable in order to effectuate the Veterans First preference. For instance, a branch chief we interviewed provided five examples of purchases under \$16,000 where, in recent, separate procurements, non-SD/VOSB small businesses had proposed prices for the same or substantially similar items that were about \$400 to \$3,000 less than those proposed by SD/VOSBs. These procurements were conducted as SD/VOSB set-asides, and awards were made to SD/VOSBs on the basis of the Veterans First preference.

The FAR establishes that adequate price competition normally establishes a fair and reasonable price, and it provides methods for determining fair and reasonable pricing, such as comparing proposed prices to each other, previous prices paid for the same or similar items, published prices, or the independent government cost estimate.¹⁹ However, a few of these contracting officers told us that some of these comparison methods may not be reliable for offers received under SD/VOSB set-asides. They stated that they lacked the confidence that using these methods consistently provided robust and well-documented support for their decision to not award to an SD/VOSB. For example, they stated that in some instances, the independent government cost estimate is outdated, and the customer responsible for preparing it conducts limited market research. This issue is not unique to VA; in 2017, we reported on shortcomings in the usefulness and documentation of independent government cost estimates across several agencies.²⁰

¹⁹An independent government cost estimate is an estimate of the expected cost of a contract or order. Such estimates are developed by government personnel before soliciting contractor proposals or making contract awards, and are used by contracting officials to determine whether proposed prices are reasonable and to support price negotiations.

²⁰GAO, *Service Contracts: Agencies Should Take Steps to More Effectively Use Independent Government Cost Estimates*, [GAO-17-398](#) (Washington, D.C.: May 17, 2017).

VA Procurement Policy officials emphasized that contracting officers must apply professional judgment and that no across-the-board standard exists—a higher price compared to non-SD/VOSBs might be appropriately found reasonable in some cases but not others, depending on many variables, including the degree of difference between the prices and the size and complexity of the requirement. However, in response to requests for clarification from contracting officers, VA officials provided conflicting informal guidance. For example, a contracting officer stated that, during a webinar training on the implementation of the Veterans First policy in late 2016, VHA's Acting Chief Procurement and Logistics Officer said that, as a general rule, he would be hesitant to pay 5 percent more than any recent prices identified in contracting officers' market research for the same or similar supplies or services from non-SD/VOSBs, a view he repeated when we interviewed him in spring of 2018.

In contrast, the Executive Director for the Office of Acquisition and Logistics said he would not advocate paying any amount above recent prices identified in contracting officers' market research for the same or similar goods or services from non-SD/VOSBs for any requirement. He stated that the Veterans First statute and policy did not authorize higher prices for goods and services from SD/VOSBs. According to a contracting officer we met with, he shared this view in a training session at a VA conference in March 2017, as well as when meeting with us in spring of 2018. A consistent message from senior management would provide VA greater assurance that its contracting officers have confidence when making fair and reasonable price determinations in set-aside acquisitions.

In one of VA's national contracting offices, the Strategic Acquisition Center, the Director told us that contracting officers were confused about how to implement the Veterans First policy in their work, particularly in making VA Rule of Two decisions and fair and reasonable price determinations. In order to address confusion and provide guidance to contracting officers, the Director stated that he provided a series of case studies to contracting officers that demonstrated effective application of these aspects of the Veterans First policy. Separately, other senior VA procurement officials stated that contracting office managers have a responsibility to address confusion and serve as a source of information for their contracting workforce.

Contracting Officers Faced Challenges in Implementing Veterans First Policy, in Part, Due to Training Shortfalls, Pressures, and Workload Issues

The judgments that VA contracting officers are asked to make—in conducting market research, making VA Rule of Two decisions, and determining whether proposed prices are fair and reasonable—can in some cases be inherently complex, and there are additional challenges that VA has faced in implementing Veterans First. There are several factors that contribute to these challenges.

Training Did Not Reach All Contracting Officers, and Did Not Fully Address the More Challenging Components of the Veterans First Policy

While VA provided training concurrently with the issuance of its 2016 Veterans First policy, the training did not reach all staff. According to VA Acquisition Academy officials, 81 percent of all VA contracting officers completed the initial training on the 2016 Veterans First policy in the summer of 2016. We reviewed academy training records for the 60 contracting officers we interviewed, and these records show that 14 of them did not take the initial training in 2016.²¹ In addition, only 52 percent of VA contracting officers completed the follow-up training on the Veterans First policy in the spring of 2018. According to the academy, the feedback provided by those that attended these training sessions was favorable, with ratings of 4.59 out of 5 and 4.75 out of 5, respectively.

In communicating about the training to contracting officers, VA sent an announcement to all contracting officers, describing the training as “strongly encouraged” but not mandatory. According to VA Acquisition Academy and Office of Acquisition and Logistics officials, this is because neither of these organizations has the authority to designate training as mandatory—only VA’s Office of Human Resources and Administration has the ability to do so.

GAO’s *Standards for Internal Control in the Federal Government* states that management should design control activities to achieve objectives

²¹We did not compare training records to the dates when each individual began work with VA under the 1102 (contracting) job series.

and respond to risks.²² In doing so, management should ensure that training is aimed at developing and retaining employee knowledge, skills, and abilities to meet changing organizational needs—such as those that occurred after the 2016 Supreme Court decision. Based on our review of the training, it does not fully address the more challenging aspects of implementing the Veterans First policy, such as making fair and reasonable price determinations when acquisitions have been set aside. Establishing more targeted training on the Veterans First policy and providing this training to all contracting officers would provide the VA with greater assurance that contracting officers have the knowledge and skills necessary to implement the more challenging components of this policy. Further, without establishing the importance of training on the Veterans First policy by assessing whether to make its attendance mandatory, management is not fully communicating its importance, and contracting officers may lack the tools needed to implement this policy.

Contracting Officers Perceive Pressure to Apply Veterans First Preferences

As previously stated, contracting officers told us they were not always confident in applying the Veterans First policy, in part because of pressure—real or perceived—from others. Contracting officers cited perceived negative scrutiny from leadership, OSD/OSDBU, Office of General Counsel reviewers, or potential protests from SD/VOSBs as reasons for their reluctance to not set aside requirements for SD/VOSBs, or to deem prices proposed by SD/VOSBs not fair and reasonable. Contracting officers explained that objections raised from any of these parties would add time to the procurement process, and a decision to cancel a set-aside because the prices were found not fair and reasonable would require yet more time to start the solicitation process again. Some contracting officers stated that they could not risk delays in awarding contracts by pursuing an approach other than setting aside for SD/VOSBs. We noted that training slides from a 2016 conference for VA contracting officials included a statement that, “contracting officers may not know if they have properly applied the VA Rule of Two standard until a court rules on the facts of a given case.” VA’s Acting Chief Acquisition Officer stated that he is aware of these perceived pressures and stated that some of these pressures are long-standing. He stated that VA had an

²²GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#), (Washington, D.C.: Sept. 10, 2014).

initial effort to communicate the Veterans First policy immediately after the 2016 Supreme Court decision, but he acknowledged that contracting officers' confusion remains, especially regarding fair and reasonable price determinations. VHA contracting officers also noted that because their customers are hospitals, there is an inherent need to avoid delays in the procurement process to prevent an adverse effect on patient care. The effect of these pressures was exacerbated by a concern we noted among contracting officers of whether their management would fully support a decision not to set-aside a contract.

VA Faces Continuing Workload Issues

The struggles that contracting officers are facing in making VA Rule of Two and fair and reasonable price determinations, as discussed above, are exacerbated by continuing workload stresses they have faced for years. In September 2016, we reported that managing workload is a challenge for VA's contracting officers. For example, one medical center official stated that his local contracting office had at times turned away some purchase requests because it could not staff them.²³ In November 2017, we also reported on contracting inefficiencies that affected contracting officers' ability to provide goods and services in a timely manner and at best value to medical centers.²⁴ Results from a recent survey of VA staff also illustrate existing workload stress within VA contracting. Specifically, in the Office of Personnel Management's Federal Employee Viewpoint Survey, federal employees are asked if they believe their workload is reasonable; according to VA's analysis of this data in 2017, 54.2 percent of the contracting officers at VA who responded said their workload was not reasonable.

VA Conducts Limited Oversight of Compliance with Subcontracting Limitations

In many cases, clauses that require compliance with and enable monitoring of subcontracting limitations are not included in VA contracts and orders with SD/VOSBs. Contracting officers are generally aware of

²³See [GAO-16-810](#).

²⁴GAO, *Veterans Affairs Contracting: Improvements in Buying Medical and Surgical Supplies Could Yield Cost Savings and Efficiency*, [GAO-18-34](#) (Washington, D.C.: Nov. 9, 2017).

subcontracting limitations, but they told us they do not have sufficient time or knowledge to conduct oversight. VA conducts some audits of compliance through a separate program. While the scale of that effort has been limited, these audits have identified a number of violations. VA, however, has not shared subcontracting limitation compliance risks or practices to improve monitoring efforts.

Contract Clauses Are VA's Primary Preventive Monitoring Mechanism, but Many Contracts We Reviewed Lacked Them

VA contracting officers are required to include two different clauses when issuing solicitations for SD/VOSB set-asides:

- One clause requires contractors to comply with SBA's subcontracting limitations regulation.
- Another enables the VA to obtain access to the SD/VOSB prime contractor's records to monitor compliance with subcontracting limitations.

SD/VOSB Set-Aside Clause Establishing Subcontracting Limitations Missing from Some Contract Actions

Under the first clause, an SD/VOSB must comply with the SBA regulation that limits the percentage of the amount paid by the government under the contract that may be subcontracted to firms that are not in the same socio-economic category—that is, firms that are not also SD/VOSBs. This is known as the subcontracting limitations requirement.²⁵ For example, under a services contract set aside for SD/VOSB contractors, an SD/VOSB prime contractor may only subcontract to non-SD/VOSBs a maximum of 50 percent of the amount paid by the government under the contract.

The purpose of the subcontracting limitations requirement is to ensure that the SD/VOSBs that are awarded set-aside contracts do not subcontract the work beyond prescribed levels, and ensure that the goal of Veterans First—to promote opportunities for veteran-owned small

²⁵13 C.F.R. § 125.6. SBA's subcontracting limitations regulations apply to the various types of small business set-asides on a government-wide basis, not just to the VA.

businesses—is not undermined. In July 2016, VA updated its standard SDVOSB and VOSB set-aside clauses to refer to SBA’s revised subcontracting limitations regulation.²⁶ For example, the SD/VOSB clause defines the criteria that firms contracting with VA must meet to be eligible for SD/VOSB set-asides and requires SD/VOSBs to agree to comply with SBA’s subcontracting limitations regulation in the performance of set-aside contracts. VA’s acquisition regulations require contracting officers to include the clause in all SD/VOSB set-aside contracts.

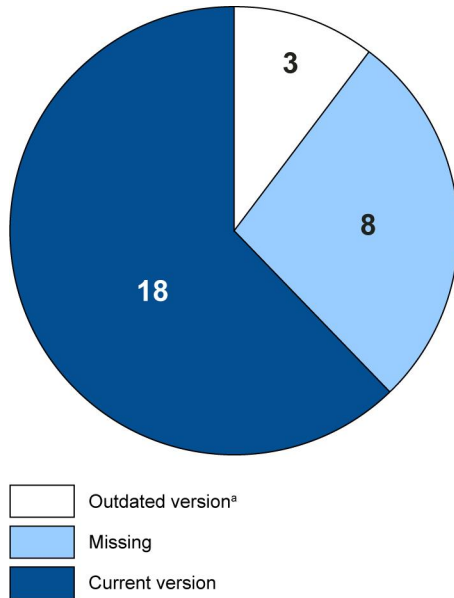
We selected 35 VHA contracts and orders for review, 29 of which were set-aside to SD/VOSBs, to determine whether they contained the July 2016 (current) version of the SD/VOSB set-aside clause.²⁷ All of our selected contract actions occurred after the 2016 Veterans First policy was issued, and after VA adopted SBA’s 2016 update of its subcontracting limitation regulation, which made the prior clause obsolete. We found that 11 of the 29 contract actions did not contain the current version of the clause—it was either missing entirely or an outdated version of the clause was used (see figure 10).²⁸

²⁶See VA Acquisition Regulation § 852.219-10 (Jul 2016) (Deviation) (VA Notice of Total Service-Disabled Veteran-Owned Small Business Set-Aside); VA Acquisition Regulation § 852.219-11 (Jul 2016) (Deviation) (VA Notice of Total Veteran-Owned Small Business Set-Aside).

²⁷Our review included both contracts and orders on existing indefinite delivery contracts. The remaining 6 selected contracts were not set-aside for SD/VOSBs.

²⁸In one of the cases where the clause was missing, the contract included the FAR limitations on subcontracting clause, which applies the prior version of SBA’s limitations on subcontracting regulation. In 2 of the 8 cases where the clause was missing, the contract was classified as being for a supply and a class waiver to the non-manufacturer rule was in place. VA officials stated that they did not believe the clause was applicable in these cases because there would be no practical effect of the subcontracting limitation given the waiver. Nevertheless, we include these cases in the figures above because the VA Acquisition Regulation prescribes use of the clause requiring limitations on subcontracting compliance in SD/VOSB set-asides without regard to whether a waiver to the non-manufacturer rule is in place.

Figure 10: Number of Selected VA Contract Actions Where the Service-Disabled/Veteran-Owned Small Business Set-Aside Clause Was Outdated, Missing, or Included



Source: GAO review of selected Veterans Affairs (VA) contract documentation. | GAO-18-648

^aOne of the contract actions in the outdated clause section above was an order that did not itself include any version of the clause, but that was issued under a VA indefinite delivery contract that included the December 2009 version of the clause. VA officials did not view this order as including an outdated version of the clause because the overarching indefinite delivery contract was awarded before July 2016, when VA issued the current version of the clause.

The contracts and orders that contained the outdated version of the clause did not reference the significantly changed version of the SBA limitations on subcontracting regulation that is currently in effect, and therefore did not reference the version of the regulation that includes the penalty provision establishing that contractors that do not comply with subcontracting limitations may be subject to a \$500,000 fine.²⁹

Contracting officials told us the contracting officers likely forgot to include the clause or included an outdated version of the clause by mistake. Without including the mandatory clause in the contract actions as required, VA lacks assurance that SD/VOSBs are aware of subcontracting limitations.

²⁹Three of the contract actions were subject to the December 2009 version of the SDVOSB set-aside clause. This clause included an outdated method (the use of personnel costs) for assessing compliance with the subcontracting limitations requirement.

Monitoring Clause Missing from Most Contract Actions

For the second clause, establishing VA's right to access information from SD/VOSBs to monitor their compliance with the subcontracting limitations requirement, we found that 22 of the 29 contracts and orders we reviewed did not contain this clause. VA contracting officials told us the clause was not included in the contract in some cases because the contracting officers were unaware of the requirement, which was established in a June 2011 Information Letter policy memorandum.³⁰ The policy memorandum directed contracting officers to include the clause in solicitations, which the Division Chief at one VISN contracting office identified as the reason it was not included in the contracts. However, the clause would not be in effect if not contained in the contract, and a VA procurement policy official confirmed that the intent was for this clause to be included in both solicitations and contracts. Without this clause, VA could face challenges in attempting to obtain information needed from the SD/VOSBs to determine their compliance with subcontracting limitations. Omission of this clause also poses a risk to VA by hindering its ability to detect violations, enforce the subcontracting limitations requirement, and ensure that the goal of Veterans First—to promote opportunities for veteran-owned small businesses—is not undermined.

In June 2018, the VA rescinded the 2011 policy memorandum and issued a class deviation to the VA Acquisition Regulation. The class deviation revised the second clause—limitations on subcontracting monitoring and compliance—and required the clause to be included in solicitations and contracts. This is an important step to communicate that this clause is required in the contract. However, as noted above, the first clause—VA's notice of set-aside clause that requires compliance with SBA's limitations on subcontracting regulation—is already required by a previous class deviation and was missing from 8 of 29 contracts we reviewed. Given this, it is uncertain whether this VA Acquisition Regulation update alone will ensure that the monitoring clause is included in all contracts.

³⁰We have previously reported that Information Letters were intended to be temporary. See [GAO-16-810](#).

VA Contracting Officers Conduct Limited Oversight to Assess Contractor Compliance with Subcontracting Limitations

VA contracting officers conduct little oversight to ensure that SD/VOSBs comply with SBA's subcontracting limitations regulations. According to the FAR, contracting officers are responsible for ensuring that the contractor complies with the terms of the contract, and, as discussed above, the terms of the contract may include subcontracting limitations.³¹ For the 29 SD/VOSB set-aside contracts and orders we reviewed, we found little evidence that contracting officers were monitoring compliance with SBA's regulatory limitations on subcontracting requirements, which includes ensuring the VA clause that requires compliance with the subcontracting limitation is in the contract.³² Contracting officers we spoke with were aware of these responsibilities but cited several barriers to executing them, including high workload, a focus on awarding over administering contracts, and uncertainty of what steps to take. Senior VA procurement officials stated that monitoring the subcontracting limitations requirement has not been a high priority and that contracting officers have competing priorities and, thus, limited time available to conduct this monitoring.

The VA's limited oversight of subcontracting limitations has been a long-standing problem.³³ In September 2016, SBA conducted a surveillance review of one of VA's VISN contracting offices. In its review of 29 contract files, SBA found no evidence that the subcontracting limitations requirement was being monitored by contracting officers and recommended that VA take measures to ensure it conducts active monitoring. In July 2017, SBA followed up to determine what steps the VISN contracting office had taken to implement its recommendation to

³¹See FAR Subpart § 1.602-2.

³²Of the 29 set-aside contracts, 8 of these did not include the clause, thus hindering VA's ability to monitor compliance with the subcontracting limitation.

³³In 2006, we reviewed 16 contracts awarded to firms owned by Alaska Native Corporations in the 8(a) program (an SBA development program for disadvantaged small businesses) and found almost no evidence that contracting officers were monitoring compliance with subcontracting limitations. In 2012, we reported no evidence of regular and systematic monitoring of the subcontracting limitations for 71 8(a) contracts. See GAO, *Federal Contracting: Monitoring and Oversight of Tribal 8(a) Firms Need Attention*, [GAO-12-84](#) (Washington, D.C.: Jan. 31, 2012); and *Contract Management: Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight*, [GAO-06-399](#) (Washington, D.C.: Apr. 27, 2006).

improve monitoring of the subcontracting limitations requirement. The SBA concluded that the VISN contracting office needed to take additional steps in order to close the recommendation.

Some of the VA contracting officers we met with told us they rely on contracting officers' representatives (COR) to monitor compliance with the subcontracting limitations and identify possible violations. CORs are generally at the location where the goods are being delivered or the services are performed to observe whether the SD/VOSB contractor is accomplishing the required work as specified in the contract. VA procurement officials told us that monitoring subcontracting limitations is the responsibility of contracting officers.

VA's Program to Assist Contracting Officers in Reviewing Subcontracting Limitations Is Limited in Scope

In June 2011, VA's Office of Acquisition and Logistics established the Subcontracting Compliance Review Program (SCRCP) within the Risk Management and Compliance Service (RMCS) to assist contracting officers in conducting subcontracting limitations reviews. RMCS conducts its own reviews of compliance with subcontracting limitations, but the scale is limited. Specifically, RMCS conducted reviews of 95 SD/VOSB and other set-aside contracts out of thousands that were awarded since 2011, and the office is in the process of reviewing another 24 contract actions. The office selects a sample of contract actions awarded each fiscal year to review and may review other contract actions if contracting officers or other VA officials contact it with referrals of instances that warrant a review. RMCS officials told us they have received very few referrals to date. Many of the contracting officers we met with were unaware that SCRCP existed, or that they could refer potential subcontracting limitations violations to it for review. However, VA's manual describing the SCRCP is housed on a portal accessible to contracting officers, and, in March 2018, VA's Acquisition Academy training included information on the SCRCP.³⁴

RMCS's subcontracting limitations reviews have identified a number of instances of non-compliance. Specifically, since 2011, the office has identified 25 instances of non-compliance with subcontracting limitations

³⁴This training included the purpose of the SCRCP, provided staff contact information, and described the benefits of a subcontracting limitations review.

among the 95 reviews it has completed, or 26 percent of selected contract actions. For example, one review found that a VOSB contractor responsible for providing project management services paid more than the allowable percentage (50 percent) of the contract's value to non-VOSB firms. In another example, the review found an SDVOSB contractor responsible for providing courier services paid more than 88 percent of the contract's value to non-SDVOSB firms at about the halfway point in the contract's period of performance. If VA's mechanisms for monitoring and enforcing subcontracting limitations are not robust, the department exposes itself to increased risk of not detecting noncompliance.

RMCS's SCRP manual states that the evidence RMCS collects is to be provided to the contracting officer so that he or she can make a determination about whether the contractor is in compliance. The manual also outlines the various remedies available to contracting officers if an SD/VOSB is suspected of being or is found to be in noncompliance with the subcontracting limitations. A RMCS official told us that remedial actions taken with respect to noncompliant contractors are determined on a case-by-case basis and that contractors are generally provided an opportunity to correct the deficiency, if the contractor submits a viable plan. In several of the cases where the RMCS office identified non-compliance, contracting officers requested that SD/VOSBs develop a plan for becoming compliant with the subcontracting limitations requirement. For example, one plan specified additional oversight steps that the VOSB would take to ensure compliance with the subcontracting limitations, such as having the project manager provide a compliance plan to senior management for any instance of subcontracting with a non-VOSB that was anticipated to exceed a significant percentage of the total value of the contract award.

RMCS officials said they had anticipated receiving additional resources to conduct the planned reviews when the SCRP was initially created but have yet to receive them. Officials stated they currently rely on three support contractor staff to conduct the reviews but are exploring the possibility of hiring additional staff to increase the number of reviews they can complete each year. In addition, the Acting Director also told us that the office has created a database that will ultimately allow contracting officers and CORs to identify contracts with which they have subcontracting limitations concerns. They have only implemented some of the database's capabilities due to resource limitations. RMCS's Acting Director stated she would like to grow the office and establish mechanisms to better facilitate communication between contracting

officers and RMCS. She noted, however, that the lack of a permanent Director for RMCS, as well as competing funding priorities have made it difficult to establish these mechanisms. The Acting Director said she is the office's sixth one in the past 2 and 1/2 years, and each person in this role has had other duties in addition to the position.

VA Has Not Communicated Subcontracting Limitation Risks or Useful Monitoring Practices to Stakeholders

Because VA has few mechanisms for monitoring subcontracting limitations and RMCS reviews are limited in scope, VA may not be able to detect the risk of fraud for the Veterans First program.³⁵ Proactive fraud risk management is meant to facilitate a program's mission and strategic goals by ensuring that taxpayer dollars and government services serve their intended purposes. To help agencies better address fraud, GAO's 2015 report, *A Framework for Managing Fraud Risks in Federal Programs* (Fraud Risk Framework), includes a comprehensive set of leading practices that serve as a guide when developing or enhancing efforts to combat fraud in a strategic, risk-based manner.³⁶ These practices include:

- Identifying and assessing risks.
- Collaborating and communicating with stakeholders—in this case, contracting officials—to share information on fraud risks.
- Applying lessons learned to improve the design and implementation of control mechanisms and communicating those changes to stakeholders.

The Fraud Reduction and Data Analytics Act of 2015, and Office of Management and Budget guidance implementing its provisions, affirm that agencies should adhere to the leading practices identified in the Fraud Risk Framework.³⁷

³⁵Fraud involves obtaining something of value through willful misrepresentation (see GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014), section 8.02, for discussion on types of fraud). Whether an act is in fact fraud is a determination to be made through the judicial or other adjudicative system and is beyond management's professional responsibility for assessing risk.

³⁶See [GAO-15-593SP](#).

³⁷Pub. L. No. 114-186, § 3, 130 Stat. 546 (2016) and Office of Management and Budget, *Management's Responsibility for Enterprise Risk Management and Internal Control*, Circular No. A-123 (Washington, D.C.: July 15, 2016).

In our review of VA's mechanisms for monitoring subcontracting limitations, we found that VA's Office of Acquisition and Logistics as well as the RMCS perform some identification and assessment of risks, but that this assessment is not comprehensive. In addition, VA is not collaborating with and communicating these risks to stakeholders, as called for in GAO's Fraud Risk Framework. By conducting a comprehensive assessment of fraud risk, VA would be better positioned to detect potential fraud related to subcontracting limitations for the Veterans First program.

VA Has Taken Some Steps to Identify and Assess Risks, but Has Not Communicated These Risks to Stakeholders

RMCS officials told us they were unable to comprehensively identify and assess the risks related to subcontracting limitations due to limited staff and resources. Nonetheless, they told us that they have identified certain situations—based on the reviews they have conducted to date and discussions with contracting officers—that may pose a higher risk of non-compliance with subcontracting limitations. These situations include:

- contracts for certain types of services, such as grounds maintenance, van transportation, and specialty trade construction;
- where a SD/VOSB has multiple contracts across several VISNs for the same services; and
- where a SD/VOSB does not have a business presence in the same geographical area where the services are being performed.

They said these were higher risk situations because the SD/VOSBs have had difficulty completing the required work on their own, or the lack of a local business presence increases the likelihood that the SD/VOSB might rely on a local, non-SD/VOSB contractor to do more than the permissible portion of the work. According to RMCS officials, they have not shared information on subcontracting limitation risks with stakeholders, such as contracting officers and their management, but they agreed this could be a helpful step. By sharing information on higher risk situations, contracting officers would have a better understanding of when to refer cases to RMCS.

Our prior work on subcontracting limitations, in the context of SBA's 8(a) program, also identified situations presenting an increased risk that

subcontracting limitations may be exceeded.³⁸ These situations included instances when the 8(a) prime contractor proposed subcontractors that were the agency's incumbent contractor or that had more experience in meeting the agency's current requirement than the small business. It also included situations where the subcontractor, rather than the prime contractor, submitted documents to or corresponded directly with government officials. These situations highlight the importance of monitoring the extent of subcontracting. SBA has also identified risk factors to consider prior to contract award, such as the incumbent contractor working as a subcontractor or if the prime contractor lacks relevant experience and must rely upon its more experienced subcontractor to win the contract.

In our review, contracting officers cited several contracts where subcontracting risk factors were present. In one case we reviewed, the contracting officer reported that a large business was the prime contractor on a previous water treatment services contract. After the 2016 Supreme Court decision, the contract was re-competed on a SDVOSB set-aside basis; a SDVOSB won the award and the incumbent contractor served as a subcontractor. According to the contracting officer, he suspected that the subcontractor was performing more than 50 percent of the work based on the SDVOSB's limited capacity, but he said he did not have the authority to request information on payments from the SDVOSB prime contractor to the subcontractor. We found that neither the set-aside clause that limits subcontracting nor the monitoring clause were included in this contract, limiting the contracting officer's ability to ensure the SDVOSB was meeting the appropriate subcontracting limitation requirement.³⁹ The COR told us that the subcontractor performed most of the water treatment services work—the primary requirement under the contract—while the SDVOSB prime contractor sent invoices and conducted oversight.

³⁸See [GAO-14-706](#).

³⁹While the contract did not include the SD/VOSB set-aside clause that applies SBA's current limitations on subcontract regulation, it did include the FAR limitations on subcontract clause, which applies the prior version of SBA's limitations on subcontracting regulation.

VA Has Identified Some Useful Monitoring Practices, but Has Not Communicated Them to Stakeholders

RMCS officials told us they have identified some helpful practices that could improve compliance with subcontracting limitations. They said they have encouraged some contracting officers to require SD/VOSBs to explain in their proposals how they planned to comply with the subcontracting limitations requirement and said that some contracting officers have also used a worksheet to collect data on the work the SD/VOSB planned to complete themselves versus subcontract.

Other VA contracting officials we met with also told us about additional practices they had implemented to facilitate monitoring of compliance with subcontracting limitations. These practices included the following:

- require the SD/VOSB contractors to submit quarterly reports during contract performance that indicate the percentage of the work completed by the SD/VOSB contractor and any subcontractors;
- hold pre-award discussions between the contracting officer and the SD/VOSB about the need to comply with subcontracting limitations; and
- convene post-award conferences between the contracting officer and COR to discuss whether the SD/VOSB is in compliance or not.

Standards for Internal Control in the Federal Government state that management should internally communicate the necessary quality information to achieve the entity's objectives.⁴⁰ Although RMCS provides information to contracting officers and their management through the SCRIP manual and related training, RMCS officials told us that they have not included these monitoring practices among the information they have shared. Having this information could improve contracting officers' ability to ensure compliance with subcontracting limitations.

Conclusions

The basic premise of the Veterans First Contracting Program has not changed in the 12 years since its implementation began. However, the 2016 Supreme Court decision prompted VA to refocus and refine its

⁴⁰See [GAO-14-704G](#).

policy, and implementing the refined policy and the associated VA Rule of Two across the entire enterprise of VA contracting has been challenging due to inherent complexities, perceived and real pressures to award contracts to SD/VOSBs, and inconsistent and sometimes conflicting management guidance. This environment created mixed messages and lessened some contracting officers' confidence about how to appropriately apply the VA Rule of Two criteria, particularly in making a determination that there is a reasonable expectation that award could be made at fair and reasonable prices.

Most of the contracting officers for the selected contracts we reviewed expressed dissatisfaction with VIP as the starting point for market research, citing difficulty in using it. While documentation of the VIP search results is required by the Veterans First policy, over three-quarters of the contract files we reviewed lacked such documentation. Such documentation, combined with support for overall market research efforts, provides VA with assurance that contracting officers have performed this search as part of the basis for their Rule of Two decision. These contracting officers also had some difficulty applying the VA Rule of Two, particularly in the more challenging component, determining whether they can reasonably expect prices offered by SD/VOSBs to be fair and reasonable—issues that could be mitigated by establishing more targeted training that would provide the VA with greater assurance that its contracting officers have the knowledge and skills necessary to implement this policy. Further, assessing whether training on the Veterans First policy should be designated as mandatory would provide VA with information necessary to determine if such training would be beneficial for all contracting officers.

Monitoring of subcontracting limitations is an important oversight tool to ensure effective implementation of VA's Veterans First program. Without ensuring that required contract clauses regarding subcontracting limitations are included in all SD/VOSB set-aside contracts, VA lacks assurance that SD/VOSBs are aware of subcontracting limitations. Additionally, VA's Subcontracting Compliance Review Program has found subcontracting limitation violations and has identified some risk factors and practices for monitoring compliance with subcontracting limitations. Conducting a comprehensive assessment of fraud risk, using GAO's Fraud Risk Framework, would help better position VA to detect potential fraud related to subcontracting limitations for the Veterans First program. Further, VA has not communicated identified risk factors and monitoring practices to stakeholders as called for in GAO's Framework.

Recommendations for Executive Action

We are making the following six recommendations to VA.

The Secretary of Veterans Affairs should ensure that VA's Director of the Office of Acquisition and Logistics, in consultation with OSDDBU, takes measures to ensure that VA contracting staff adhere to the requirements for documenting the required Vendor Information Pages searches in contract files. (Recommendation 1)

The Secretary of Veterans Affairs should ensure that the Director of VA's Office of Acquisition and Logistics directs the VA Acquisition Academy to provide more targeted training for the more challenging components of implementing the Veterans First policy, such as making fair and reasonable price determinations. (Recommendation 2)

The Secretary of Veterans Affairs should, in consultation with VA's Office of Human Resources and Administration, and the Director of VA's Office of Acquisition and Logistics, assess whether training on the Veterans First policy should be designated as mandatory and take appropriate action based on the assessment results. (Recommendation 3)

The Secretary of Veterans Affairs should ensure that the Director of the Office of Acquisition and Logistics establishes a mechanism to ensure that mandatory clauses relating to subcontracting limitations are consistently incorporated in all contracts that are set aside for SD/VOSBs. (Recommendation 4)

The Secretary of Veterans Affairs should ensure that the Director of the Office of Acquisition and Logistics conducts a fraud risk assessment for the Veterans First program. (Recommendation 5)

The Secretary of Veterans Affairs should ensure that the Director of the Office of Acquisition and Logistics directs the Risk Management and Compliance Service to share, through guidance, training, or other methods, subcontracting limitation risks and monitoring practices with contracting officers and their management. (Recommendation 6)

Agency Comments

We provided a draft of this report to the Department of Veterans Affairs and the Small Business Administration for review and comment. VA provided written comments on the draft report. In its comments, which are reprinted in appendix II, VA concurred with all of our 6 recommendations. SBA provided technical comments, which were incorporated as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees, the Secretary of Veterans Affairs, the Administrator of the Small Business Administration, and other interested parties. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-4841 or by email at oakleys@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 III.



Shelby S. Oakley
Director, Contracting and National Security Acquisitions

Appendix I: Objectives, Scope, and Methodology

You requested that we examine changes to how the Department of Veterans Affairs (VA) implements the Veterans First program as a result of the Supreme Court's decision. In June 2016, the Supreme Court's decision in *Kingdomware Technologies, Inc. v. United States* clarified conflicting interpretations of the requirement for the preference, concluding that VA must restrict competition to veteran-owned small businesses if the contracting officer reasonably expects that at least two such businesses will submit offers and the award can be made at a fair and reasonable price that offers best value to the United States.¹ This report assesses: (1) how VA procurement obligations to veteran-owned small businesses changed in the period from fiscal years 2014 through 2017; (2) what actions VA has taken to update Veterans First policies and regulations and provide training following the Supreme Court's decision; (3) what challenges, if any, VA is encountering in applying Veterans First policies; and (4) the extent to which VA has mechanisms in place to monitor compliance with subcontracting limitations by veteran-owned small businesses, and the effectiveness of such mechanisms.

To assess how VA procurement obligations to veteran-owned small businesses changed in the period from fiscal years 2014 through 2017, we obtained data from VA's Electronic Contract Management System (eCMS) on all contracts from fiscal years 2014 through 2017, chosen to provide data before and after the Supreme Court decision. We chose to exclude orders reported in Express Reports—summaries of multiple orders placed on existing contracts—from our analysis. These actions were only consistently reported in eCMS starting in 2017; because they represent billions of dollars of obligations with relatively little set-asides to service-disabled veteran-owned small businesses and veteran-owned small businesses (SD/VOSB), including them would have distorted year-to-year comparisons of percentages set aside for SD/VOSBs. We analyzed these eCMS data to determine changes in the use of set-asides for SD/VOSBs relative to overall VA contracting obligations during this

¹See *Kingdomware Technologies, Inc. v. United States*, 579 U.S. ___, 136 S. Ct. 1969 (2016).

period. We used this analysis to determine the extent to which VA set-aside contract obligations to SD/VOSBs in the period after the Kingdomware decision compared to the period before the decision. We adjusted obligations for inflation to fiscal year 2017 dollars using the fiscal year gross domestic product price index. We also analyzed the data to identify patterns of set-asides as a percentage of obligations among different contracting activities and across VA contracting organizations. To determine the extent to which new businesses are obtaining SD/VOSB certification, we obtained Vendor Information Pages (VIP) data from VA's Office of Small and Disadvantaged Business Utilization (OSDBU) for fiscal years 2014 through 2017. We used these data to identify the change in the total number of certified SD/VOSBs in VIP during this period. We also analyzed VA's eCMS data to determine the number of unique, individual SD/VOSBs that received awards for set-asides during the same period. With these data from VIP and eCMS, we compared the number of certified SD/VOSBs to the number of businesses awarded set-asides for each year during this period. To assess reliability of these data, we also reviewed available eCMS documentation and interviewed officials responsible for maintaining eCMS data to gather information on processes, accuracy, and completeness of these data. We determined that these eCMS and VIP data were sufficiently reliable for the purpose of describing changes in VA's use of SD/VOSB set-asides over this period.²

To assess what actions VA has taken to update Veterans First policies and regulations and provide training following the Supreme Court's decision, we analyzed policies, regulations, guidance, and training materials related to the program, and compared these to what VA had in place prior to the decision. We obtained and analyzed the program's initial Information Letter, policy memorandum, and revisions to VA's Acquisition Regulations, which detailed the Department's intention to comply with federal statute. We also obtained and reviewed additional program documentation, including briefings, presentations, and training provided to contracting officers. We met with leadership at VA's national contracting organizations to discuss implementation of the Veterans First

²We also reviewed eCMS data related to procurement action lead times in an attempt to determine whether VA was taking longer to make contract awards since the 2016 Supreme Court decision. However, we were unable to do so due to unreliable data. Specifically, we found that about 60 percent of contract actions were missing data on procurement action lead times across fiscal years 2014 through 2017. Additionally, VA contracting officials and eCMS administrators agreed that the data are not reliable. Because this issue is not specific to the Veterans First program and has implications for all of VA acquisition, we plan to perform additional work regarding these data in the future.

policy within their organizations, and interviewed senior officials in VA's Office of Acquisition and Logistics—including Office of Procurement Policy and VA Acquisition Academy—OSDBU, Office of General Counsel, and the Veterans Health Administration's (VHA) Procurement and Logistics Office to discuss policies, guidance and training regarding the Veterans First program.

To assess what challenges, if any, VA is encountering in applying the Veterans First policy, we gathered documentation from six contracting organizations across the VA. We conducted reviews of eCMS data to determine VA's use of set-asides and the increase in the use of set-asides for all VA contracting organizations. Based on our analysis of these data, we determined that VHA had the greatest use of set-asides in fiscal year 2017. As such, we conducted site visits at a non-generalizable selection of three VHA regional offices, known as Veterans Integrated Service Networks (VISN).

The three VISNs we selected are as follows:

- VISN 8: St. Petersburg, Florida
 - Network Contracting Office 8
 - Orlando, Florida VA Medical Center
 - Tampa, Florida VA Medical Center
- VISN 12: Westchester, Illinois
 - Network Contracting Office 12
 - Hines, Illinois VA Medical Center
 - Milwaukee, Wisconsin VA Medical Center
- VISN 16: Ridgeland, Mississippi
 - Network Contracting Office 16
 - Jackson, Mississippi VA Medical Center
 - New Orleans, Louisiana VA Medical Center

We focused our site visits on VHA, because it is the largest contracting organization in the Department. We selected these VISNs primarily based on changes in total contract obligations to SDVOSBs and VOSBs from fiscal year 2015 to fiscal year 2017—the first full fiscal years before and after the Supreme Court decision—selecting two with among the largest percentage changes, and one with the lowest. The first site visit to VISN 8

was chosen because it had a high change in the percent of obligations on SD/VOSB set-asides from fiscal years 2015 through 2017 and high total obligations in fiscal year 2017. After completing the first site visit, we decided to exclude obligations for construction-related contracts, as our analysis of VA's eCMS data found that construction had not been affected much by the 2016 Veterans First policy because the majority of construction contracts have always been—and continue to be—awarded to SD/VOSBs. The second site visit to VISN 12 was chosen because it had a low change in the percent of non-construction obligations on SD/VOSB set-asides from fiscal years 2015 through 2017 with high total non-construction obligations in fiscal year 2017. The final site visit to VISN 16 was chosen because it had a high change in the percent of non-construction obligations on SD/VOSB set-asides from fiscal years 2015 to 2017 with high total non-construction obligations in fiscal year 2017. At each selected VISN, we interviewed the VISN Deputy Network Director. We also obtained documentation from and interviewed leadership at the National Acquisition Center, Strategic Acquisition Center, and the Technology Acquisition Center.

At the selected VISNs, we interviewed leadership at their respective Network Contracting Offices, and selected a non-generalizable sample of 35 total contracts and orders—29 of which were set aside for SDVOSBs or VOSBs—selected based on high dollar value, and for procurements of construction, services, or supplies. For each of the selected contracts and orders, we reviewed the contract files and interviewed both the contracting officer and the customer—in most cases the contracting officer's representative. We also held roundtable discussions of Veterans First implementation, training, and other matters with 8 to 11 contracting officers at each location, randomly selected from the construction, services, and supply teams.

We selected a non-generalizable sample of 12 contract actions from VISN 8, 11 contract actions from VISN 12, and 12 contract actions from VISN 16. The selection was based primarily on:

- contracts and orders that were set-aside to SD/VOSBs;
- product and service codes for services and supplies; and
- awards with a total value above \$1 million as well as those between \$150,000 and \$1 million.

We obtained and reviewed the contract files for each of the selected contract actions, which are also stored in eCMS, including signed awards,

solicitations, market research reports, fair and reasonable price determinations, independent government cost estimates, statements of work, and other documents. We visited each of the Network Contracting Offices and interviewed the contracting officer for each of the selected contract actions and discussed the set-aside determination and their experiences with the Veterans First policy; because some were responsible for more than one, we interviewed 30 contracting officers for the 35 selected contracts and orders. We interviewed leadership at each location, and held 5 roundtable discussions with contracting officers from various product lines—supplies, services, construction, and leasing—whose contracts were not included in our non-generalizable sample. We also interviewed the customer—in most cases the contracting officer’s representative or subject matter expert—for each of the selected contract actions. Finally, we met with leadership at VA’s national contracting organizations—including the National Acquisition Center, Strategic Acquisition Center, Technology Acquisition Center, and Construction and Facilities Management—to discuss the implementation of the 2016 Veterans First policy within their organizations.

To assess the extent to which VA has mechanisms in place to monitor compliance with subcontracting limitations by veteran-owned small businesses and the effectiveness of such mechanisms, we analyzed VA and Small Business Administration (SBA) acquisition policies and regulations to identify the monitoring mechanisms in place to ensure compliance with subcontracting limitations. To assess the effectiveness of VA’s mechanisms, we leveraged our reviews of files for the 29 selected contracts that were set aside, and we assessed whether the required set-aside and monitoring clauses were included. In cases where we selected an order, we reviewed the overarching indefinite delivery contract if it was awarded by VA. We also assessed the extent to which the files reflected evidence of monitoring. We reviewed VA’s Information Letter that established the Risk Management and Compliance Service’s Subcontracting Compliance Review Program and the program’s manual for conducting subcontracting limitations compliance audits and analyzed the audit results. We also assessed the extent to which these mechanisms met GAO internal control and fraud framework criteria. We interviewed senior VA procurement officials responsible for developing and/or implementing these mechanisms and providing training to contracting officers and contracting officers’ representatives. We also

reviewed our prior work and SBA and VA Inspector General reports on VA and other agencies' compliance with subcontracting limitations.³

We conducted this performance audit from October 2017 to September 2018 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.

³Department of Veterans Affairs Inspector General, *Audit of Veteran-Owned and Service-Disabled Veteran-Owned Small Business Programs*, 10-02436-234 (Washington, D.C.: July 25, 2011) and SBA, *Surveillance Review Report, VA Network Contracting Office 19, Glendale, CO* (Washington, D.C.: Sept. 19, 2016).

Appendix II: Comments from the Department of Veterans Affairs



THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

September 10, 2018

Ms. Shelby S. Oakley
Director
Contracting and National Security Acquisitions
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Oakley:

The Department of Veterans Affairs (VA) has reviewed the Government Accountability Office (GAO) draft report: ***"VETERANS FIRST PROGRAM: VA Needs to Address Implementation Challenges and Strengthen Oversight of Subcontracting Limitations"*** (GAO-18-648).

The enclosure sets forth the actions to be taken to address the GAO draft report recommendations.

VA appreciates the opportunity to comment on your draft report.

Sincerely,

A handwritten signature in cursive script that reads "Robert L. Wilkie".

Robert L. Wilkie

Enclosure

Enclosure

Department of Veterans Affairs (VA) Comments to
Government Accountability Office (GAO) Draft Report
***“VETERANS FIRST PROGRAM: VA Needs to Address Implementation Challenges
and Strengthen Oversight of Subcontracting Limitations”***
(GAO-18-648)

Recommendation 1: The Secretary of Veterans Affairs should ensure that VA’s Director of the Office of Acquisition and Logistics, in consultation with OSDBU, takes measures to ensure that VA contracting staff adhere to the requirements for documenting the required Vendor Information Pages searches in contract files.

VA Comment: Concur. VA has launched policy updates; a new case management system to facilitate easier documentation of the required Vendor Information Pages (VIP) searches; and post-award reviews and audits to ensure VIP searches are evidenced in the contract files. VA is beginning collaborative efforts to consolidate our evidence to better demonstrate this recommendation’s implementation. Implementation of this recommendation is ongoing.

Recommendation 2: The Secretary of Veterans Affairs should ensure that the Director of VA’s Office of Acquisition and Logistics directs the VA Acquisition Academy to provide more targeted training for the more challenging components of implementing the Veterans First policy, such as making fair and reasonable price determinations.

VA Comment: Concur. The VA Acquisition Academy is integrating fair and reasonable price determinations training with a course planned for fiscal year 2019. Implementation of this recommendation is ongoing.

Recommendation 3: The Secretary of Veterans Affairs should, in consultation with VA’s Office of Human Resources and Administration, and the Director of VA’s Office of Acquisition and Logistics, assess whether training on the Veterans First Policy should be designated as mandatory and take appropriate action based on the assessment results.

VA Comment: Concur. VA is working with the appropriate internal offices to determine how best to provide additional instances of the Veterans First Policy training and whether the training should be designated as mandatory. Implementation of this recommendation is ongoing.

Recommendation 4: The Secretary of Veterans Affairs should ensure that the Director of the Office of Acquisition and Logistics establishes a mechanism to ensure that mandatory clauses relating to subcontracting limitations are consistently incorporated in all contracts that are set aside for SD/VOSBs.

VA Comment: Concur. VA will incorporate best practices from policy, risk management, and operational perspectives to ensure implementation of this recommendation. Implementation of this recommendation is ongoing.

Enclosure

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Recommendation 5: The Secretary of Veterans Affairs should ensure that the Director of the Office of Acquisition and Logistics conducts a fraud risk assessment for the Veterans First program.

VA Comment: Concur. VA agrees to implement a fraud risk assessment for the Veterans First Program that will include internal VA stakeholders. Implementation of this recommendation is ongoing.

Recommendation 6: The Secretary of Veterans Affairs should ensure that the Director of the Office of Acquisition and Logistics directs the Risk Management and Compliance Service to share, through guidance, training, or other methods, subcontracting limitation risks and monitoring practices with contracting officers and their management.

VA Comment: Concur. VA agrees that information sharing should be improved and is working to develop subcontracting limitation risks and monitoring practices that capture and integrate lessons learned into training tools and methods. Implementation of this recommendation is ongoing.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Shelby S. Oakley, 202-512-4841 or oakleys@gao.gov

Staff Acknowledgments

In addition to the individual named above, Lisa Gardner, Assistant Director; Pete Anderson; Matthew T. Crosby; Susan Ditto; Jeff Hartnett; Alexandra Jeszeck; Teague Lyons; Lorraine Ettaro; Suellen Foth; Ashley Rawson; Eric Schwab; Roxanna Sun; and Alyssa Weir made key contributions to this report.

Appendix IV: Accessible Data

Data Tables

Accessible Data for VA Contract Obligations for Set-Asides and Non-Set-Asides, Fiscal Years 2014 through 2017

	SD/VOSB	All other	Not a set aside
2014	2.291	1.27	11.251
2015	2.282	1.046	10.153
2016	2.994	1.211	10.192
2017	3.903	1.038	10.193

Accessible Data for Figure 2: VA Obligations for SD/VOSB Set-Asides and Other Categories, Fiscal Years 2014 through 2017

	SD/VOSB	All other	Not a set-aside
2014	2.291	1.27	11.251
2015	2.282	1.046	10.153
2016	2.994	1.211	10.192
2017	3.903	1.038	10.193

Accessible Data for Figure 3: VA Awards Set Aside for SD/VOSBs and Other Categories, Fiscal Years 2014 through 2017

	SD/VOSB	All other	Not a set-aside
2014	5.017	12.38	130.308
2015	4.761	10.537	124.177
2016	7.427	9.607	118.419
2017	13.876	7.323	107.576

Accessible Data for Figure 4: VA Obligations for Construction and Non-Construction Set-Asides for SD/VOSBs, Fiscal Years 2014 through 2017

n/a	Construction	
n/a	SD/VOSB	Non-SD/VOSB
2014	1.459	0.964
2015	1.495	0.809
2016	1.547	0.823
2017	1.397	0.408

n/a	Non-construction	
n/a	SD/VOSB	Non-SD/VOSB
2014	0.832	11.556
2015	0.788	10.39
2016	1.447	10.58
2017	2.505	10.823

Accessible Data for Figure 5: Percentage of Obligations for SD/VOSB Set-Asides in VISN Contracting Offices, Fiscal Year 2017

	VISN percentage
1	29.63
2	31.12
4	29.49
5	26.35
6	31.4
7	29.16
8	31.91
9	24.85
10	27.24
12	32.18
15	40.22
16	30.07
17	21.18
19	22.17
20	16.98
21	27.65

	VISN percentage
22	27
23	27.99

Accessible Data for Figure 6: Obligations on SD/VOSB Set-Aside and Non-SD/VOSB-Set-Aside Contracts and Orders in Fiscal Years 2014 through 2017 for VA’s National Acquisition Center (NAC), Strategic Acquisition Center (SAC), and Technology Acquisition Center (TAC)

	SDVOSB	Non SDVOSB
2014	0.033	1.397
	0.083	0.644
	0.296	2.586
2015	0.007	0.937
	0.089	0.529
	0.324	2.772
2016	0.005	1.222
	0.189	0.755
	0.721	2.574
2017	0.007	1.174
	0.244	1.309
	1.236	2.847

Accessible Data for Figure 7: Number of SD/VOSB Certified Firms in VA Vendor Information Pages (VIP) Database, and Number of SD/VOSBs Receiving Set-Aside Awards, Fiscal Years 2014 through 2017

	Set-aside awards	VIP
2014	1016	6078
2015	950	6433
2016	1174	7311
2017	1663	10263

Accessible Data for Figure 10: Number of Selected VA Contract Actions Where the Service-Disabled/Veteran-Owned Small Business Set-Aside Clause Was Outdated, Missing, or Included

Outdated version	3
Mission	8
Current version	18

Agency Comment Letter

Accessible Text for Appendix II Comments from the Department of Veterans Affairs

Page 1

September 10, 2018

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Contracting and National Security Acquisitions

U.S. Government Accountability Office

441 G Street, NW

Washington, DC 20548

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Enclosure

Page 2

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Page 3

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