

“The prime is responsible for managing the subcontractor.”

Written by Nick Sanders
Friday, 24 June 2016 00:00

This truism was posted recently in a LinkedIn group thread. It was posted as if it were some great profundity, instead of an example of the obvious. *Of course* the prime is responsible for managing its subcontractors. If you’ve read this blog for any length of time, you know we frequently pontificate on the importance of managing subcontractors. Subcontractor management may be the single most important differentiator between projects that fail and projects that succeed.

Contractors that don’t effectively manage their subcontractors not only risk suboptimal program outcomes, but they also risk being accusing of “excessive pass-through costs.” Excessive pass-through costs are what happens when a prime incurs too much subcontractor costs and can’t show a Contracting Officer that it (the prime) adds value to the work being performed by the subcontractors. (See FAR clauses 52.215-22 and 52.215-23.)

But what does “managing” mean in this context? What does it mean to “manage” subcontractors? Is it the same thing as managing one’s own workforce? If not, what’s the difference?

FAR 42.202(e)(2) states—

The prime contractor is responsible for managing its subcontracts. The CAO’s review of subcontracts is normally limited to evaluating the prime contractor’s management of the subcontracts (see Part 44).

That seems to point toward FAR Part 44 as the location where we can learn about subcontractor management. Unfortunately, while that Part of the FAR has quite a bit to say about the adequacy of contractors’ purchasing systems and granting of consent to subcontract, it has very little to say about the expectations regarding how a prime (or higher tier sub) should manage its subcontractors.

This shouldn’t really be surprising. If you read the FAR Part 42 direction quoted above, and look at the entire section to provide context, it’s quite clear that the statement “*The prime contractor is responsible for managing its subcontracts*”

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” is directed to the government Contracting Officer and not to anybody else. It’s a reminder to a Contracting Officer not to get overly involved in the prime-subcontractor relationship, to limit any review to the types of contractor management activities specified in FAR Part 44. These contractor management activities are all about placing the subcontract and not about any kind of post-award administrative activities. According to FAR 44.303, the the types of subcontractor “management” activities subject to CO review include—

- (a) The results of market research accomplished;
- (b) The degree of price competition obtained;
- (c) Pricing policies and techniques, including methods of obtaining certified cost or pricing data, and data other than certified cost or pricing data;
- (d) Methods of evaluating subcontractor responsibility, including the contractor’s use of the System for Award Management Exclusions (see 9.404) and, if the contractor has subcontracts with parties on the Exclusions list, the documentation, systems, and procedures the contractor has established to protect the Government’s interests (see 9.405-2);
- (e) Treatment accorded affiliates and other concerns having close working arrangements with the contractor;
- (f) Policies and procedures pertaining to small business concerns, including small disadvantaged, women-owned, veteran-owned, HUBZone, and service-disabled veteran-owned small business concerns;
- (g) Planning, award, and postaward management of major subcontract programs;
- (h) Compliance with Cost Accounting Standards in awarding subcontracts;

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- (i) Appropriateness of types of contracts used (see 16.103);
- (j) Management control systems, including internal audit procedures, to administer progress payments to subcontractors; and
- (k) Implementation of higher-level quality standards.

And that’s about it. While there are some potentially fruitful areas of interest (e.g., “postaward management of major subcontract programs” and “management control systems ... to administer progress payments to subcontractors”) the obvious focus of governmental review is on pre-award and award procedures—and

not

on what happens after a subcontract is awarded. (In a related note, we were unable to find any official definition of what a “major subcontract program” was or what differentiated a “major” subcontract from a “non-major” subcontract. That lack of definition kind of makes it tough for a CO to review much of anything, in our view.)

So why has the GAO told Congress that “The FAR emphasizes the prime contractor’s responsibility in managing its subcontractors.” (See GAO-11-61R, Oct. 28, 2010) As we’ve seen, that’s a misleading statement. The FAR absolutely *does not* emphasize anything even close to what GAO was implying. More to the point, why does DCAA make such a big deal about a prime (or higher tier) contractor’s duty to manage its subcontractors?

Here’s [a link](#) to an official DCAA presentation to subcontractors that discusses the responsibilities of the prime (or higher tier) contractor. It states: *The prime contractor is primarily responsible for subcontract award, technical and financial performance, monitoring, and payment to the subcontractor for the work accomplished under subcontract terms.*

That’s quite true and unobjectionable; but subsequently the presentation veers into new territory, stating that “common prime or higher tier subcontract deficiencies” include: “

Failure to verify the subcontractor has an adequate accounting system

” and “

Failure to obtain an adequate incurred cost submission from subcontractor.

” Those are interesting notions but, unfortunately for DCAA, they cannot be found anywhere in

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any contract clause.

More tellingly, our colleagues over at Redstone consulting [believe](#) that DCAA and DCMA are “rewriting” FAR 42.202 to require primes and higher tier subs to “audit” their subcontractors. Michael Steen wrote—

If and when DCAA audits a prime contractor indirect cost rate proposal, DCAA is now training its auditors to focus on any and all subcontract costs on any type of flexibly priced prime contract (cost-type, fixed-price incentive, T&M). If the prime contractor cannot demonstrate that it ‘audited’ the costs claimed by a [subcontractor \(cost-type\) subcontract](#), DCAA is now questioning 100% of those subcontract costs (DCAA is not auditing the subcontract costs on behalf of the prime contractor because that is not DCAA’s responsibility). Virtually the same end-game for T&M contracts with T&M subcontracts; if the prime did not audit the subcontractor records, 100% disallowance. And if you think that a fixed price (FFP) subcontract mitigates prime contractor risk, not exactly if the FFP subcontract is under a cost-type prime contract. DCAA will likely second guess the sufficiency of the prime contractor cost or price analysis leading to a DCAA assertion that the FFP subcontract is not sufficiently documented as a fair and reasonable price; hence, the entire subcontract cost (price) is unreasonable under FAR 31.201-3.

We think this whole thing has gotten out of hand. A minor reminder to Contracting Officers that primes are responsible for managing their subcontractors (*duh*) has evolved into another way to question the adequacy of a contractor’s purchasing system, or to question incurred costs. Clearly, that’s not what the FAR drafters intended, but that seems to be where we are.