

April 2004

CONTRACT MANAGEMENT

DOD Needs Measures for Small Business Subcontracting Program and Better Data on Foreign Subcontracts





Highlights of [GAO-04-381](#), a report to Committee on Small Business, House of Representatives

Why GAO Did This Study

More small businesses are turning to subcontracting as a way to participate in the federal government's \$250 billion procurement program. DOD, accounting for about two-thirds of federal procurements, has a critical role in providing opportunities to small businesses through subcontracting programs such as the Test Program for Negotiation of Comprehensive Small Business Subcontracting Plans (Test Program). In addition, Congress raised concerns about the potential for small businesses to lose opportunities to firms performing work outside of the United States.

GAO was asked to review (1) DOD's assessment of the Test Program's effectiveness, (2) the performance of contractors participating in the Test Program, (3) the Defense Contract Management Agency's (DCMA) oversight of contractors' small business subcontracting efforts, and (4) the extent and reasons contractors are subcontracting with businesses performing outside the U.S.

What GAO Recommends

GAO recommends that the Secretary of Defense (1) establish metrics to assess the overall effectiveness of the Test Program and (2) establish procedures to improve the quality of the information in its database of subcontracts to firms performing outside the U.S. DOD concurred with GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-04-381.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David Cooper at (202) 512-4841 or cooperd@gao.gov.

CONTRACT MANAGEMENT

DOD Needs Measures for Small Business Subcontracting Program and Better Data on Foreign Subcontracts

What GAO Found

In order to foster small business participation in subcontracting, government contractors with larger dollar value contracts are required to have subcontracting plans that establish goals for contractors to award small businesses a percentage of subcontract dollars. DOD created the Test Program to provide more small business opportunities and reduce the administrative burden for contractors in managing their subcontracting programs. Many of DOD's largest contractors participate in the program.

Although the Test Program was started more than 12 years ago, DOD has yet to establish metrics to evaluate the program's results and effectiveness. As a result, there is no systematic way of determining whether the program is meeting its intended objectives and whether further changes need to be made. DOD contracted for an assessment of the Test Program in 2002, but the results of the assessment are considered preliminary and, therefore, have not been reported. DOD is required to report the results of the Test Program in 2005, when the program is set to expire.

DOD contractors participating in the Test Program have experienced mixed success in meeting their various small business subcontracting goals. DOD and contractor officials noted that a changing acquisition environment has added to their challenge in meeting small business goals. Two of the major challenges they identified include (1) the increased breadth, scope, and complexity of DOD prime contracts that require, among other things, teaming arrangements with other, typically large contractors and (2) prime contractors' strategic sourcing decisions to leverage their purchasing power by reducing the number of their suppliers including small businesses.

DCMA plays a key role in overseeing the performance of contractors in the Test Program and has made significant changes to its policy and guidance. The revised approach is designed to better monitor contractors' efforts, provide more consistency in assessing contractor performance, and hold contractors accountable for achieving their subcontracting goals. DCMA is still in the process of revamping its oversight activities.

GAO could not assess the full extent contractors used firms performing outside the U.S. because of data reliability concerns. Contractors in GAO's review reported several reasons for awarding subcontracts to firms performing outside the U.S., such as fulfilling commitments included in offset agreements or executing teaming arrangements for major defense programs. Without accurate and complete information on subcontracts to firms performing outside the U.S., DOD cannot make informed decisions on industrial base issues.

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Abbreviations

DCMA	Defense Contract Management Agency
FAR	Federal Acquisition Regulation
HUBZone	Historically Underutilized Business Zone
LMI	Logistics Management Institute

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G A O

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

April 5, 2004

The Honorable Donald A. Manzullo
Chairman
The Honorable Nydia M. Velazquez
Ranking Democratic Member
Committee on Small Business
House of Representatives

Recognizing the importance of creating a dynamic environment where small businesses—with their innovation and diversity—can flourish, the federal government has sought to improve small business access to its \$250 billion procurement program. Small businesses more and more are turning to subcontracting as a way to participate in federal procurements. Contractors with larger dollar value contracts¹ are required to have subcontracting plans that establish goals for small business' share of subcontract dollars to be awarded. Some in Congress have raised concerns about the need to improve access of small businesses to federal contracting opportunities. In addition, they have raised concerns about small businesses losing subcontracting opportunities to firms performing work outside of the United States.

The Department of Defense (DOD) plays a key role in the success of the federal government's small business programs because it accounts for about two-thirds of federal procurements. Over the last several years, information reported by DOD contractors shows that the dollar amount of subcontracts awarded to small businesses² has increased and is higher than it has ever been. On the other hand, the share of DOD's contracting activity awarded to small businesses as subcontracts has declined steeply

¹ Subcontracting plans are required for most contracts over \$500,000 or \$1 million for construction contracts. FAR 19.702(a)(1); 13 CFR § 125.3(a).

² According to DCMA officials, DOD contractors are supposed to report actual subcontract achievements on the Standard Form 294 or 295. How contractors report the data depends on their accounting system. For example, if they are on an accrual basis, they may capture the subcontract award at any convenient point in time (e.g., when they execute the subcontract or purchase order). If they operate on a cash basis, they would capture the transaction when they pay the subcontractor. The government allows contractors to decide which way as long as they follow Generally Accepted Accounting Principles (GAAP). One of the principles of GAAP is that a contractor must apply the same methodology consistently.

in recent years—from about 43 percent in 1995 to about 34 percent in 2002. DOD created the Test Program for Negotiation of Comprehensive Small Business Subcontracting Plans (Test Program) to provide more small business opportunities and reduce the administrative burden for contractors in managing their subcontracting programs.³ Many of DOD’s largest contractors participate in the Test Program, and the Defense Contract Management Agency (DCMA) plays a key role in overseeing their performance.

Due to DOD’s critical role in providing opportunities to small business, we reviewed (1) DOD’s assessment of the Test Program’s effectiveness, (2) the performance of contractors participating in the Test Program, (3) DCMA oversight of contractors’ small business subcontracting efforts, and (4) the extent and reasons contractors are subcontracting with businesses performing outside the U.S.⁴

To conduct this work, we interviewed and obtained documentation from the Office of the Under Secretary of Defense, Office of Small and Disadvantage Business Utilization, DCMA, DOD’s Office of Program Acquisition and International Contracting, and several contractors. We limited our review of internal controls to reviewing DCMA’s plans, methods, and procedures used to meet its small business subcontracting program mission, goals, and objectives. Because of concerns about data reliability of prime contract data,⁵ we limited our use of this data to providing background information and identifying contractors. We did not independently verify subcontract data obtained from DOD and contractors but, instead, relied on DCMA reviews of contractors’ reporting systems to assure data accuracy and completeness. We performed our work from March 2003 to March 2004 in accordance with generally accepted government auditing standards. A more detailed description of our scope and methodology is found in appendix I.

Results in Brief

Although the Test Program was started more than 12 years ago, DOD has yet to establish metrics to evaluate the program’s overall results and

³ National Defense Authorization Act for Fiscal Years 1990 and 1991, P.L. 101-189, § 834.

⁴ DOD collects data about businesses performing work outside the U.S., but not data on whether businesses are domestic or foreign-owned.

⁵ For more information about data reliability concerns, see U.S. General Accounting Office, *Reliability of Federal Procurement Data*, [GAO-04-295R](#) (Washington, D.C.: Dec. 30, 2003).

effectiveness. DOD contracted for an assessment of the Test Program in 2002. However, the results of that assessment are considered preliminary, and the report has not been issued.⁶ DOD, DCMA, and contractor officials we interviewed have various views on the strengths and weaknesses of the program. Some officials believe the Test Program increases high-level corporate attention, while others thought it reduces accountability at lower corporate-levels and visibility of contractors meeting their small business goals for individual contracts. DOD is required to report the results of the Test Program in 2005 when the program is set to expire.

DOD contractors participating in the Test Program have experienced mixed success in meeting their various small business subcontracting goals. DOD and contractor officials noted that a changing acquisition environment has added to their challenge in meeting small business goals. Two of the major challenges they identified include (1) the increased breadth, scope, and complexity of DOD prime contracts that require, among other things, teaming arrangements with other, typically large contractors and (2) prime contractors' strategic-sourcing decisions to leverage their purchasing power by reducing the number of their suppliers including small businesses. According to DOD and contractor officials, both have the potential to either restrict subcontracting opportunities for small businesses or push those opportunities to lower tiers of the supply chain. Contractor officials also said their ability to meet some small business goals is influenced by the limited supply of qualified small businesses that could provide the needed goods and services.

To improve oversight of contractor performance in meeting small business subcontracting goals, DCMA began changing its approach in 2002. The revised approach is designed to better monitor contractors' efforts, provide more consistency in assessing contractor performance, and hold contractors accountable for achieving their subcontracting goals. While DCMA has made significant changes to its policy and guidance, it is still in the process of revamping its oversight activities.

We could not assess the full extent contractors' subcontract with firms performing outside the U.S. because of data reliability concerns. DOD only recently took action to improve the information collected on subcontracting with overseas firms. Contractors in our review reported

⁶ Logistics Management Institute, *Review of the Department of Defense Comprehensive Subcontracting Plan Test Program*, AQ001R2 (McLean, Va.: July 2002), Draft.

several reasons for awarding subcontracts to firms performing outside the U.S., such as fulfilling commitments included in offset agreements⁷ or executing teaming arrangements for major defense programs.

This report contains two recommendations to the Secretary of Defense to establish metrics to assess the overall effectiveness of the Test Program and improve the quality of the information in its database of subcontracts to firms performing outside the U.S. In written comments on a draft of this report, DOD concurred with both recommendations.

Background

Over the last 10 years, DOD prime contract and total subcontract dollar awards have increased. From 1993 to 2002, DOD prime contract dollars increased almost 15 percent, from \$136.8 billion to \$157.1 billion.⁸ As shown in table 1, total subcontract dollars awarded by DOD contractors⁹ increased more than 40 percent, from \$53.0 billion to \$75.5 billion. In addition, small businesses have generally received increasing dollar amounts from DOD contractors over a 10-year period—from \$19.9 billion in fiscal year 1993 to \$25.8 billion fiscal year 2002.¹⁰

⁷ An agreement between a U.S. supplier of defense articles or services and a foreign country under which the supplier agrees to purchase goods and services of the foreign country in consideration for the country's purchase of the supplier's defense articles or services. 22 U.S.C. 2776(e)(1).

⁸ The total dollar amounts are for dollars submitted on Individual Contracting Action Reports, DD Form 350, for actions that obligate or de-obligate more than \$25,000.

⁹ The annual subcontracting data was obtained from the Office of the Under Secretary of Defense, Office of Small and Disadvantage Business Utilization for fiscal years 1993 through 2002. We did not independently test the reliability of the data received from this office, which relies on DOD contractors to report this subcontract information semi-annually on Standard Form 295 (SF 295).

¹⁰ The dollars reported in this paragraph are in constant fiscal year 2002 dollars.

Table 1: Total Subcontract and Small Business Subcontract Awards from DOD Contracts, Fiscal Years 1993 through 2002

Dollars in billions

Fiscal year^a	Total subcontract dollars awarded	Subcontract dollars awarded to small businesses
1993	\$53.0	\$19.9
1994	52.4	20.1
1995	50.9	21.7
1996	52.5	21.9
1997	59.1	24.5
1998	56.9	23.9
1999	55.3	22.7
2000	57.0	22.4
2001	61.3	23.8
2002	\$75.5	\$25.8

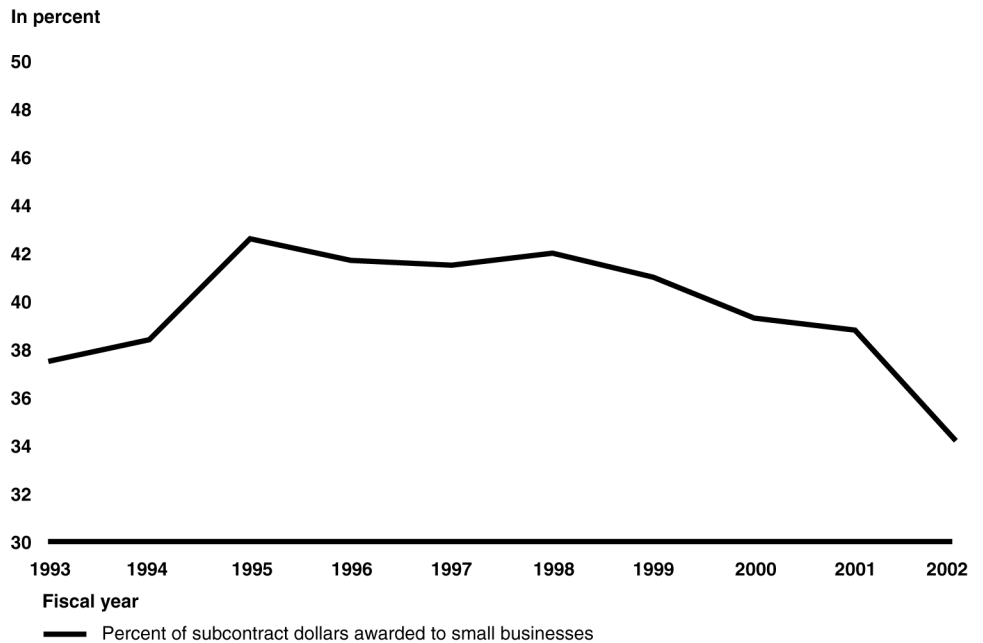
Source: GAO analysis of DOD-provided data.

^aIn constant fiscal year 2002 dollars.

However, as shown in figure 1, small businesses' share of total subcontract dollars from DOD contractors has decreased in recent years. The percent share that small business received has ranged from a high of about 43 percent (\$21.7 billion) in fiscal year 1995 to a low of about 34 percent (\$25.8 billion) in fiscal year 2002.¹¹

¹¹ All dollars are in constant fiscal year 2002 dollars.

Figure 1: Percentage of Total Subcontract Dollars Awarded to Small Businesses from DOD Contracts, Fiscal Years 1993 through 2002



Source: GAO analysis of DOD data.

In order to foster the participation of small businesses in subcontracting, the Federal Acquisition Regulation (FAR) requires DOD contractors to have subcontracting plans for most contracts of more than \$500,000 (\$1 million for construction contracts).¹² These plans document what actions the contractor will take to provide various types of small businesses with the maximum practicable opportunities to participate in subcontracting. See appendix II for description of small business categories. Contractors with DOD are to provide semiannual reports to DCMA on their small business achievements for each contract that has a subcontracting plan as well as semiannual summary reports that encompass all their contracts with a particular agency.

¹² FAR 19.702 (a). However, subcontracting plans are not required (1) from small businesses; (2) for personal service contracts; (3) for contracts or contract modifications performed outside a state, territory, or possession of the U.S., the District of Columbia, and the Commonwealth of Puerto Rico; or (4) for modifications of contracts within the general scope of the contract that do not contain the clause at FAR 52.219-8, Utilization of Small Business Concerns. FAR 19.702 (b).

The National Defense Authorization Act for Fiscal Years 1990 and 1991 authorized DOD to establish the Test Program for Negotiation of Comprehensive Small Business Subcontracting Plans (Test Program), which allowed the negotiation, administration, and reporting of subcontracting plans on a plant, division, or companywide basis rather than a plan for each individual contract. The purpose of the Test Program is to increase subcontracting opportunities for various types of small businesses while reducing the administrative burdens on contractors. The companies that participated in this Test Program in fiscal year 2002 accounted for about 41 percent of DOD's subcontracting activity in that same fiscal year. The Office of the Under Secretary of Defense, Office of Small and Disadvantage Business Utilization is responsible for the overall assessment of the Test Program. Originally scheduled for fiscal years 1991 through 1992, the Test Program has been extended several times and is scheduled to end September 30, 2005.¹³ Under the Test Program, small business goals are negotiated annually, whereas for individual plans, goals are generally negotiated once for the life of the contract.¹⁴

As of fiscal year 2003, 15 contractors have comprehensive plans under the Test Program. DCMA is responsible for reviewing DOD contractors' subcontracting plans and monitoring and assessing contractor's performance to determine how well contractors are implementing their plans and meeting their small business goals. DCMA is also involved in annually negotiating goals with contractors participating in the Test Program.

Since 1982, DOD has required prime contractors to report quarterly to DOD's Office of Program Acquisition and International Contracting on contracts exceeding \$500,000 when the contractor or its first tier subcontractor will perform any part of the contract that exceeds \$100,000 outside the U.S., unless a foreign place of performance (1) is the principal place of performance and (2) is identified in the firm's offer.¹⁵ First-tier

¹³ Section 817, P.L. 106-65.

¹⁴ Under the Test Program, the comprehensive subcontracting plan is to target specific industry categories where types of small businesses have not historically participated. For individual plans, the contractor must pay liquidated damages if the contracting officer determines the contractor failed to make a good faith effort to comply with the subcontracting plan. For both types of plans, the reporting requirement is semiannually.

¹⁵ DFARS 252.225-7004(a)(2). Contracts and subcontracts for commercial items, military construction, ores, natural gas, utilities, petroleum products and crudes, timber, and subsistence are not required to be reported.

subcontractors that award subcontracts in excess of \$100,000 to be performed outside the U.S. are also subject to the reporting requirement. Reported information is to include the type of supply or service provided, the principal place of subcontract performance, and the dollar value of the transaction. The information is used as part of DOD's efforts to monitor foreign procurements and assess matters related to defense trade balances and domestic industrial base capabilities.¹⁶ DOD's Office of Program Acquisition and International Contracting reports to the Director of Defense Procurement and Acquisition Policy.

DOD Has Yet to Assess the Overall Outcome of Its Test Program

Although the Test Program has been in existence since fiscal year 1991, DOD does not know if it is achieving its intended objectives to provide more small business subcontracting opportunities and to reduce administrative burden for contractors. The Office of the Under Secretary of Defense, Office of Small and Disadvantage Business Utilization, which is to report the results of the Test Program in December 2005, shortly after the program is set to expire, commissioned a preliminary study of the program in 2002. The data assessing the merits of the program were never formally released, but the resulting preliminary report had a number of recommendations. DOD recognizes that it needs to establish metrics and other criteria for measuring program results in meeting the intended objectives. We found that DOD and contractor officials have various views on the strengths and weaknesses of the program.

Past Assessment of the Test Program Was Preliminary

To assess the Test Program, DOD commissioned a preliminary review of the program by the Logistics Management Institute (LMI). LMI noted in its draft report that, in terms of achievements for subcontracting to small businesses, the Test Program results improved impressively between 1991 and 1996—from small businesses receiving 12 percent of total subcontracts to receiving about 36 percent—but declined to about 29 percent by 2000. LMI attributed the decline to factors external to the program—some of which we discuss later. Most of its recommendations dealt with addressing ways of improving small business achievements, but also included program-specific recommendations, such as

- increasing visibility of subcontracting activity at the corporation's division and program level, where feasible;

¹⁶ 10 U.S.C. sec 2505 requires periodic national technology and industrial base assessments.

-
- deducting directed-source procurements from subcontracting achievement calculations;
 - allowing subcontracting plan renegotiations to reflect major contract awards that occur after negotiations;
 - establishing annual meetings of program participants and DCMA to allow exchange of ideas, best practices, and lessons learned;
 - permitting removal of poor performing participants after appropriate notice;
 - requiring participants to track and annually report administrative savings and costs and results of their outreach activities; and
 - limiting enrollment to 20 participants.

While the final report has not been issued, DOD officials said they have taken into consideration a number of the recommendations from the study by LMI. For example, DCMA has taken steps to improve oversight of contractor performance and hold contractors more accountable for achieving their subcontracting goals, and DOD has chartered a council to share Test Program knowledge and experience. In addition, some DOD program offices require contractors to report on their subcontracting activity at the program level to increase visibility of subcontracting to small businesses.

DOD Lacks Test Program Measurements to Assess Overall Effectiveness

Despite DOD's attempts to assess the program, it still does not know whether using the Test Program is affecting subcontracting opportunities for small businesses and reducing administrative burden for the contractors. DOD, through DCMA, is to report on each participating contractor's performance by December 15, 2005 by comparing the contractor's performance under the program with its performance for 3 fiscal years before the acceptance into the program.¹⁷ DOD officials told us they are uncertain how they will measure contractors' performance to meet their reporting requirement and assess trends over time. This uncertainty is in part due to not having the original participants in the program to establish a baseline to evaluate performance and changes in company compositions. Further, these officials noted that mergers and acquisitions can greatly change company compositions and business bases from year to year making trend determinations difficult. DCMA officials told us they plan on hiring a contractor to help them complete their review

¹⁷ 65 FR 7509 (Feb. 15, 2000).

of the overall results of the Test Program and will use the results of the LMI study as a tool to help develop Test Program metrics.

Views Varied on Merits of the Test Program

DCMA and contractor officials we interviewed gave varied opinions—both positive and negative—on the Test Program. Some said that while they were uncertain about its increasing small business opportunities, they thought participating in the Test Program helped increase the visibility of the results of small business program companywide or divisionwide. Others said the comprehensive plan sometimes resulted in lost visibility of individual contract performance and reduced accountability at the program level. In fact, one contractor recently stopped participating in the program because of the lost ability to monitor individual contract performance. DCMA and contractor officials we interviewed said they were uncertain if there had been a reduction of administrative burden since, for example, under the Test Program contractors were required to prepare a detailed plan, negotiate small business goals each year, and submit performance data semiannually. Plus, certain large DOD programs requested contractors to report small business data. Many agreed that, regardless of what type of plan contractors used, success of the small business program relies on contractor management’s commitment to meeting small business goals. DCMA and contractor officials also stated that contractor management must have the ability to monitor company performance on those goals.

DOD Contractors Have Mixed Success in Reaching Small Business Goals

Between fiscal years 1999 and 2003, the DOD contractors we reviewed had varied success in meeting their small business goals. DOD and contractor officials provided several reasons for the mixed success of the subcontracting program, but DOD has not formally studied those factors that may encourage or discourage the participation of small businesses in DOD subcontracts.

Contractors Have Met Some Small Business Goals, but Results Are Inconsistent

In the past 5 years, the 15 DOD contractors participating in the Test Program had varying success in meeting their small business goals established in their subcontracting plans. Overall, the contractors in the Test Program were not consistent from year to year in meeting their goals for the traditional small business categories. For example, in at least 3 of the past 5 years, 11 of the 15 contractors met their overall small business goals, seven contractors met their goals for small disadvantaged businesses, and six contractors met their goals for women-owned small businesses.

Changing Contracting Environment May Affect Contractors' Ability to Meet Small Business Goals

DOD and contractor officials noted that a changing acquisition environment has added to the challenge in meeting their small business goals. Changes included (1) the increased breadth, scope, and complexity of DOD prime contracts that require, among other things, teaming arrangements with other, typically large contractors and (2) prime contractors' strategic sourcing decisions to leverage their purchasing power by reducing the number of their suppliers including small businesses. Contractor officials also said that the relatively limited supply of qualified small businesses that could provide the needed goods and services also increases the difficulty in meeting small business goals. DOD has not studied to what degree the changing acquisition environment or other factors contribute to the success or failure of its small business subcontracting program.

Contractor and DCMA officials report that the breadth, scope, and complexity of DOD prime contracts for weapons systems has increased over the years. According to officials, this has had several consequences, which have limited the opportunities for small businesses. First, prime contractors are increasingly relying on teaming arrangements to win contracts. Their teaming partners, typically large businesses, receive a sizable portion of the first-tier subcontracts. For example, under a major defense contract, the contractor awarded about 56 percent of its total subcontract dollars to its teaming partners, significantly reducing the opportunities of small businesses to win first-tier subcontracts. Also, prime contractors are increasingly serving as systems integrators instead of systems manufacturers and are buying major assemblies rather than parts and components. Systems integrators are often responsible for the development, management, and eventual delivery of a large weapon system. Consequently, as in the case of teaming arrangements, systems integrators often use large businesses as first-tier subcontractors. Contractor officials said that although small businesses may still be receiving contract dollars through second- or lower-tier subcontracts, contractors could only count their first-tier subcontract awards towards their small business goals.

In addition, many contractors have made the strategic-sourcing decision to reduce the number of suppliers in their supplier base. Contractors report reducing their supplier bases by as much as 50 percent over the past 5 years in a move to leverage their purchases, cut costs, and improve

performance to remain competitive in the world market.¹⁸ Contractors also noted that by reducing the number of contractors, they often relied on larger corporatewide contracts, which could also affect their small business suppliers. For example, officials of one contractor noted that when it went to a single information systems contractor, it no longer contracted with a number of small firms.

Finally, contractors report difficulty in finding qualified small businesses to provide the goods and services needed. Contractor officials said this is particularly true for small business programs with certification requirements—such as the programs for small disadvantaged businesses and Historically Underutilized Business Zone (HUBZone) businesses—and for very recent programs, such as the service-disabled veterans program. The Small Business Administration has certified significantly fewer small disadvantaged businesses and HUBZone firms than hoped. Consequently, contractors often have difficulty meeting small disadvantaged business goals, and few have met their HUBZone goals.¹⁹ Further, according to DCMA officials responsible for on site monitoring of subcontracting plans, qualified businesses in different small business categories usually compete for the same type of work. Consequently, according to these DCMA officials, contractors have difficulty meeting goals for all small business types and often report wide fluctuations in subcontracting achievements among the groups, depending on which ones win contracts in a given year. The categories of small business that DOD uses include small businesses, small disadvantaged businesses, women-owned small businesses, veteran-owned and service-disabled veteran-owned small businesses, HUBZone businesses, Historically Black Colleges and Universities, and Minority Institutions.²⁰

¹⁸ For more information on supplier base management, see U.S. General Accounting Office, *Best Practices: Taking a Strategic Approach Could Improve DOD's Acquisition of Services*, [GAO-02-230](#) (Washington D.C.: Jan. 18, 2002).

¹⁹ For more information on the small disadvantaged business and HUBZone programs, see U.S. General Accounting Office, *Small Business: Status of Small Disadvantaged Business Certifications*, [GAO-01-273](#) (Washington, D.C.: Jan. 19, 2001) and *Small Business: HUBZone Program Suffers From Reporting and Implementation Difficulties*, [GAO-02-57](#) (Washington, D.C.: Oct. 26, 2001).

²⁰ See appendix II for more information on the various small business concerns.

DCMA Is Taking Steps to Improve Oversight of the Subcontracting Program

Since 2002, DCMA has taken steps to help improve its oversight of DOD's small business program. These steps include issuing an updated policy for monitoring contractors' small business subcontracting programs, issuing new guidance to help DCMA personnel in implementing small business program requirements, and developing new criteria for rating contractor performance.

DCMA Role Encompassed a Broad Range of Responsibilities

Previously, DCMA, through its small business specialists, carried out its small business subcontracting program responsibilities through (1) contractor orientation and training, (2) small business outreach and "matchmaking," (3) Test Program review and negotiation, and (4) contractor performance evaluations. Training primarily involved informing the contractors and other DCMA personnel of contractor responsibilities and small business program requirements. Outreach and "matchmaking" activities included attending or arranging small business conferences and open houses and identifying qualified small businesses to contractors.

DCMA policies and procedures also required small business specialists to review contractors' subcontracting performance and perform two kinds of reviews: annual reviews of Test Program participants and reviews of contractor subcontract performance.²¹

- Test Program plan reviews—annually assess each contractor participating in the Test Program. The review includes determining how well the contractor is performing under the plan, including whether it met its goals for the year. However, these reviews do not result in an overall rating.
- Contractors' subcontract-performance reviews—assess all DOD contractor facilities with subcontracting plans, whether comprehensive or individual.²² In general, DCMA reviews the DOD contractors it is responsible for monitoring on an annual basis.²³ The review assesses contractor policies and procedures, outreach activities, record keeping and reporting procedures, training that contractor personnel received to

²¹ These are often referred to as "640 Reviews" because of the form used.

²² For more discussion on DCMA's reviews, see U.S. General Accounting Office. *Small Business Subcontracting Report Validation Can be Improved*, GAO-02-166R (Washington, D.C.: Dec. 13, 2001).

²³ DCMA officials said they review almost all of the contractors included in their reviews annually.

implement their small business subcontracting program, and contractor performance on meeting small business goals. DCMA assigned ratings on a 5-point scale from “outstanding” to “unsatisfactory.” DCMA small business specialists said that because the rating criteria were loosely defined, contractors could receive different ratings depending on the interpretation of the small business specialist. For example, in fiscal year 2001, one company’s performance received a “highly successful” rating even though it had not met any of its three long-standing small business goals²⁴ for that period of the review. In fiscal year 2002, DCMA rated another company’s performance as “unacceptable” although it had demonstrated similar performance on its goals.

DCMA Has Increased Focus on Oversight

DCMA’s new policy and guidance emphasizes the agency’s oversight function. In July 2003, DCMA published an updated policy for monitoring contractors’ small business subcontracting programs. While DCMA continues to conduct its reviews under its revised policy, it created more specific criteria for determining contractor performance. The criteria particularly emphasize contractors’ small business goal achievements and contractor accountability, including the contractors participating in the Test Program. For example, under DCMA’s new rating criteria, to receive a “highly successful” performance rating, the contractor must meet three long-standing small business goals and at least one of the newer goals (e.g. veteran-owned small business) as well as demonstrating significant success in other initiatives identified in its subcontracting plan.

In September 2003, DCMA published a new procedural guide to assist DCMA Small Business Specialists in implementing the small business program. For example, the guidance provides factors, such as a contractor’s past performance, that should be considered when negotiating goals with Test Program participants. DCMA continues to assess the oversight of the Test Program and whether further changes need to be made.

Other steps DCMA has taken that allow the more efficient use of its resources include establishing a risk-based approach to its reviews of contractors and limiting its training and outreach functions. The risk-based approach allows DCMA to skip a review of a contractor for 1 year if the contractor’s previous year’s rating was “outstanding,” there were no

²⁴ DOD considers the long-standing small business goals to include the overall small business, small disadvantaged business, and woman-owned small business.

significant changes in their contracting activity, and there were no significant personnel changes affecting the contractor's small business program. In addition, according to DCMA officials, DCMA is significantly limiting its training and outreach functions on the basis that other organizations, such as the Small Business Administration and Procurement Technical Assistance Centers,²⁵ already provide these services.

Extent of Subcontracting Activity with Firms Performing Outside U.S. Is Unknown, and Reasons for Subcontracting Varied

We could not determine the extent of subcontracting to firms performing outside the U.S. because of inconsistent reporting of subcontracting activities by contractors and poor database management by DOD. According to the contractors in our review, most subcontracts to firms performing outside the U.S. accounted for a small percentage of their total subcontract dollars. Further, the contractors stated that most of the dollars to firms performing outside the U.S. were awarded on a noncompetitive basis. These contractors reported several reasons for awarding subcontracts to firms performing outside the U.S. in fiscal year 2002.

Concerns Remain about Reliability of Data on Subcontracts Performed Outside U.S.

We could not assess the full extent that defense contractors' subcontract with firms performing outside the U.S. In November 1998, we reported that DOD's Office of Program Acquisition and International Contracting did not have safeguards for ensuring the completeness and accuracy of its database of subcontracts to firms performing outside the U.S.²⁶ At that time, we found instances in which DOD contractors did not report their subcontracts to firms performing outside the U.S. in accordance with DOD's reporting requirements because they were unaware of the reporting requirements or misunderstood the criteria for reporting this type of subcontract. Plus, we identified that DOD lacked standards and procedures for managing this database.

In October 2003, during our review, the Director of Defense Procurement and Acquisition Policy—through the Office of Program Acquisition and

²⁵ States, colleges and universities, tribal organizations, and non-profit organizations under contract with DOD typically run these centers. They are to provide assistance in contracting with federal, state, and local governments.

²⁶ U.S. General Accounting Office, *Defense Trade: Weaknesses Exist in DOD Foreign Subcontract Data*, [GAO/NSIAD-99-8](#) (Washington, D.C.: Nov. 1998).

International Contracting—began to take the following actions to address contractor compliance

- sent letters to the top 100 parent companies of DOD contractors to remind them about DOD reporting requirements for subcontracts to firms performing outside the U.S. and requested they ensure all their subsidiaries also comply with this reporting requirement,
- sent a memorandum to the Senior Acquisition Executives of the Military Department and the Defense Agencies requesting they remind their contracting officers of the reporting requirement,
- engaged in outreach efforts with government and industry personnel to help ensure this effort to improve contractor compliance was fully communicated,
- sent a memorandum to DCMA requesting its assistance in periodically verifying that contractors are complying with the reporting requirements, and
- clarified reporting requirements for subcontracts to firms performing outside the U.S.

The Office of Program Acquisition and International Contracting intends to perform periodic verification of reporting of subcontracts to firms performing outside the U.S. and is in the process of establishing those procedures. Because no action had been taken to improve data reliability until recently, we could not rely on the data available to determine the extent that DOD contractors were subcontracting with firms outside the U.S.

Contractors Report Awarding a Small Percentage of Subcontract Dollars to Firms Performing Outside the U.S.

Contractors at four of the five locations we visited spent between approximately 2 and 6 percent of their total DOD subcontracting dollars in fiscal year 2002 on subcontracts to firms performing outside the U.S.²⁷ The fifth contractor subcontracted about 18 percent of its subcontracting dollars with firms performing outside the U.S. in fiscal year 2002 due to a teaming arrangement for a large defense contract it was awarded. According to a contractor official, this percentage would more typically be around 10 percent. At the five contractor locations, the total subcontract

²⁷ The five contractor locations we visited are: Raytheon Company, Space and Airborne Systems, El Segundo, Calif.; The Boeing Company, Integrated Defense Systems, El Segundo, Calif.; Northrop Grumman Corp., Air Combat Systems, El Segundo, Calif.; Northrop Grumman Corp., Space and Technology (formerly TRW Space and Electronics), Redondo Beach, Calif.; and Lockheed Martin Aeronautics Company, Ft. Worth, Tex.

dollars to firms performing outside the U.S. ranged between approximately \$29 million and \$1.9 billion in fiscal year 2002. These subcontracts were for items such as parts for military systems, communication equipment for satellites, components for military aircraft, and sensors for satellite weather forecasting.

While one contractor reported awarding most of its subcontract dollars to firms performing outside the U.S. on a competitive basis in fiscal year 2002, four contractors reported awarding the majority of their subcontract dollars non-competitively. Consequently, small businesses generally did not have the opportunity to compete for these types of subcontracts. Contractor officials said that even when their subcontracts with firms performing outside the U.S. were competed, they were not necessarily for the type of products that small businesses had the expertise or technology to provide. For example, one contractor competitively awarded a contract for an amplifier used in communication equipment to a firm outside the U.S. The contractor did not identify or solicit small businesses in the competition because of the unique technology and expertise required for that particular amplifier.

Subcontracts Awarded for Various Reasons

Contractor officials said the reasons for the awards to firms performing outside the U.S. in fiscal year 2002 include:

- **Directed source**—Contractor officials stated some subcontracts were awarded to companies outside the U.S. because DOD directed them to subcontract with a certain supplier. For example, a prime contractor was directed by DOD to award a subcontract to a company outside the U.S. to produce a sensor for a weather forecasting satellite because the company previously had a contract directly with the U.S. Government.
- **Offset agreements**²⁸—The contractors said that to sell military goods and services to other countries, they often have to form agreements with foreign countries that necessitate subcontracting with foreign firms to some degree. For example, one U.S. prime contractor awarded a subcontract to a firm in a foreign country because a prior offset agreement required the contractor to purchase about \$1 billion in goods and services from firms in that country. The \$32.3 million subcontract was for a

²⁸ An agreement between a U.S. supplier of defense articles or services and a foreign country under which the supplier agrees to purchase goods and services of the foreign country in consideration for the country's purchase of the supplier's defense articles or services. 22 U.S.C. 2776(e)(1).

structural frame for the troop ramp and an air deflector for the C-17 transport aircraft.

- **International agreements**—Sometimes subcontracts are awarded to companies outside the U.S. because of international agreements between the U.S. and foreign countries. For instance, a contractor awarded a series of subcontracts to firms performing outside the U.S. based on an international agreement in which a 13-nation consortium contributed to the development of components for a missile to be used by these nations.²⁹ Some of the components produced by the various countries included control systems, rocket motors, and guidance systems.
- **Team Arrangements**—This is an arrangement where two or more contractors form a partnership or joint venture to act as a potential prime contractor or a potential prime contractor agrees with one or more other contractors to have them act as its subcontractors under a specified Government contract or acquisition program.³⁰
- **Product specialization**—Contractor officials said it was very expensive to develop and change suppliers of specialized parts; therefore, DOD contractors typically continue to award contracts to the same supplier that originally supplied the products. That supplier may be located outside the U.S. For instance, one contractor awarded a subcontract to such a supplier because it was the only one that had a specification drawing for the production of pedestals for a radar system. In another case, a DOD contractor awarded a subcontract to a company outside the U.S. because it was the only supplier that already had the tools and the expertise to manufacture and produce a horizontal stabilizer for the F-5 aircraft.

Conclusions

Because of its large contracting operations, DOD is critical to the success of federal programs designed to provide opportunities for small businesses. DOD has recognized the importance of its role in federal contracting; has taken limited steps to help improve opportunities for small businesses, such as the Test Program; and has revised DCMA guidance to hold contractors more accountable for their small business goals. However, after 12 years of implementing the Test Program, DOD does not know whether these initiatives are effective. While DOD has collected data over the years, it has not established metrics to evaluate the effectiveness of the Test Program. As a result, there is no systematic way

²⁹ According to a contractor official at this firm, the number of countries involved in the program can change from year to year depending on various circumstances. In fiscal year 2002, 10 countries, including the U.S., were in the program.

³⁰ For additional information on contractor team arrangements, see FAR 9.6.

of determining whether the program is meeting its intended objectives and whether further changes need to be made.

In addition, the reliability of the data submitted by contractors on their subcontracts to firms performing outside the U.S. remains a concern. DOD has only recently started to take action on improving its data collection and has yet to establish procedures for validating the information. Without accurate and complete information on subcontracts to firms performing outside the U.S., DOD cannot make informed decisions on industrial base issues.

Recommendations for Executive Action

We are making the following two recommendations to the Secretary of Defense:

In order to evaluate the effectiveness of the Test Program, we recommend the Secretary of Defense direct the Office of the Under Secretary of Defense, Office of Small and Disadvantage Business Utilization, to develop metrics to assess the overall results of its Test Program.

Also, to ensure DOD has the information it needs to accurately determine the number and dollar amount of subcontracts to firms performing outside the U.S., we recommend the Secretary of Defense direct DOD's Office of Program Acquisition and International Contracting to establish procedures to improve the quality of the information in its database of subcontracts performed outside the U.S.

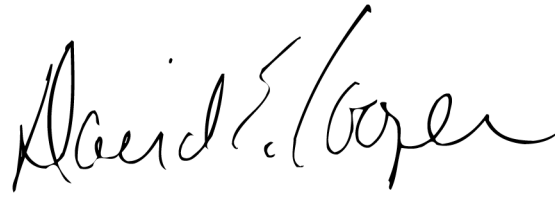
Agency Comments and Our Evaluation

DOD provided us with written comments on a draft of this report. DOD concurred with our findings and recommendations and noted some additional actions it took or is taking to address our recommendations. We incorporated these actions in this report where appropriate. DOD's comments appear in appendix III.

As requested by your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter.

At that point, copies of this report will be sent to interested congressional committees and the Secretary of Defense. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-4841, or Hilary Sullivan at (214) 777-5652, if you have any questions regarding this report. Major contributors to this report were Vijay Barnabas, David Bennett, Frederick Day, Michael Gorin, Gary Middleton, Pauline Reaves, Sylvia Schatz, and Suzanne Sterling.

A handwritten signature in black ink that reads "David E. Cooper". The signature is written in a cursive style with a large, prominent initial "D".

David E. Cooper
Director
Acquisition and Sourcing Management

Appendix I: Scope and Methodology

To determine DOD's assessment of the Test Program's effectiveness, we reviewed legislation, regulations, directives, and policies regarding this program. We also reviewed a July 2002 study conducted by LMI for DOD that looked at the overall results of the Test Program. In addition, we met with officials at DCMA headquarters, district, and field locations as well as officials at selected contractor locations to discuss their views on the advantages and disadvantages of the Test Program.

To determine the performance of contractors participating in the Test Program, we collected data on the 15 DOD contractors (i.e., parent companies or their subsidiaries) participating in the Test Program. More specifically, we obtained 5 years of small business goal and performance data, fiscal years 1999 to 2003, on the extent that the contractors were meeting their small business goals from DCMA headquarters and district officials as well as contractor officials. The contractors in the Test Program as of fiscal year 2003 are the following

- The Boeing Company;
- General Electric Aircraft Engines;
- Harris Corporation, Government Communications Systems Division;
- Lockheed Martin Aeronautics Company;
- Lockheed Martin Simulation, Training & Support (formerly Information Systems);
- Lockheed Martin Missiles & Fire Control;
- Lockheed Martin Space Systems Company;
- Northrop Grumman Air Combat Systems;
- Northrop Grumman Electronic Systems and Sensors;
- Raytheon Company;
- Textron Systems, a Textron Company;
- Bell Helicopter Textron Inc.;
- United Technologies Corp, Hamilton Sundstrand Division;
- United Technologies Corp, Pratt & Whitney Government Division; and
- United Technologies Corp, Sikorsky Aircraft Division.

To determine DCMA's oversight of contractors' small business subcontracting efforts, we met with officials at DCMA headquarters, district, and field locations as well as officials at selected contractor locations to identify and discuss DCMA's role. We also gathered information on updated policy and guides for monitoring contractors' small business subcontracting programs and new criteria for rating contractor performance. We limited our review of internal controls to

reviewing DCMA's plans, methods, and procedures used to meet its small business subcontracting program mission, goals, and objectives.

To determine the reasons and extent contractors are subcontracting with businesses performing outside the U.S.¹ we identified the contractors' rationale with officials at the five selected contractor locations. We also gathered information for the most current year that data was available, fiscal year 2002, from contractor officials at same five locations. We did not independently verify this data. In addition, we reviewed the steps DOD had taken to address past database deficiencies and discussed recent changes at DOD's Office of Program Acquisition and International Contracting on their management of the database of subcontracts performed by contractors outside the U.S.

We conducted our review between March 2003 and March 2004 in accordance with generally accepted government auditing standards.

¹ DOD collects data about businesses performing work outside the U.S. but does not request information if the business is domestic or foreign-owned.

Appendix II: Small Business Concern Categories

Program	Description
Small business concern	A small business concern is one that is independently owned and operated and is not dominant in its field of operation. 15 U.S.C. 632(a)(1). A small business concern is further defined as (1) a business entity that is organized for profit; (2) with a place of business located in the U.S.; and (3) which operates primarily within the U.S. or which makes a significant contribution to the U. S. economy through tax payments or use of American products, materials, or labor; and (4) meets the size standard for its primary business activity or industry as designated by the applicable North American Industry Classification System (NAICS) codes. 13 C.F.R. 121.101(a); 121.105(a); FAR 19.001.
Small disadvantaged business concern	A small disadvantaged business is a small business concern that is 51% or more owned by one or more socially and economically disadvantaged persons who manage and operate the concern. 15 U.S.C. 637(d)(3)(C). Black Americans, Hispanic Americans, Asian Pacific Americans, Subcontinent Asian Americans, and Native Americans are presumed by regulation to be socially disadvantaged. 13 C.F.R. 124.103(b). Other individuals can qualify if they show by a “preponderance of the evidence” that they are socially disadvantaged. 13 C.F.R. 124.103(c). A small disadvantaged must also (1) meet SBA’s established size standard for its main industry; and (2) have principals who have a net worth, excluding the value of the business and personal home, of less than \$750,000. 13 C.F.R. 124.1002(b) (c).
Woman-owned small business concern	A woman-owned business is a small business concern that is 51% owned by one or more women who manage and operate the concern. 15 U.S.C. 637(d)(3)(D); FAR 2.101.
Veteran-owned small business concern	A veteran-owned business is a small business concern that is 51% owned by one or more veterans who manage and operate the concern. 15 U.S.C. 637(d)(3)(E); FAR 2.101.
Service-disabled veteran-owned small business concern	A service-disabled veteran-owned business is a small business concern that is 51% owned by one or more service-disabled veterans who manage and operate the concern. 15 U.S.C. 632(q)(2); FAR 2.101.
HUBZone small business concern	A HUBZone is a small business concern that (1) meets SBA’s size standards for its primary industry classification; (2) is owned and controlled by one or more U.S. citizens; (2) has a principal office located in a HUBZone (a historically underutilized business zone, which is in an area located within one or more qualified census tracts, qualified non-metropolitan counties, or lands within the external boundaries of an Indian reservation); and (3) has at least 35 percent of its employees residing in a HUBZone. 15 U.S.C. 632(p)(3) (5); 13 C.F.R. 126.103; 126.203.
Historically black college or university	A historically black college or university means an institution determined by the Secretary of Education to meet the requirements of 34 C.F.R. 608.2. FAR 2.101.
Minority institution	A minority institution is an institution of higher education whose enrollment of a single minority or a combination of minorities (American Indian, Alaskan Native, Black, and Hispanic—Mexican, Puerto Rican, Cuban, and Central or South American) exceeds 50 percent of the total enrollment. FAR 2.101; 20 U.S.C. 1067k(2) (3).

Source: GAO review of laws and regulations.

Appendix III: Comments from the Department of Defense



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

March 10, 2004

Mr. David E. Cooper
Director, Acquisition and Sourcing Management
U.S. General Accounting Office
441 G Street, N.W.,
Washington, D.C. 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the GAO draft report, "CONTRACT MANAGEMENT: DOD Needs Measures for Small Business Subcontracting Program and Better Data on Foreign Subcontracts," dated February 12, 2004 (GAO Code 120206/GAO-04-381).

The report contained two recommendations as follow:

Recommendation 1: That the Secretary of Defense direct the Office of Small and Disadvantaged Business Utilization to develop metrics to assess the overall results of its test program.

Recommendation 2: That the Secretary of Defense direct DoD's Office of Program Acquisition and International Contracting to establish procedures to improve the quality of the information in its database of subcontracts performed outside the U.S.

The Department concurs with the recommendations. The detailed response is enclosed.

FRANK M. RAMOS
Director
Small and Disadvantaged Business
Utilization

Enclosure



GAO DRAFT REPORT - DATED FEBRUARY 12, 2004
GAO CODE 120206/GAO-04-381

“CONTRACT MANAGEMENT: DOD NEEDS MEASURES FOR
SMALL BUSINESS SUBCONTRACTING PROGRAM AND BETTER DATA ON
FOREIGN SUBCONTRACTS”

DEPARTMENT OF DEFENSE COMMENTS
TO THE RECOMMENDATIONS

Note: Page numbers in the draft report may differ from those in this report.

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense direct the Office of Small and Disadvantaged Business Utilization to develop metrics to assess the overall results of its test program. (p. 20/GAO Draft Report)

DOD RESPONSE: Concur.

As noted in the report, GAO has expressed concern that the share of DoD’s contracting activity awarded to small businesses as subcontracts has declined steeply in recent years – from 43 percent in 1995 to 34 percent in 2002. In attempting to establish a cause as to why this small business share of activity has decreased, the GAO has spent considerable effort reviewing, among other things, the Test Program for Negotiation of Comprehensive Small Business Subcontracting Plans (Test Program). In particular they reviewed (1) DoD’s assessment of the Test Program’s effectiveness, (2) the performance of contractor’s participating in the Test Program, and (3) DCMA’s oversight of contractors’ small business subcontracting efforts.

At the Test Program’s inception the only goals (and subsequent performance reporting) required to be incorporated into the subcontracting plan were for small and small disadvantaged businesses. A women-owned small business goal was later added. Today, Test Program participants provide subcontracting goals and report performance for small, small disadvantaged, women-owned small, HUB zone small, veteran-owned small and service-disabled veteran owned small businesses. We mention this to note that the Test Program as it was originally implemented is not the Test Program of today; contributing to the difficulty in developing and evaluating appropriate metrics.

Originally there were eight contractor’s participating in the Test Program:

- Textron Inc., Bell Helicopter Division
- McDonnell Douglas Helicopter
- Litton, Inc., Ingalls Shipbuilding
- Unisys, Paramax Systems Corporation
- Boeing Corporation
- Martin Marietta – Aerospace Division
- General Electric – Aircraft Engine Group

Lockheed Georgia company

These prime contractors were selected because they represented a variety of industry sectors and also represented contracting activity across all the Military Services. The original metrics were to look at the performance of these eight participants against a control group (i.e. other prime contractors in the same industry sectors). In 1994, the Under Secretary of Defense (Acquisition and Technology) issued a report on the Test Program. The report concluded that the Test Program, thus far, did not lead to a definitive conclusion that the Test should be continued or discontinued. However, the report did provide several recommendations that might be considered if the Test Program were to be continued. The Test Program was continued and several changes were made.

The most basic challenge in establishing meaningful metrics is that the eight original Test Program participants identified above are not the participants today. Our intent was for the performance of those original participants to form a baseline from which to evaluate performance (positive or negative) in future years. The current participants, in large part, are not those eight. Mergers and acquisitions, which greatly changed company compositions and businesses bases, made the original baseline essentially meaningless.

What metrics do we use today?

DoD, through DCMA, tracks each participating contractor's performance against itself by comparing its performance under the Program with prior years' performance. While this may provide an indication of how a particular contractor is performing, it does not address the larger issue of the overall success of the Test Program.

DoD, through DCMA, performs an annual review that assesses a contractor's performance against its subcontracting plan. Again, while this may provide an indication of individual performance, it does not address the overall Test Program.

DoD also tracks overall subcontracting goals and accomplishments. This is accomplished by the Standard Form (SF) 295 reporting. This metric addresses the broad category of subcontracting and includes all prime contractors with subcontracting plans, but does not limit itself to those contractors participating in the Test Program.

We concur with your recommendation that metrics be established to assess the overall results of the Test Program. Toward this end, we have or will be taking the following steps:

- DCMA has recently improved its oversight of the overall small business subcontracting program. They have done this by:
 - Updating policy for monitoring contractor's subcontracting programs;
 - Issuing new guidance for DCMA personnel tasked with assisting contractors to achieve their goals; and
 - Developing new criteria for rating contractor performance.

- DoD has chartered the Department of Defense Comprehensive Small Business Subcontracting Test Program Working Council. The mission of this Council is to bring together the collective knowledge and experience of the DoD, DCMA and Military Services to establish a coalition to achieve the vision of increased subcontracting to small businesses by major Defense contractors. The Council's vision is to determine and then remove barriers to increased participation by small businesses in DoD subcontracting with Test Program participants.
- DoD is thoroughly reviewing the Logistics Management Institute (LMI) DRAFT report, *Review of the Department of Defense Comprehensive Subcontracting Plan Test Program*. As noted in this GAO report, we have implemented several of the recommendations contained in the LMI draft. We are continuing to review this report and will use it as a tool, where appropriate, to develop consequential Test Program metrics.

As outlined above, participants in the Test Program are reviewed and monitored. Determining the overall accomplishments of the Test Program is important to us and we will take all appropriate steps to measure and manage the Program accordingly.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense direct DoD's Office of Program Acquisition and International Contracting to establish procedures to improve the quality of the information in its database of subcontracts performed outside the U.S. (p. 20/GAO Draft Report)

DoD RESPONSE: Concur.

As noted in the report, GAO has expressed concern that DoD has no mechanism for ensuring contractor compliance with the reporting requirement at 252.225-7004 and as a result, foreign subcontract data may be understated. To alleviate GAO's concerns about contractor compliance with the DFARS requirement, the Director of Defense Procurement and Acquisition Policy (DPAP) has taken the following steps:

- The Director, DPAP, wrote letters to the top 100 parent companies of DoD contractors reminding them of the reporting obligation and requesting that these companies ensure that all their subsidiaries also comply with the reporting requirement.
- A memorandum was sent to the Senior Acquisition Executives of the Military Department and the Defense Agencies requesting that they remind their contracting officers of this reporting requirement and requesting that their contracting officers pass this reminder on to DoD defense contractors.
- The Director, DPAP, sent a memorandum to the Defense Contract Management Agency (DCMA) requesting assistance in periodically verifying that contractors

are complying with the reporting requirement. The Office of Program Acquisition and International Contracting (PAIC) will be meeting with DCMA to develop appropriate procedures that will facilitate the verification process without unduly burdening either DCMA personnel or defense contractors.

- In line with the foregoing, DPAP engaged in an extensive outreach effort with government and industry personnel to ensure that this endeavor was fully communicated to all stakeholders.
- PAIC requested the Defense Acquisition Regulation Council open a Defense Federal Acquisition Regulation Supplement (DFARS) case to ensure that the existing provisions and clauses clearly and succinctly lay out the reporting requirements. The International Acquisition Committee has met and drafted a proposed revision to the provisions and clauses governing foreign subcontractor reporting. A proposed rule will be published in the *Federal Register* sometime in the next month or so and public comments will be solicited. We are also revising the DD 2139 itself to facilitate the manner in which contractors enter subcontracting data.

As discussed above, we are making every effort to ensure the completeness and accuracy of subcontractor data, including the management of the database. Since the 1998 GAO report, we have removed outdated fields and re-organized the database in a manner that facilitates data entry. We have also instituted a process for verifying database entries into critical fields and have developed an initial set of procedures for database entry and verification. We continually review the process to determine if there are other improvements that can be made. We believe DoD has undertaken the appropriate steps to manage its foreign subcontracting database.

Related GAO Products

Joint Strike Fighter Acquisition: Cooperative Program Needs Greater Oversight to Ensure Goals Are Met. [GAO-03-775](#). Washington D.C.: July 21, 2003.

Sourcing And Acquisition: Challenges Facing the Department of Defense. [GAO-03-574T](#) Washington D.C.: March 19, 2003.

Small Business Contracting: Concerns About the Administration's Plan to Address Contract Bundling Issues. [GAO-03-559T](#). Washington D.C.: March 18, 2003.

Small Business Administration: The Commercial Marketing Representative Role Needs to Be Strategically Planned and Assessed. [GAO-03-54](#). Washington D.C.: November 1, 2002.

Best Practices: Taking a Strategic Approach Could Improve DOD's Acquisition of Services. [GAO-02-230](#). Washington D.C.: January 18, 2002.

Small Business Subcontracting Report Validation Can Be Improved. [GAO-02-166R](#). Washington D.C.: December 13, 2001.

Small Business: More Transparency Needed in Prime Contract Goal Program. [GAO-01-551](#). Washington D.C.: August 1, 2001.

Small Business: Status of Small Disadvantaged Business Certifications. [GAO-01-273](#). Washington D.C.: January 19, 2001.

Small Business: Trends in Federal Procurement in the 1990s. [GAO-01-119](#). Washington D.C.: January 18, 2001.

Defense Trade: Observations on Issues Concerning Offsets. [GAO-01-278T](#). Washington D.C.: December 15, 2000.

Defense Trade: Weaknesses Exist in DOD Foreign Subcontract Data. [GAO/NSIAD-99-8](#). Washington D.C.: November 13, 1998.

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