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Mitigating Subcontractor Risk through Quality Assurance

The vital importance of a prime contractor's quality assurance plan with its subcontractors cannot be overstated; if overlooked, it may be a matter of "life or death" for the prime contract. BY WANDA N. WALLACE, CPCM, CFCM

Risk is unquestionably inherent in U.S. federal government contracting. Consequently, risk assessment and mitigation are fundamental to sound contract management practices throughout the full contract life cycle.

Acquisition requirements—such as those imposed by the National Defense Authorization Act for Fiscal Year 2017,[1] which established a government preference for fixed-price contracts[2]—shift more risk from the government to its contractors. Therefore, prudent prime contractors must understand how to research, identify, and assess risk—including risk associated with subcontractors and vendors.

As far back as 1986, the *Packard Commission Report* stated, "the second greatest risk factor [in the government acquisition process] is the failure of the prime contractor to adequately manage its subcontractors with whom the federal government has no privity."[3] Hence, in an environment in which an estimated 60–80% of the $560 billion government acquisition dollars are expended with subcontractors,[4] integrating first and sub-tier subcontractors into the prime contractors' risk management planning is undeniably crucial.

While mitigating subcontractor risk includes a multitude of methods and steps (from early vetting and selection through subcontract closeout), *quality assurance* is a key component to help ensure that delivered goods and services meet the standards imposed by the contract.

Quality Assurance as a Component of Supplier Risk Management

Due to the high percentage of subcontracted goods and services purchased by the federal government, subcontractor risk is among the principal challenges faced by government contractors. Prime contractors must plan, evaluate, and assess risk to avoid it, address it as it arises, and establish rigorous and reliable strategies to manage it before and when it is encountered.

While quality assurance can be a powerful tool in developing an overarching supplier risk management strategy, managers may be inexperienced in its use as a subcontract administration function. Worse still, previous problem-free subcontracts may lead to the conclusion that such planning is unwarranted. Organizations may have incorporated quality assurance plans within their internal processes but failed to flow them down effectively to their respective subcontractors, resulting in delays, higher costs, reduced profits, and dissatisfied customers. Further, while appropriately flowed-down plans may exist, they may not include adequate plans to ensure full compliance.

The Importance of Subcontractor Quality Assurance to the Government

From the government's standpoint, subcontractor quality assurance matters. Government customers demand and deserve quality deliverables – from contractors that deliver the prescribed contract requirements and offer products and services at a competitive price. Of the over $500 billion the government spends in contracting per year, the majority of products and services awarded in prime contracts are subcontracted out to one or many large and small business firms.[5] That fact should not in any way lessen the government's expectations regarding quality. A quality assurance plan – including that flowed down to subcontractors – provides one means by which the government can be assured that acquired goods and services meet contract specifications and offer the contemplated value.

The Importance of Subcontractor Quality Assurance to the Prime Contractor

Quality assurance of subcontractors is likewise of vital importance for prime contractors. Plainly stated, if overlooked, it may be a matter of "life or death" for the prime contract. Anything done that was not in the best interest of the government, including failure to meet quality requirements or to deliver supplies or perform the services within the time specified, may be grounds for terminating all or part of a contract:

> A contractor is responsible for contract performance and thus is subject to default termination if its subcontractor fails to perform or deliver or fails to proceed which endangers timely performance.[6]

This accountability remains even in instances when the government designates a subcontractor as a sole acceptable source.[7] Thus, the success or failure of a prime contract may well be determined by effective subcontract management – i.e., how well the prime manages the outcomes of its lower-tier subcontractors and suppliers.

Quality Assurance and Quality Assurance Planning

Quality assurance is defined as "the planned and systematic activities implemented in a quality system so that quality requirements for a product or service will be fulfilled,"[8] and in the context of subcontract management, it has been further characterized as "the varying functions, including inspection, performed by the contractor to determine whether a subcontractor has fulfilled the contract obligations pertaining to quality and quantity."[9] Unlike quality control, which is a reactive, product-oriented system designed to identify issues and defects after development, quality assurance is proactive and process-oriented, with the goal of ensuring methods are in place to prevent defects and failures.

A *quality assurance plan* is the composite documentation of the activities and functions of the quality system, defining and delineating the associated objectives, roles, procedures, responsibilities, tasks, and schedules. The procedures for assuring quality are clearly detailed in quality assurance plans. Quality assurance plans establish measurable parameters, or metrics, for determining satisfactory subcontractor performance on an interim and recurring basis. Based on the quality assurance plan, prime contractors can develop activities, or mechanisms, to perform checks and inspections of the subcontractor's work during and after the performance of its tasks.

For the government, a "quality assurance surveillance plan" (QASP) is a tool by which government customers may set forth the methods and frequency of meetings, required reports, and inspections to monitor both prime

FIGURE 1.

DEFINE REQUIREMENTS
- Clearly define the requirement and quality objectives based on the prime contract specifications.

DEFINE ROLES AND RESPONSIBILITIES
- Define the roles (the position each team member plays) and responsibilities (specific tasks or duties as a function of defined roles).

ESTABLISH SCHEDULES AND DELIVERABLES
- Establish applicable schedules, timelines, and allocation of work effort.
- Determine the deliverables—product, process, plan,etc.—required to produce a successful outcome.

MONITOR
- Determine methods of monitoring performance—e.g., inspections, performance assessments, and progress reports.

DEVELOP CORRECTIVE ACTION PLAN
- Establish a policy for addressing and correcting nonconformance problems or performance deficiencies.

DOCUMENT AND COMMUNICATE
- Prepare, document, and distribute surveillance plan.

ADJUST AND UPDATE
- Analyze gaps and areas of improvement.
- Continually review, adjust, and update as necessary.

and subcontractor performance:

> The QASP is used for managing contractor performance assessment by ensuring that systematic quality assurance methods validate that contractor quality control efforts are timely, effective, and are delivering the results specified in the contract or task order. The QASP directly corresponds to the performance objectives and standards (i.e., quality, quantity, timeliness) specified in the performance work statement (PWS). It provides specific details on how the government will survey, observe, test, sample, evaluate, and document contractor performance results to determine if the contractor has met the required standards for each objective in the PWS.[10]

The QASP communicates what will be evaluated to ensure the contractor meets the government's expectations, as well as the related methods and timeframes. It further spells out the consequences of meeting or not meeting those expectations, such as the assessing of liquidated damages or, ultimately, contract termination.

Use of the QASP in the *prime-sub* relationship provides another instrument for the prime contractor to determine whether the subcontractor truly understands the requirement and further provides a means to verify that the subcontractor is satisfactorily following the level of performance undertaken.[11] It is important to note that each individual subcontract will have its own distinctive QASP. Although plans for each of the prime's subcontractors may be similar in structure, evaluation methods, etc., this is no "one size fits all" situation. For instance, evaluation of a subcontractor performing vehicle maintenance services on a transportation contract will only measure those relevant requirements.

Timing is Critical

Development of an effective quality assurance plan necessitates a careful consideration of timing. Prime contractors may not complete negotiations with their subcontractors until the prime contract is in place and, consequently, the tendency may be to wait and develop the plan at this juncture. However, a solid risk mitigation strategy urges the development of the plan during the pre-award process, as a part of the subcontractor procurement process. Prime contractors should, in their bid requests, state applicable requirements for performance, quality, acceptability, and documentation. Moreover, the requirement of a quality assurance plan may be included as a part of the solicitation and evaluation process of potential subcontractors. During post-award activities, plans can be further expanded, based on final contract negotiations and requirements.

In one real-world example, one prime contractor's desire to shift its quality stance from reactive to proactive motivated the contractor (a provider of building maintenance services) to implement similar processes in its subcontractor quality assurance plans. As a provider of services with up to 50% of contracts performed by subcontractors, the prime contractor identified a need to improve its reputation and consistency and bolster past performance ratings, thereby increasing its chances of winning new contracts. Starting with its pre-award activities throughout contract performance, the overarching goal of quality assurance

was consistently underscored in its prime/sub relationships.

Quality Assurance Planning Steps

How does a prime contractor implement an effective quality assurance plan for its subcontractors? While myriad methods and measures have been propagated, **FIGURE 1** on page 41 lists fundamental steps recommended for inclusion in a successful plan.

To illustrate how a prime contractor can execute these steps with its subcontractors, consider the previously mentioned real-world example. The prime contractor started with adjusting the method in which solicitations were issued to potential subcontractors. Detailed processes were put in place for review of statements of work prior to release to prospective bidders. In addition to defining the work, statements included a clear description of the quality standards associated with the work. Upon selection of subcontractors to perform services, a detailed, written quality plan was developed and incorporated into the subcontract. Schedules and deliverables, along with responsible parties, were included in the plan. Throughout the contract cycle, performance is monitored and measured against the plan, with regular communication and meetings to discuss successes, concerns, and performance breakdowns. As required, plans for corrective action were implemented and monitored. Establishing a solid quality assurance plan enabled this prime contractor to more fully hold its subcontractors accountable for performance standards and increased the level of service provided to its government customers.

As each of the steps outlined in **FIGURE 1** is defined and executed, changes and adjustments will likely be necessary as the contract progresses. Although the objectives remain the same, a regular review by both the prime and subcontractor is an important part of quality assurance planning to ensure consistent understanding and adherence among all the parties.

Conclusion

When the government purchases products or services, the prime contractor is held responsible for the quality standards of deliverables as specified in the contract. Any subcontractors utilized must likewise adhere to standards mandated by the prime contractor. Proper management of the subcontract and the prime/sub relationship is essential.

As a supply chain expands, and the number of subcontractors utilized increases, it inherently limits the control of the prime, which subsequently creates greater risk of noncompliance. Considering that approximately $300–$400 billion of government contracting dollars are spent with subcontractors, serious attention must be given to the quality of the goods and services provided by this portion of the contracting group.

Quality assurance is an essential characteristic of risk management and prime contractors cannot afford not to flow quality assurance plans down to the subcontractor. While the type and level of planning will vary depending on the subcontracting scope, well-documented, robust quality assurance planning is highly likely to ensure compliance, meet (and exceed) requirements, and effectively manage interactions with the respective government agencies. **CM**

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ENDNOTES

1 *Pub. L.* 114-328.

2 *See* Ian Patterson, "2017 NDAA Establishes Preference for DOD Fixed-Price Contracts," Smallgovcon (December 21, 2016), *available at* http://smallgovcon.com/statutes-and-regulations/2017-ndaa-establishes-preference-for-dod-fixed-price-contracts/. (According to the GAO Contracting Data Analysis Assessment of Government-wide Trends (available at https://www.gao.gov/assets/690/683273.pdf), federal agencies used fixed price 63% of contracts for an average of 63% of obligations, mitigating risk to the government.)

3 Bonnie Ross, The Subcontract Management Institute, "Reducing Performance Risks from Lower-Tier Subs," presented at the 2018 NCMA Government Contract Management Symposium (December 3, 2018): 7.

4 As per the Government Accountability Office (GAO), *see* https://www.gao.gov/assets/690/683273.pdf.

5 *See* Michael Fischetti, "Most Government Spending Goes to Subcontractors, Outside of Agency Supervision" (January 28, 2015), *available at* http://www.aptac-us.org/news/government-spending-goes-subcontractors-outside-agency-supervision/; *see also* Daniel Snyder, "Federal Government Spending Trends: Five Years in Five Charts" (January 9, 2019), *available at* https://news.bloomberglaw.com/federal-contracting/federal-contract-spending-trends-five-years-in-five-charts (stating that the government spent over $560 billion in contracts in fiscal year 2018).

6 John Cibinic Jr., James F. Nagle, and Ralph C. Nash Jr., *Administration of Government Contracts*, fifth ed. (Riverwoods, IL: Wolters Kluwer, 2016): 842.

7 *Ibid.*

8 American Society for Quality (ASQ), "Quality Control & Quality Assurance," *available at* https://asq.org/quality-resources/quality-assurance-vs-control.

9 *Ibid.*

10 Defense Acquisition University, definition of "Quality Assurance Surveillance Plan (QASP)," Acquipedia, *available at* https://www.dau.mil/acquipedia/Pages/acquipedia.aspx#!all|Q. (Although the definition uniquely suggests a government-prime perspective, nothing suggests that a prime contractor cannot or should not develop a QASP for its subcontractors or require its submission during subcontract negotiations.)

11 "Five Strategies for Reducing Subcontractor Risk and Hiring Qualified Subcontractors," *Construction Executive* (August 29, 2017), *available at* http://constructionexec.com/article/five-strategies-for-reducing-subcontractor-risk-and-hiring-qualified-subcontractors.