From time to time we discuss small business reporting issues. Also known as socioeconomic reporting, the requirements are implemented by FAR Part 19 and associated contract clauses, as well as by agency supplemental clauses. In many cases the contract language prescribes rules for how to calculate subcontract award percentages for the various socioeconomic strata the Federal government wants to see reported.

In general, the rules of what to report and how to calculate the metrics for reporting are complex and nuanced. The whole situation is counter-intuitive and the more cynical amongst us may be tempted to call it just a game. Nonetheless, it's real and it's important. Prime contractors willing to commit to tough socioeconomic subcontract award goals often receive a competitive advantage.

We recall one article we **posted** here three years ago, about a shipbuilder who lost more than $1 million in award/incentive fees because it made math errors in its socioeconomic reporting calculations and, when corrected, its true small business subcontract award percentages were below the contractually required levels. *Oops!*

In that same article, we wrote—

… small business plans need to be more than paper. … In order to successfully implement your plan, it needs to be 'owned' by somebody in your organization with authority to make it happen, and there needs to be policies and procedures that describe how it will work. Those policies and procedures must be cross-functional, in that everybody who makes a decision regarding which entities receive work must be aware of the overall organizational commitments.

Too often we have seen 'paper' plans with no ownership, with no accountability or responsibility or authority, and with little or no policies and procedures that describe their workings. When we encounter such situations, we can say, with a high degree of confidence, that those plans will never be successful.

We were reminded of that old article and our commentary when we read a recent Department of Energy Office of Inspector General **report** about errors in small business reporting by two

Hanford site contractors, Mission Support Alliance, LLC (MSA) and CH2M HILL Plateau Remediation Company (CHPRC). In case you care, MSA is made up of Leidos and Centerra Group, plus ancillary team members, whereas CHPRC is a subsidiary of Jacobs (formerly Jacobs Engineering Group), who acquired CH2M at the end of 2017.

The DOE OIG looked at both MSA's and CHPRC's socioeconomic reporting, and did not like what it saw. We gave you a link in the paragraph above, but let's summarize the findings.

Looking first at MSA, it seems that its prime contract defined both "self-performed" and "subcontracted" work. According to the IG, the contract limited the amount of work that MSA could self-perform to 60% of total contract value, and required MSA to subcontract at least 25% of total contract value. The IG found that, although MSA reported meeting those requirements, its calculations had errors; and when those errors were corrected, it did not it fact meet those requirements—"resulting in a potential breach of contract."

As with many IG reports we see, there is a mix of facts and judgment that underlie the reported findings. Factually, MSA inaccurately excluded $574 million in large business subcontractor team members' costs from its self-performed work scope calculations. Judgmentally, the IG did not give MSA credit for subcontracting $333 million to small businesses through a subsidiary because "we were not able to verify the amount of work scope subcontracted by the subsidiary." While auditors must of course be professionally skeptical of assertions, we are not aware of any requirement that MSA obtain, retain, or provide verification of socioeconomic statistics reported by an affiliated entity.

Another area of judgment concerned $5 million in subcontract awards to a small business that became a large business during contract performance. Although the DOD OIG report provided no details – and it's certainly possible that either the DEARS or the contract specified how this situation should be handled – normally the situation is governed by 13 CFR § 121.404. That section does not require a change in the socioeconomic business size unless the subcontractor recertifies, as it must in certain situations. Thus, we are left wondering whether the subcontractor was required to recertify and MSA failed to obtain the new certification, or if MSA obtained the new certification and failed to use it properly, or if MSA properly reported the stratum of the subcontractor because no recertification was required.

Finally, we need to talk about MSA's small business subcontractors used to manage incumbent employees. The IG noted that—

MSA and CHPRC inherited responsibility for certain employees of the previous contractor and had to offer them first right of refusal to employment. These employees, referred to as incumbent employees, were eligible to continue participation in the Hanford Site Pension Plan and accrue Benefit Service, as defined in the Hanford Site Pension Plan. To provide employment for certain incumbent employees, MSA and CHPRC arranged employment through its subcontractors, many of which were small business entities.

The DOE IG refused to agree that MSA should receive $233 million of small businesses award credit when reporting awards to incumbent employee management subcontractors. This is another area of judgment that affected the audit report. The basis for the IG's conclusion was that there was an employer-employee relationship between MSA and the employees, notwithstanding the fact that there was a subcontractor in the middle. The IG report stated that—

… MSA:

- Provided the employees;
- Assigned and supervised the work to be performed;
- Directed when, where, and how work was performed;
- Controlled training and development;
- Provided workers with necessary tools, equipment, and work facilities;

- Provided administrative support functions (i.e., payroll, human resources, etc.); and

- Controlled employee termination authority.

In contrast, the small business entities did not provide employer functions for the incumbent employees, as expected.

In other words, those small businesses didn't seem to add any real value to the management of the incumbent employees, in the judgment of the DOD OIG auditors.

Importantly, MSA's (and CHPRC's) alleged use of "shell" subcontracts (our term, not the auditors') also led to allegations of unallocable contract costs. The audit report stated—

… the subcontractors with incumbent employees charged MSA for employer administrative functions, despite no apparent corresponding benefit. It appeared that MSA already provided most employer administrative functions but still charged the Department of Energy for the associated costs. When we asked MSA officials for justification to support the incumbent employee subcontractors charging indirect costs for employer administrative functions, they could not provide specific details of the subcontractors providing employer functions. Due to the scope of our audit, we did not determine an exact dollar amount of potentially unallowable costs. It is MSA's responsibility to review these subcontractor indirect costs for allocability and the Contracting Officer's responsibility to determine the extent to which they are unallowable. These indirect costs could be up to an estimated $31.6 million.

We've spent a lot of time on MSA's issues. What about CHPRC? As with MSA, the DOE IG asserted that CHPRC excluded a large business subcontractor team member from its self-performed work scope. In addition, CHPRC has the same issues as MSA does with respect to subcontractors that managed its incumbent employees. However, the DOE OIG concluded

that “when we adjusted CHPRC’s reported figures, it appeared that CHPRC may still be able to meet its self-performance and small business subcontracting contractual requirements, as of September 2018.” Thus, CHPRC’s issues do not seem as serious as the ones that MSA is facing.

Let’s conclude this by looking at causality. The DOE OIG audit report stated—

The issues we identified in this report occurred, in part, because of weaknesses in MSA’s and CHPRC’s prime contract oversight. Specifically:

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MSA did not have formal procedures for reviewing and validating its own small business subcontracting reports.

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MSA and CHPRC did not adequately evaluate the appropriateness of incumbent employee subcontract arrangements.

MSA lacked formal procedures for reviewing and validating its small business subcontracting reports, which included self-performance figures, prior to submission to the Richland Operations Office. According to MSA, not including team member costs as self-performed work scope was an inadvertent mistake because the MSA personnel involved did not appreciate that the self-performed work limitation in its contract applied to subcontract costs awarded to large business subcontractor team members. If MSA had detailed procedures for reviewing and validating small business subcontracting reports, MSA likely would have identified these discrepancies on its own.

Now go back and read the quote from one of our previous articles on small business reporting. The one where we asserted that “there needs to be policies and procedures that describe how it will work.” Yeah. *That.*

As noted, there is a mix of both factual and judgmental findings in the DOE Office of Inspector General audit report. One might reasonably take issue with some of the more judgmental aspects of the report; however, it seems inescapable that a prime contractor must have robust policies and procedures, to include appropriate internal controls, on its socioeconomic reporting. This is especially true where there is contract language that makes certain metrics that are otherwise just goals into mandatory requirements.