

# U.S. Department of Labor

Office of Inspector General—Office of Audit

## REPORT TO THE EMPLOYMENT AND TRAINING ADMINISTRATION



## JOB CORPS CONTRACTOR AND DOL PROCUREMENT PRACTICES NEED IMPROVEMENT

Date Issued: September 24, 2014  
Report Number: 26-14-002-03-370

## BRIEFLY...

Highlights of report number 26-14-002-03-370, issued to the Assistant Secretary for Employment and Training.

### WHY READ THE REPORT

Federal regulation established the ostensible subcontractor rule to prevent large businesses from using small businesses to evade the Small Business Administration's (SBA) small business size requirements for federal procurements. This report highlights 4 Job Corps center operator contracts where small business prime contractors, Alutiiq Education and Training (AET) and Alutiiq Professional Services (APS), and their large business subcontractor, ResCare, Inc. (ResCare), appeared to have violated the ostensible subcontractor rule. As a result, up to \$126.5 million in government funds set aside for small businesses may not have been used as intended. Additionally, this report highlights instances where ResCare, as a prime contractor, did not comply with the Federal Acquisition Regulation (FAR) and its own procurement policies when it awarded subcontracts and made purchases at the centers it operated.

### WHY OIG CONDUCTED THE AUDIT

We conducted this audit due to the procurement risks associated with a prior SBA determination of an ostensible subcontracting violation involving ResCare, as well as to follow up on a Fiscal Year 2012 OIG audit that substantiated an anonymous complaint regarding ResCare's procurement practices. We performed work to answer the following question:

Did the practices of ResCare and the prime contractors it performed work for comply with federal procurement regulations?

### READ THE FULL REPORT

To view the report, including the scope, methodology, and full agency response, go to:  
<http://www.oig.dol.gov/public/reports/oa/2014/26-14-002-03-370.pdf>.

September 24, 2014

## JOB CORPS CONTRACTOR AND DOL PROCUREMENT PRACTICES NEED IMPROVEMENT

### WHAT OIG FOUND

ResCare and its prime contractors did not always comply with federal procurement regulations.

ResCare appeared to be an ostensible subcontractor to 2 small business contractors for their small business set-aside prime contracts to operate the Bamberg, Cleveland, Westover, and Northlands Job Corps Centers. We found significant potential existed that: ResCare performed the primary and vital contract requirements at these 4 centers; the small businesses were unusually reliant on ResCare to operate the centers; and that together, ResCare and the small businesses circumvented the rule established to ensure small businesses could compete fairly for the small business set-aside contracts. We also found that the U.S. Department of Labor (DOL) did not have the processes and controls to carefully consider ResCare's relationship with the small businesses when awarding the prime contracts, as required by federal regulation.

Additionally, we determined that ResCare, as a prime contractor, did not always comply with the FAR and its own procurement policies when awarding subcontracts and purchase orders at the centers it operated. Significant deficiencies included soliciting and awarding subcontracts without competitive bidding and open competition, splitting purchases to fall under a monetary threshold that required competition or sole-source justification, and making purchases without obtaining required prior approvals.

### WHAT OIG RECOMMENDED

In summary, we recommended the Assistant Secretary for Employment and Training refer the small business set-aside contracts we identified to SBA for review and guidance on corrective action, if warranted; develop procedures and provide training to ensure each small business set-aside contract is free of potential violations of affiliation rules, conduct its planned procurement system review for ResCare in Fiscal Year 2015; and develop procedures to ensure ResCare complies with its own center operator contract provisions and procurement policies and procedures.

AET and APS disagreed with our conclusion that they appeared to have violated the ostensible subcontractor rule. However, ResCare and DOL agreed with our audit results and recommendations, and stated that they had either taken or planned to take corrective actions to address the issues identified in this report.

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**U.S. Department of Labor**

Office of Inspector General  
Washington, D.C. 20210



September 24, 2014

## **Inspector General's Report**

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In Fiscal Year (FY) 2014, the Employment and Training Administration's (ETA) Office of Job Corps (Job Corps) program provided education, training, and support services to approximately 60,000 students at 125 Job Corps Centers (JCC) throughout the United States and Puerto Rico. As of June 2014, the Department of Labor (DOL) had contracted with ResCare, Inc. (ResCare) to operate 12 centers under 9 separate prime contracts.<sup>1</sup> As an operator, ResCare was directly responsible for center administration and management, including the awarding of subcontracts for center goods and services. As of June 2014, ResCare also had received subcontracts to provide services at 5 centers operated by 3 small business prime contractors. ETA administered all Job Corps prime contracts through its Office of Contracts Management (OCM). Prior to October 2010, this responsibility belonged to the Office of the Assistant Secretary of Administration and Management (OASAM).

We conducted this audit due to the procurement risks associated with a prior Small Business Administration (SBA) determination on the contractor-subcontractor relationship between a small business selected by OASAM for a small business set-aside contract to operate a JCC with ResCare as its subcontractor. We also conducted our audit to follow up on a FY 2012 performance audit the Office of Inspector General (OIG) conducted in response to an anonymous complaint referred to us by ETA's OCM.

In 2010 and 2011, SBA found a small business was ineligible for a set-aside contract because it would have allowed ResCare, a large business, to perform primary and vital contract requirements intended for the small business. SBA also found this small business was unusually reliant on ResCare's qualifications to win the JCC contract.<sup>2</sup> Furthermore, weak procurement controls identified during our 2012 hotline complaint

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<sup>1</sup> Private contractors and other federal agencies operate centers for DOL through competitive contracting processes and interagency agreements, respectively.

<sup>2</sup> SBA Size Determination No. 6-2011-009 (2010) and subsequent decision SBA No. SIZ-5192 (2011).

audit regarding a specific subcontract awarded by ResCare indicated subcontracting deficiencies may be systemic.<sup>3</sup> We performed work to answer the following audit objective:

Did the practices of ResCare and the prime contractors it performed work for comply with federal procurement regulations?

In order to answer the objective, we performed audit work in the following areas:

- A) Contractor-subcontractor relationships between JCC operators selected by DOL for small business set-aside contracts and ResCare as a subcontractor.
- B) Subcontracts ResCare awarded as the prime contractor operating JCCs.

Our scope for auditing contractor-subcontractor relationships between small businesses and ResCare included the information relevant to the prime contracts and subcontracts in effect during FYs 2011 through 2012 (October 1, 2010, through September 30, 2012). The audit team reviewed information obtained from ETA; ResCare; Alutiiq Education and Training, LLC (AET) and Alutiiq Professional Services, LLC (APS)—collectively referred to as Alutiiq Youth Services, LLC (AYS), the umbrella company for the prime operators of 6 of the 7 JCC contracts where ResCare was a subcontractor.<sup>4</sup> We also reviewed the basis for SBA's determination that a small business was ineligible for the small business set-aside contract to operate the Turner JCC because ResCare was its ostensible subcontractor.<sup>5</sup> While SBA has stated prior size determination cases are not: (1) binding on either a SBA Government Contracting Area Office or its Office of Hearings and Appeals; (2) precedent-setting for other cases; or (3) controlling in any other size determination case, SBA has cited prior size determinations in a number of cases for illustrative purposes.<sup>6</sup> Accordingly, we used our comparison to SBA's Turner decision for illustrative purposes and neither made a size determination regarding AET or APS for the contracts-subcontracts we tested, nor concluded that ResCare definitively was an ostensible subcontractor for any of the contracts-subcontracts we tested, as these areas are the sole purview of SBA.<sup>7</sup>

Our scope for auditing subcontracts ResCare awarded as the prime contractor covered FY 2011 through FY 2012. We judgmentally selected and reviewed subcontract and

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<sup>3</sup> OIG Report No. 26-12-004-03-370, Conflict of Interest Complaint on a Job Corps Center Operator Subcontract Award had Merit (Washington, DC: September 28, 2012).

<sup>4</sup> Our scope included 2 centers no longer operated by AYS, which included 2 subcontracts to ResCare, as of June 2014.

<sup>5</sup> SBA Size Determination No. 6-2011-009 (2010) and subsequent decision SBA No. SIZ-5192 (2011). The ostensible subcontractor rule, 13 CFR 121.103 (h)(4), stated that when a subcontractor performs the primary and vital requirements of a contract, ... , or the prime contractor unusually relies upon a subcontractor, SBA considers the 2 businesses affiliated for the purposes of that procurement. In these cases, the small businesses are ineligible for small business set-aside contracts.

<sup>6</sup> For example, see SBA No. SIZ-5066 (2009), SBA No. SIZ-5269 (2011), SBA No. SIZ-5371 (2012), and SBA No. SIZ-5504 (2013).

<sup>7</sup> The FAR Part 19, Subpart 19.301-1.

purchase order (PO) transactions made by 4 of the 14 JCCs operated by ResCare during the period: Guthrie, Old Dominion, Pinellas, and South Bronx.<sup>8</sup>

We conducted audit work at ETA headquarters in Washington, DC, and additional fieldwork at our Chicago, IL; San Francisco, CA; and Washington, DC offices. See Appendix A for a detailed description of our audit scope and methodology.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

## RESULTS

### **Objective — Did the practices of ResCare and the prime contractors it performed work for comply with federal procurement regulations?**

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#### *Job Corps Contractor and DOL Procurement Practices Need Improvement*

ResCare and its prime contractors did not always comply with federal procurement regulations in ResCare's performance of work as a subcontractor, as well as ResCare's procurement activity as a prime contractor for JCC contracts.

ResCare and 2 small business prime contractors appeared to have circumvented the ostensible subcontractor rule (13 CFR 121.103 (h)(4)), which was established to prevent large businesses from using small businesses to evade SBA's small business size requirements. Furthermore, DOL did not carefully consider the relationships between ResCare and these 2 small businesses as required by the Federal Acquisition Regulation (FAR) when awarding the prime contracts, which likely contributed to the potential ostensible subcontracting violations we identified.<sup>9</sup> Ostensible subcontractor rule violations are the sole purview of SBA, but we identified sufficient evidence in 4 subcontracts ResCare received that we believe warrant an ETA referral to SBA for review and guidance on corrective action, if warranted.<sup>10</sup> If SBA determines any of these 4 contracts-subcontracts violated the ostensible subcontractor rule, up to \$126.5 million in government funds set aside for small businesses were not used as intended.

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<sup>8</sup> Our scope included 2 centers no longer operated by ResCare as of June 2014.

<sup>9</sup> The FAR Part 19, Subpart 19.301-1 (b), the FAR Part 19, Subpart 19.302 (b), and the FAR Part 44, Subpart 44.202-2(b). While the FAR Part 44, Subpart 44.202-2(b) referred to post award subcontracts, DOL, in practice, approved subcontracts specified in subcontracting plans submitted by potential small business prime contractors as part of the prime contract award for the operation of JCCs.

<sup>10</sup> Federal regulation allows ETA to make post-award protests to SBA's Government Contracting Area Office. COs have no time limitation to file a protest and as such, may file a protest before or after an award. Moreover, CO protests are always considered timely whether filed before or after award. See the FAR Part 19, Subpart 19.302 (b) and the FAR Part 19, Subpart 19.302 (c)(1), and the FAR Part 19, Subpart 19.302 (d)(2).

We also determined ResCare, as a prime contractor, did not comply with the FAR and its own procurement policies when awarding subcontracts and POs at the centers it operated. ResCare's procurement records failed to demonstrate that ResCare awarded subcontracts through open competition and made purchases with required center approvals.

**A) ResCare Appeared to be an Ostensible Subcontractor to 2 Small Businesses.**

ResCare appeared to be an ostensible subcontractor to AET and APS for their 4 small business set-aside prime contracts to operate the Bamberg, Cleveland, Westover, and Northlands JCCs. We found significant potential existed that: ResCare performed the primary and vital contract requirements at these 4 JCCs; AET and APS were unusually reliant on ResCare to operate the centers; and that together, ResCare, AET, and APS circumvented the rule established to ensure small businesses could compete fairly for the small business set-aside contracts. We also found DOL lacked the processes and controls to carefully consider ResCare's relationship with AET and APS when awarding the prime contracts, as required by the FAR.

We did not make a size determination regarding AET and APS or conclude that ResCare definitively was an ostensible subcontractor for the 4 contracts we identified, as these areas are the sole purview of SBA. As such, we believe ETA should refer these procurements to SBA for review, as well as seek SBA guidance on corrective action, if warranted.<sup>11</sup> If SBA determines any of these 4 contracts-subcontracts violated the ostensible subcontractor rule, up to \$126.5 million in government funds set aside for small businesses were not used as intended.

Small Business Set-Asides and FAR Requirement to Consider Relationships and Affiliations

At the beginning of each FY, SBA negotiates with agencies to establish individual small business contracting and subcontracting goals that, in the aggregate, constitute government-wide goals. SBA is responsible for ensuring it establishes government-wide goals for participation of small business concerns at the statutory levels, and that agencies report their achievements relative to their respective agency goals.<sup>12</sup> DOL posts procurement opportunities more than \$25,000, including those set aside for small businesses, on FedBizOpps.gov.<sup>13</sup>

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<sup>11</sup> Federal regulation allows ETA to make post-award protests to SBA's Government Contracting Area Office. COs have no time limitation to file a protest and as such, may file a protest before or after an award. Moreover, CO protests are always considered timely whether filed before or after award. See the FAR Part 19, Subpart 19.302 (b) and the FAR Part 19, Subpart 19.302 (c)(1) ), and the FAR Part 19, Subpart 19.302 (d)(2).

<sup>12</sup> Each agency that fails to achieve any proposed prime or subcontract goal is required to submit a justification to SBA on why they failed to achieve a proposed or negotiated goal with a proposed plan of corrective action.

<sup>13</sup> Fedbizopps.gov is the single government point-of-entry for Federal government procurement opportunities over \$25,000.

In its decision on whether or not to set aside a solicitation for small businesses, DOL is not required to make determinations of responsibility with regard to prospective offerors; rather DOL is required to make an informed business judgment that there are small businesses expected to submit offers that are capable of performing the contract.<sup>14</sup> Once DOL decides to set aside a contract for small businesses, DOL clearly indicates in the solicitation that the procurement opportunity is set aside for small businesses, and includes the small business size standard, as well as governing FAR clauses. DOL does not require small businesses to submit a subcontracting plan with their bids, but includes language in solicitations that requests small businesses submitting bids provide a listing of subcontracts that were anticipated. As part of this list, small businesses should include, at a minimum, a list of the functions, tasks, and positions proposed and their anticipated dollar values. DOL evaluates the bids received based on the evaluation factors specified in the solicitation, performs a cost-realism analysis, and either makes an award or does not make an award accordingly.

Once DOL sets aside a solicitation for small businesses, DOL is required to consider ostensible subcontracting as part of the contract award process. Specifically, the FAR requires DOL to accept an offeror's small business size representation unless another offeror submits a size protest, or the Contracting Officer (CO) has reason to question the small business size status of an offeror.<sup>15</sup> In practice, however, DOL approved subcontracts specified in subcontracting plans submitted by potential small business prime contractors as part of the prime contract award for the operation of JCCs. As such, DOL had a responsibility to carefully consider potential close working relationships or affiliations, such as ostensible subcontracting, between prime and subcontractors that may hinder free competition or result in higher prices.<sup>16</sup>

### Potential Ostensible Subcontracting Violations

As of FY 2012, 3 JCC operators with small business set-aside prime contracts awarded 7 subcontracts to ResCare. Through its subcontracts with AET, APS, and Education Management Corporation (EMC), ResCare provided services such as academics, career preparation, career training and transition, safety and security, and management support. See Table 1 for the value of these subcontracts awarded to ResCare by the 7 operators for each of the 7 centers.

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<sup>14</sup> GAO Bid Protest decision, Marshall & Swift-Boeckh, B-407329; B-407329.2 (December 18, 2012).

<sup>15</sup> The FAR Part 19, Subpart 19.301-1 (b).

<sup>16</sup> The FAR Part 19, Subpart 19.301-1 (b), the FAR Part 19, Subpart 19.302 (b), and the FAR Part 44, Subpart 44.202-2(b).

**Table 1: JCC Subcontracts Awarded to ResCare**

JCC Name	JCC Center Operator	Dollar Value of ResCare Subcontracts (rounded)	Active (Yes/No/Pending)
Westover	AET	\$21.3 million	Yes
Bamberg	AET	\$6.5 million	Yes
Detroit	AET	\$10.5 million	Yes
Flint/Genesee	APS	\$10.4 million	Yes
Phoenix	EMC	\$9.7 million	Yes
<b>Total Active</b>		<b>\$58.4 million</b>	
Cleveland	AET	\$5 million	No
Northlands	APS	\$10.4 million	No
<b>Total Inactive</b>		<b>\$15.4 million</b>	

We tested all 7 subcontracts ResCare received from the 3 small business center operators using factors SBA cited in its Turner decision, such as academics and career technical training, including staffing for these areas, proposed key and total JCC staffing, technical proposal element weights, and percentage of subcontracted work. As we previously discussed, prior size determination cases are not binding on SBA and do not set precedent for or control other cases; however, SBA has cited prior size determinations in a number of cases for illustrative purposes. Accordingly, we used our comparison to SBA’s Turner decision for illustrative purposes and neither made a size determination regarding AET or APS for the contracts-subcontracts we tested, nor concluded that ResCare definitively was an ostensible subcontractor for any of the contracts-subcontracts we tested, as these areas are the sole purview of SBA.

Our results indicated ResCare appeared to be an ostensible subcontractor to AET and APS for 4 JCC small business set-aside contracts. SBA considers factors such as ownership, management, previous relationships with or ties to another business, and contractual relationships, in determining whether affiliation exists, as defined by 13 CFR §121.103 (a). If SBA determined a small business violated affiliation rules to obtain a small business set-aside procurement, SBA considers the small business as other than small and therefore ineligible for that procurement.<sup>17</sup> Affiliation may occur in a number of ways, one of which is ostensible subcontracting. The ostensible subcontractor rule, 13 CFR 121.103 (h)(4), states when a subcontractor performs the primary and vital requirements of a contract ... or the prime contractor unusually relies upon a subcontractor, SBA considers the 2 businesses affiliated for the purposes of that procurement. According to SBA, to make a determination of ostensible subcontracting, SBA considers all aspects of the relationship between the prime and subcontractor, including the terms of the proposal (such as contract management, technical responsibilities, and the percentage of subcontracted work); agreements between the prime and subcontractor (such as teaming agreements); and whether the subcontractor was the incumbent contractor, but was ineligible to submit a proposal because it exceeded the applicable size standard for that solicitation.

<sup>17</sup> SBA uses the terminology “other than small” in small business size determination cases.

The bid proposals AET and APS submitted to ETA and OASAM for its JCC small business set-aside prime contracts for center operation at the Bamberg, Cleveland, and Westover JCCs (AET) and the Northlands JCC (APS) contained significant similarities to AET's proposal to operate the Turner JCC, where SBA found in 2010 that AET, a small business, would have allowed ResCare, a large business, to perform primary and vital contract requirements intended for AET. SBA also found that AET was unusually reliant on ResCare's qualifications to win the Turner JCC contract. For example, ResCare personnel would have comprised the majority of the staff for academics and career technical tasks—over 96 percent and 85.7 percent—respectively. At the 4 JCCs we identified, ResCare personnel comprised 81.8 percent to 100 percent (academics) and 78.9 percent to 94.2 percent (career technical). We also identified similarities between other technical responsibilities and percentage of work subcontracted to ResCare, as well as reliance on ResCare's staff and qualifications to operate these 4 JCCs. Table 2 summarizes the significant, though not all-inclusive, similarities on which we based our conclusion that ResCare appeared to be an ostensible subcontractor at 4 JCCs.<sup>18</sup>

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<sup>18</sup> While some staffing information changed from the proposed subcontracts as compared to the executed contracts, the information in Table 2 represents the information available to the ETA and OASAM COs during the proposal evaluation stage of these procurements. In addition, we determined that differences in staffing between the proposed subcontracts and the executed subcontracts would not have materially altered our results.

**Table 2: Similarities of 4 JCC ResCare Subcontracts to Turner Case (SBA No. SIZ-5192)**

<b>Primary and Vital Contract Requirements</b>					
<b>ResCare</b>	<b>Turner (SBA No. SIZ-5192)</b>	<b>Bamberg AET</b>	<b>Cleveland AET<sup>a,b</sup></b>	<b>Westover AET</b>	<b>Northlands APS<sup>a,c</sup></b>
Responsible Department Agency for Prime Contract Award to AET or APS	OASAM	ETA	ETA	OASAM	OASAM
Subcontract to perform Career Technical Training	Yes	Yes	Yes	Yes	Yes
Percentage of Center's Career Technical Tasks Staff	85.71%	78.95%	87.80%	85.42%	94.29%
Subcontract to Perform Academics	Yes	Yes	Yes	Yes	Yes
Percentage of Center's Academic Staff	96%	94.12%	100%	100%	81.82%
<b>Unusual Reliance</b>					
<b>ResCare:</b>	<b>Turner (SBA No. SIZ-5192)</b>	<b>Bamberg</b>	<b>Cleveland</b>	<b>Westover</b>	<b>Northlands</b>
Subcontract Percentage of Total Contract	23%	19.12%	37.35%	27.22%	25.27%
Percentage of Center's Full Time Equivalent Staff	32.22%	24.16%	31.72%	34.48%	30.22%

<sup>a</sup> AET and APS no longer operate the Cleveland and Northlands JCCs, respectively. As we previously noted, the information in Table 2 represents the information available to the ETA and OASAM COs during the proposal evaluation stage of these procurements.

<sup>b</sup> ETA awarded AET the Cleveland JCC center operator contract as a short term sole-source contract as a result of ETA's termination of the previous center operator, Applied Technologies Services Inc., for default. Seratto, Inc. is the current operator of the Cleveland JCC.

<sup>c</sup> As of June 2013, ETA granted APS 4 extensions for its Northlands JCC contract totaling 15 months, which it accomplished through contract modifications, in violation of the FAR Part 52, Subpart 52.217-8.

In addition, AET and APS appeared to rely on the past experience of ResCare in the majority of instances. In 3 of the 4 bids for these JCCs, AET and APS cited past partnerships or teams with ResCare to support their ability to operate these JCCs, though they did not cite formal teaming agreements or mentor-protégé relationships.<sup>19</sup>

These conditions occurred because ResCare, a large business, and AET and APS, small businesses, failed to recognize, misinterpreted, or disregarded that their

<sup>19</sup> According to the SBA and as referenced in 13 CFR §121.103, teaming agreements and mentor-protégé relationships do not exempt potential offerors from the ostensible subcontractor rule. OIG also verified with AYS that AET and APS did not have past, pending, or current mentor-protégé relationships with ResCare.

relationships created an actual or appearance of affiliation such that ResCare may be an ostensible subcontractor for these small business set-aside contracts. Together, ResCare, AET, and APS may have financially benefitted from evading the small business size requirements. As such, ResCare, AET, and APS may have created an unfair competitive advantage over other small businesses competing for these 4 JCC center operator contracts, which contradicts the federal government's policy to provide maximum practicable opportunities in its acquisitions to small businesses, as well as the guiding principles of the FAR to use contractors with the ability to perform and promote competition in federal acquisitions.<sup>20</sup>

We also determined gaps in DOL oversight likely contributed to these occurrences. During the bid solicitation, evaluation, and award selection process, DOL did not have processes and controls to ensure large businesses were not performing primary and vital requirements of JCC contracts as subcontractors for small business firms or that small businesses were not unusually reliant on large businesses to perform their contractual requirements. In their bid proposals to operate the 4 noted JCCs, AET and APS provided information to DOL that should have warranted closer consideration. Specifically, both small businesses identified ResCare, a large business, as a subcontractor providing significant center services, including academic and career technical training. As we previously discussed, ETA and OASAM had a responsibility to consider these potential working relationships and affiliations, such as ostensible subcontracting, between ResCare, AET, and APS. As such, DOL did not meet the FAR requirement to carefully consider potential close working relationships or affiliations, such as ostensible subcontracting, between prime and subcontractors that may hinder free competition or result in higher prices.<sup>21</sup>

Furthermore, ETA was not able to provide the OIG a listing of all JCC subcontractors and stated it largely did not monitor the activities of its prime contractors' subcontractors due to "privity of contract." Federal agencies cannot require subcontractors to take action because privity of contract exists only between the prime contractor and subcontractor. As such, only the prime contractor can interact directly with its subcontractors and require them to take action.<sup>22</sup> Privity, however, does not prevent ETA from developing and maintaining a mechanism or procedures to use as detection or monitoring tools to mitigate the procurement risks posed by close working relationships or affiliations between prime and subcontractors. If SBA determines any of these 4 contracts-subcontracts violated the ostensible subcontractor rule, up to \$126.5 million in government funds set aside for small businesses were not used as intended.<sup>23</sup> Additionally, these conditions also exposed DOL to procurement risk posed by potential non-compliance with government-wide statutorily mandated small business

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<sup>20</sup> The FAR Part 1, Subparts 1.102(b)(1)(ii) and 1.102(b)(1)(iii).

<sup>21</sup> The FAR Part 19, Subpart 19.301-1 (b), the FAR Part 19, Subpart 19.302 (b), and the FAR Part 44, Subpart 44.202-2(b).

<sup>22</sup> For example, federal agencies can request the prime contractor initiate post-award conferences with its subcontractors, but must recognize the lack of privity of contract between the Government and subcontractors. FAR Part 42, Subparts 42.505(a) and 42.505(b)(1).

<sup>23</sup> See Exhibit 1 – Potential Funds Not Used As Intended – Ostensible Subcontracting for details.

contracting goals in Section 15(g)(1) of the Small Business Act. Specifically, if DOL awarded small business set-aside contracts to businesses that are not considered small businesses for those procurements, the data reported for DOL's small business contracting may be overstated. SBA also stated if a firm that has been awarded a small business set-aside contract is found to be other than small, then SBA believes that the procuring agency should not be able to continue to take small business credit for purposes of its small business goals.

#### AYS Did Not Agree that ResCare Appeared to be an Ostensible Subcontractor

We provided AYS with the evidence supporting our conclusion that ResCare appeared to be an ostensible subcontractor to AET and APS. However, AYS generally did not respond to the similarities we noted in Table 2. Instead, AYS asserted we should not have concluded ostensible subcontracting violations occurred because factors SBA cited in its Turner decision are not present for each of the 4 center operator contracts and subcontracts we noted. AYS' assertion is not accurate for 2 reasons. First, we used our comparison to SBA's Turner decision for illustrative purposes and neither made a size determination regarding AET or APS for the contracts-subcontracts we tested, nor concluded that ResCare definitively was an ostensible subcontractor for any of the contracts-subcontracts we tested, as these areas are the sole purview of SBA. Instead, we identified sufficient evidence to indicate ostensible subcontractor violations appeared to have occurred and, as such, we believe ETA should refer these procurements to SBA for review and take corrective action, if warranted. Second, while SBA considers all aspects of the relationship between the prime and subcontractor before making a determination of ostensible subcontracting, it specifically noted in its Turner decision that an ostensible subcontractor analysis is extremely fact-specific to the procurement at hand. Furthermore, as previously discussed, SBA has consistently stated that prior size determination cases are not binding on SBA and do not set precedent for or control other cases. As such, AYS' assertion that all factors relating to the Turner case need be present for SBA to determine ostensible subcontracting violations occurred for the 4 procurements we identified is incorrect.

We also provided ETA with the evidence supporting our belief that ResCare appeared to be an ostensible subcontractor to AET and APS, and that ETA should refer these 4 contracts-subcontracts to SBA for review and guidance, if warranted. ETA stated it was unable to agree or disagree and requested OIG involve SBA to determine if an ostensible subcontractor relationship occurred at the time of the center operator contract awards. ETA also stated SBA's determination could impact the award of option years to AET and APS, as well as have a significant impact on the operation of the JCCs where AET and APS hold center operations contracts. We believe ETA, not OIG, should seek the review from SBA regarding the 4 potential ostensible subcontracting violations we identified and take corrective action, if warranted.

## **B) ResCare Did Not Always Comply with the FAR and Its Own Procurement Policies.**

ResCare did not always comply with the FAR and its own procurement policies when awarding subcontracts and POs. A Contractor Purchasing System Review (CPSR) conducted by ETA in 2012 identified a number of serious deficiencies, including documentation that failed to demonstrate ResCare solicited and awarded subcontracts through competitive bidding and open competition. The CPSR also showed ResCare's procurement policies and procedures did not address key procurement topics and provide appropriate guidance.<sup>24</sup> We conducted testing for ResCare procurement activity not covered by ETA in its 2012 CPSR and identified additional deficiencies caused by ResCare's failure to follow its own procurement policies and procedures. Of the 4 JCCs we reviewed, we determined 3 centers circumvented ResCare procurement policies by splitting POs so they fell under the \$3,000 micro-purchase threshold and would not require competition or sole-source justification; and that purchases at 2 centers were made without obtaining required prior approval for the POs.<sup>25</sup>

### ETA-Conducted CPSR Report in 2012 Identified Numerous Deficiencies

Due to a conflict of interest complaint that OIG substantiated at the Homestead JCC, ETA withdrew ResCare's CPSR certification effective September 24, 2012. This withdrawal required all ResCare-operated JCCs to secure consent from their respective ETA CO prior to the award of any subcontract that meets the requirements of the FAR.

We reviewed the CPSR that ETA conducted of ResCare in 2012 in accordance with the FAR.<sup>26</sup> Based on the CPSR, ETA would either re-approve or continue to not approve ResCare's procurement system. ETA issued its CPSR report on October 5, 2012, that contained 31 findings and 15 recommendations. These findings included the following significant items:

- 8 findings that ResCare's procurement files did not adequately demonstrate ResCare solicited and awarded subcontracts through competitive bidding and open competition;
- 8 findings that ResCare-operated JCCs have deficiencies in attracting, identifying, verifying, and utilizing small businesses. It further highlights that the centers did not check the Central Contractor Registration properly, verify the size of their vendors' businesses, or conduct adequate small business outreach in their local areas;

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<sup>24</sup> CPSR Report 2012-6.

<sup>25</sup> The micro-purchase threshold is \$3,000 per the FAR Part 2, Subpart 2.101.

<sup>26</sup> The FAR Part 44, Subparts 44.202-2 and 44.301-303 allow for the approval of purchasing systems that demonstrate compliance with the FAR principles after a rigorous review of the contractor's policies, procedures, and performance under that system.

- 4 findings that documentation demonstrating ResCare checked the Excluded Parties List Service and obtained statements from certain subcontractors that the subcontractor or its principals were not suspended, debarred, or proposed for debarment by the Federal Government at the time of award were not contained in the procurement files;
- 3 findings that ResCare did not have documentation that the CO reviewed ResCare's Procurement/Property Operations Manual (PRC) and procurement Standard Operating Procedures (SOP); and
- 1 finding that showed some of ResCare's PRCs did not address corporate policies, key procurement topics, and contain appropriate references.

Based on the findings and recommendations contained in the CPSR and the results of OIG's report on the conflict of interest complaint at the Homestead JCC, ETA recommended ResCare submit a Corrective Action Plan (CAP), submit updated and approved SOPs, and conduct a follow-up center review to determine if all corrective actions had been successfully implemented within 6 months of ETA approving the CAP. Once ResCare completed these actions, ETA would make a final recommendation to ResCare on whether ResCare had made and implemented satisfactory changes to allow ETA to issue a new certification or determine that its withdrawal of ResCare's certification should continue. ResCare submitted a CAP and updated SOPs to ETA for review; however, ETA officials stated they decided not to review and approve the CAP pending the results of this OIG audit. In addition, ETA officials stated that it will conduct a new review of ResCare's purchasing system that would include an assessment of areas with previously identified weaknesses.<sup>27</sup>

#### ResCare Centers Split Purchases to Avoid Competition and Made Purchases Without Prior Management Approval

We judgmentally selected 4 JCCs operated by ResCare and tested FY 2011 and FY 2012 transactions for procurement deficiencies not covered by ETA in its 2012 CPSR. We identified additional deficiencies caused by ResCare's failure to follow its own procurement policies and procedures.<sup>28</sup> PRC 4010 referenced Job Corps' Policy and Requirements Handbook (PRH) Section 5.6, which indicated center operators and Outreach and Admissions/Career Transition Services contractors shall follow all applicable procurement regulations, to include those contained in the FAR. PRC 4010 provided detailed guidance requiring competition or sole-source justification as follows:

##### Competition

- Effective competition will constitute the basic principle of procurement and that effective procurement planning, source selection, and award

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<sup>27</sup> Based upon budgetary constraints, ETA was planning to complete this review in FY 2015.

<sup>28</sup> See Appendix A, Judgmental Data Selection and PO Testing at Judgmentally-Selected JCCs.

are mandatory to provide material and services of quality and quantity at the lowest cost obtainable in adherence with ethical practices, contract stipulations, and government statutes and directives.

Documentation

- Each purchase order file should include a copy of the following:
  3. Justification for the procurement action taken. In each instance where a competitive procurement in excess of \$3,000 is not made, full written justification for the action taken must be included in the procurement file.

Of 105 invoices we tested as potential micro-purchase violations, we identified 32 invoices related to 30 POs, totaling approximately \$61,000, that exceeded the micro-purchase threshold. We determined 3 of the JCCs circumvented the policies by splitting POs so they fell under the \$3,000 micro-purchase threshold and would not require competition or sole-source justification. For example, the Pinellas JCC avoided competition by splitting a purchase of dri-mesh shirts totaling \$8,034 into 3 POs of \$2,678 each. As another example, the South Bronx JCC avoided competition by splitting the purchase of first responder training for students totaling \$3,600 into 2 POs of \$2,400 and \$1,200.

Table 3 summarizes the number and dollar value of the micro-purchase violations we identified by center.

**Table 3: Micro-purchase Violations**

<b>Job Corps Center Name</b>	<b>Number of Invoices</b>	<b>Number of POs Related to Invoices</b>	<b>Dollar Value of Micro-purchase Violations (rounded)</b>
Old Dominion	2	2	\$4,178
Pinellas	19	18	\$37,959
South Bronx	11	10	\$19,173
<b>Total</b>	<b>32</b>	<b>30</b>	<b>\$61,310</b>

We also tested our 4 judgmentally-selected centers for compliance with ResCare’s policies for preparing purchase requisitions and POs. We found ResCare could not provide support that it met its own procurement policies and procedures for the transactions we identified in Table 3. Both PRC 4210 and 4230 referenced Job Corps’ PRH Section 5.6, which indicated center operators and Outreach and Admissions/Career Transition Services contractors shall follow all applicable procurement regulations, to include those contained in the FAR. PRCs 4210 and 4230 provided detailed guidance as follows:

- PRC 4210, Preparing Purchase Requisition – The purchase request form is signed by the requestor and submitted to the head of the department for approval. After department head approval, the purchase requisition is then routed in the following order:

- a. Purchasing (for price bidding, lowest price, source determination and shipping information);
  - b. Accounting (for account designation and recording of information in the commitments log);
  - c. Department Head of Administration;
  - d. Center Director (if \$3,000 or more involved); and
  - e. Purchasing for actual purchase and preparation of the purchase order
- PRC 4230, Preparing the Purchase Order – When purchase order is confirmation of order already placed, state same prominently, **capital letters**, in center of description area.

In addition, we examined the information ResCare provided for the 105 invoices to determine if the JCCs generated POs after the related invoice date. OIG identified 23 POs dated after the receipt of 27 invoices for related purchases totaling approximately \$47,000. We determined that JCCs made these purchases without obtaining required prior approval at 2 of the 4 JCCs we tested. Specifically, JCCs generated POs for approval after they made purchases and vendors submitted invoices. For example, at the Pinellas JCC, the center generated a PO 6 weeks after making a purchase. As another example, at the South Bronx JCC, the center also generated a PO 6 weeks after making a purchase.

Table 4 summarizes the number and dollar value of POs generated after invoice dates by center.

**Table 4: POs Generated After Invoice Dates**

Job Corps Center Name	Number of Invoices	Number of POs Related to Invoices	Dollar Value of POs Generated After the Invoice Date (rounded)
Pinellas	12	12	\$25,653
South Bronx	15	11	\$21,359
<b>Total</b>	<b>27</b>	<b>23</b>	<b>\$47,012</b>

Note: \$17,498 of the Pinellas POs and \$10,359 of the South Bronx POs listed in table 4 (a total of \$27,857) are also included in the micro-purchase violations noted in table 3.

We estimated up to \$61,310 for the micro-purchase violations and up to an additional \$19,155 for the other PO violations not included in the micro-purchase violations for a total of \$80,465 in funds put to better use if improvements to ETA oversight result in its COs identifying violations.<sup>29</sup>

These conditions occurred because ResCare disregarded the FAR and its own procurement policies and procedures. ResCare acknowledged the deficiencies ETA found in its CPSR review and provided ETA a CAP intended to address these deficiencies.<sup>30</sup> ResCare acknowledged it made micro-purchase errors, as well as

<sup>29</sup> PO violations not included in the micro-purchase violations: \$47,012 - \$27,857 = \$19,155 (see also Table 4).

<sup>30</sup> OIG did not assess ResCare's CAP or determine that the CAP adequately addressed deficiencies ETA identified.

generated POs after the receipt of invoices for purchases, and provided documentation for the violations discussed above. However, the information and documentation they provided did not support that ResCare met its own procurement policies and procedures for these purchases.

We also determined a limited CPSR that OASAM conducted in 2010 was a contributing factor to the procurement deficiencies we and ETA identified.<sup>31</sup> Specifically, OASAM granted its approval of ResCare's procurement system in 2010 for a period of 3 years based on a CPSR conducted by OASAM's contractor.<sup>32</sup> The contractor based its recommendation for CPSR approval on a review of procurement activities at only 1 of the JCCs ResCare operated and the procurement policies, procedures, and directives submitted by the center and ResCare's corporate office. ETA officials told us that a review of only 1 JCC was driven by budgetary constraints. We believe a more representative review of ResCare's procurement activities in 2010, given its volume of JCC subcontracts and POs, may have identified the systemic deficiencies identified during the ETA-conducted CPSR in 2012 and during this audit.

## **RECOMMENDATIONS**

We recommend that the Assistant Secretary for Employment and Training require the Regional Job Corps Offices and respective ETA COs to:

1. Refer the 4 small business set-aside contracts we identified held by AET and APS to SBA for review and guidance on corrective action, if warranted;
2. Develop and implement a mechanism or procedures for ensuring each small business set-aside contract is free of potential violations of affiliation rules;
3. Develop and implement a comprehensive training plan for procurement staff, including training on affiliation, ostensible subcontracting, and the scope of privity;
4. Conduct the new CPSR planned for ResCare in FY 2015, or, if the new CPSR is cancelled or delayed, follow up on ResCare's CAP, as well as the procurement weaknesses identified in ETA's 2012 CPSR report and this OIG audit report.
5. Develop and implement procedures to ensure ResCare complies with its center operator contract provisions and its own procurement policies and procedures, such as a memorandum to ResCare reinforcing that the centers it operates receive the required approval and documentation for

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<sup>31</sup> CPSR Report 10-002. OASAM's approval required ResCare to obtain CO consent only for health related subcontracts.

<sup>32</sup> As we previously noted, the Office of Job Corps' contracting function was under the OASAM prior to October 2010.

purchases and that center purchases are free of micro-purchase violations.

### **ETA's RESPONSE**

The Assistant Secretary for Employment and Training agreed with our results and recommendations and stated it will take steps to address the issues identified in the report, which include: referring three of the four identified small business set-aside contracts to SBA for review, as ETA has since awarded the Cleveland JCC contract to another vendor; consulting with OASAM's Procurement Policy Office and the SBA to develop universal procedures to assist DOL procurement staff in ensuring small business set aside contracts are free of potential violations of affiliation rules; providing additional training to procurement staff on contractor affiliation; and seeking support from SBA to help identify warning signs of potential contractor/subcontractor affiliation problems.

ETA stated it will conduct a new CPSR of ResCare in early FY 2015 that will consist of site visits to the corporate office and three ResCare-operated JCCs, as well as issue a copy of the CPSR report and purchasing system approval decision to OIG. ETA affirmed COs/Specialists and CO Representatives (COR) have responsibility for adequately monitoring contractor performance. ETA stated it will take additional steps to reemphasize the importance of adequate contract monitoring for COs/Specialists and CORs and noted it had established a quarterly COR training program that will include training to provide sufficient oversight of contract terms and conditions. Lastly, ETA stated that OCM will develop a COR contract monitoring checklist to assist CORs in providing adequate oversight of the JCC contracts. ETA's complete response is included in Appendix C.

### **RESCARE'S RESPONSE**

ResCare agreed with our results and recommendations and stated that based on OIG's recommendations, it had taken steps to address the issues identified in this and OIG's 2012 audit report. ResCare stated it had strengthened its procurement policies and enhanced its practices, as well as conducted training in these areas. ResCare stated it will take additional steps to continue monitoring progress to confirm total compliance across all JCCs operated by ResCare. ResCare provided a number of supporting documentation including: the CAP it submitted to ETA based on CPSR 2012-6; revised ResCare policies distributed to all ResCare-operated JCCs in 2013; training that ResCare's Director of Property/Purchasing conducted in October 2013 to ensure JCC properly implemented the revised policies; documentation for ResCare's use of an outside vendor in December 2013 to conduct additional training as recommended by ETA OCM; a listing of unscheduled audits conducted by ResCare's Purchasing/Property Director in 2013 and 2014 to confirm JCCs have effectively implemented ResCare's revised procurement policies; and a listing of a Purchasing/Subcontract reviews added to its Best in Class audits scheduled in

2013 and 2014 that ResCare’s Program Support Team conducted. ResCare’s complete response is included in Appendix D.<sup>33</sup>

## **AYS’ RESPONSE**

AYS disagreed with our results and recommendations. AYS asserted the audit did not comply with generally accepted government auditing standards because it relied solely on the Turner case for criteria, used incorrect and insufficient criteria, and an ETA referral to SBA for review would have no practical effect. AYS asserted SBA’s decision was “an incorrect and incomplete statement of the law regarding the ostensible subcontractor rule;” however, this is an issue for SBA to discuss, not OIG. Contrary to AYS’ assertion, OIG did not use the Turner case as the sole criteria to conduct this audit; rather we used Turner as an illustrative case in conjunction with our review of the criteria noted in the report. In addition, AYS asserted, “the Draft Report presumes that the JCCs at issue are identical in all material respects to the Turner JCC,” but this is incorrect. OIG made no such assumption and stated that we found significant similarities to the Turner case, not that these contracts-subcontracts were identical to those in the Turner case or that the JCCs we identified are identical to the Turner JCC.

AYS asserted we ignored the “key employees” aspect of these contracts, but this is incorrect. We stated in the report that we tested all 7 subcontracts ResCare received from the 3 small business center operators using factors SBA cited in its Turner decision, such as academics and career technical training, including staffing for these areas, proposed key and total JCC staffing, technical proposal element weights, and percentage of subcontracted work. In addition, AYS asserted OIG ignored the performance information contained in the proposals for the 4 contracts-subcontracts where we identified ResCare appeared to be an ostensible subcontractor. AYS’ assertion is incorrect. As we note in the report, for 3 of these 4 contract proposals, AYS cited the longstanding partnerships and teams with ResCare for JCC operations and services.

AYS continued to assert that all three factors SBA cited in the Turner case need to be present for these other JCCs. We disagree. Though we considered the information AYS provided to us in its Statement of Facts response, we emphasize that the Job Corps program is a no-cost education and vocational training program authorized by WIA and, as such, education and career technical services are primary and vital components of this program and JCC operation. In fact, education and career technical tasks carried significant weight in each solicitation. We also find it important that in the appeal of the Turner case, SBA upheld the Area Office’s original determination that AET was unduly reliant on ResCare and then added its own finding that ResCare would perform primary and vital contract requirements—career preparation and career development (academics and career technical training). The SBA Office of Hearings and Appeals noted that these “were the most heavily weighted elements of each offeror’s technical proposal, indicating that the DOL considered these to be the most important elements to

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<sup>33</sup> OIG did not assess ResCare’s attachments to its written comments.

be performed.” As we note in the report, SBA bases size determinations after consideration of all aspects of the relationship between the prime and subcontractor and that each case is fact-specific.

AYS’ complete response is included in Appendix E.

We appreciate the cooperation and courtesies that AYS, ETA, and ResCare personnel extended to OIG during this audit. OIG personnel who made major contributions to this report are listed in Appendix F.



Elliot P. Lewis  
Assistant Inspector General  
for Audit

## **Exhibit**

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**Exhibit 1****Potential Funds Not Used As Intended – Ostensible Subcontracting**

If SBA determines any of the 4 contracts-subcontracts below violated the ostensible subcontractor rule, up to \$126.5 million in government funds set aside for small businesses were not used as intended.

To determine the amount of potential government funds not used as intended, we estimated the total value of the prime contracts, inclusive of option years, based on the exercised prime contracts. Where the specific values of the option years was not provided in the contract, we estimated the option year values based on the second base year of the contracts, where sufficient information was present to make the estimate.

<b>Job Corps Center Name Contract Details</b>	<b>Center Operator / Job Corps Region</b>	<b>Prime Contract Base and Option Value Total</b>
Bamberg DOLJ11UA00033 8/1/2011 - 7/31/2013 (base) 8/1/2013 - 7/31/2016 (options)	AET / Atlanta	\$38,526,407
Westover DOLJ10QA00002 8/1/2010 - 7/31/2012 (base) 8/1/2012 - 7/31/2015 (options)	AET / Boston	\$30,735,014 <sup>a</sup>
Northlands <sup>b,c</sup> DOLJ09QA00011 7/1/2010 - 6/30/2012 (base) 7/1/2012 - 6/30/2015 (options)	APS / Boston	\$41,196,422
<b>Subtotal</b>		<b>\$110,457,843</b>
Cleveland <sup>b,d</sup> DOLJ11RA00042 3/1/2011 - 2/29/2012 (base) 3/1/2012 - 8/31/2012 (6 mos. option)	AET / Chicago	\$16,001,859 <sup>a</sup>
<b>Total</b>		<b>\$126,459,702</b>

<sup>a</sup> The values in the table above for the Westover and Cleveland JCCs represent the base prime contract values only. We did not have sufficient information to estimate option year values.

<sup>b</sup> AET and APS no longer operate the Cleveland and Northlands JCCs, respectively.

<sup>c</sup> As of June 2013, ETA granted APS 4 extensions for its Northlands JCC contract totaling 15 months, which it accomplished through contract modifications, in violation of the FAR Part 52, Subpart 52.217-8.

<sup>d</sup> ETA awarded AET the Cleveland JCC center operator contract as a short term sole-source contract as a result of ETA's termination of the previous center operator, Applied Technologies Services Inc., for default. Seratto, Inc. is the current operator of the Cleveland JCC.

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## Appendices

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**Objective, Scope, Methodology, and Criteria**

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**Objective**

Our audit objective was to answer the following question:

Did the practices of ResCare and the prime contractors it performed work for comply with federal procurement regulations?

In order to the answer the objective, we performed audit work in the following areas:

- A) Contractor-subcontractor relationships between JCC operators selected by DOL for small business set-aside contracts and ResCare as a subcontractor.
- B) Subcontracts ResCare awarded as the prime contractor operating JCCs.

**Scope**

Our scope included the information relevant to the prime contracts and subcontracts in effect during FY 2011 through FY 2012.<sup>34</sup> The audit team reviewed information obtained from ETA; ResCare; AET and APS—collectively referred to as AYS, the umbrella company for the prime operators of 6 of the 7 JCC contracts where ResCare was a subcontractor, and 4 ResCare-operated JCCs: Guthrie, Old Dominion, Pinellas, and South Bronx. We also reviewed a small business size determination and related appeal issued by SBA for the Turner JCC small business set-aside contract.<sup>35</sup> We conducted audit work at ETA's National Office in Washington, DC. We conducted additional fieldwork at our Chicago, IL, San Francisco, CA, and Washington, DC, offices from October 2012 through December 2013.

We considered the internal control elements of control environment, risk assessment, control activities, information and communication, and monitoring during our planning and substantive audit phases.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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<sup>34</sup> We updated the contract-subcontract information through June 2014, as appropriate.

<sup>35</sup> Size Determination No. 6-2011-009 (2010) and subsequent appeal decision SBA No. SIZ-5192 (2011).

## Methodology

To accomplish our objective, we reviewed applicable laws, regulations, and policies; reviewed ETA and OASAM reports on ResCare’s purchasing system; tested PO information provided by ResCare and 4 ResCare-operated JCCs for FY 2011 and FY 2012; and interviewed management and staff at ETA and ResCare, as well as AYS.

We also reviewed a protest a small business made in 2010 for the Turner JCC small business set-aside contract, which challenged the small business size status of the small business OASAM selected for the award.<sup>36</sup> SBA has sole purview to make determinations of small business size and SBA determines whether a small business qualifies as a small business concern or is affiliated with a large business using a number of factors. If SBA determined a small business violated affiliation rules, such as ostensible subcontracting, to obtain a small business set-aside procurement, SBA considers the small business as other than small and ineligible for that procurement. As a result of the Turner JCC protest, SBA found ResCare was an ostensible subcontractor to AET.

To assess whether ResCare was potentially an ostensible subcontractor to other small businesses with small business set-aside prime contracts for JCC operation, we used the size determination factors SBA used in the Turner decision to evaluate the 7 relevant JCC subcontracts ResCare received during FY 2011 and FY 2012.<sup>37</sup> As previously discussed in this report, prior size determination cases are not binding on SBA and do not set precedent for or control other cases; however, SBA has cited prior size determinations in a number of cases for illustrative purposes. Accordingly, we used our comparison to SBA’s Turner decision for illustrative purposes and neither made a size determination regarding AET or APS for the contracts-subcontracts we tested, nor concluded that ResCare definitively was an ostensible subcontractor for any of the contracts-subcontracts we tested, as these areas are the sole purview of SBA. We also used this information to determine whether ETA should refer any of the contracts-subcontracts we tested to SBA for review and corrective action, if warranted.

## Internal Controls

We considered the internal control elements of control environment, risk assessment, control activities, information and communication, and monitoring during our planning and substantive audit phases. We evaluated ResCare’s internal controls for reasonable assurance that its processes for awarding of subcontracts and payment of invoices satisfied federal and Job Corps requirements. We also evaluated ETA’s internal controls for reasonable assurance that its monitoring of prime and subcontracts satisfied federal requirements. Our consideration of these controls would not necessarily disclose all matters that might be reportable conditions. In addition, inherent limitations of internal

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<sup>36</sup> Shortly after OASAM announced AET as the successful bidder, another small business that competed for the contract filed a protest with SBA challenging AET’s size status and eligibility for the contract award.

<sup>37</sup> Our scope included two centers no longer operated by AYS, which included subcontracts to ResCare, as of June 2014.

controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected.

### Data Reliability

We also relied on the computer-processed data contained in ResCare's general ledger for 4 JCCs. We assessed the reliability of the data by: (1) performing various tests of required data elements; (2) obtaining information from ResCare and center operator staff knowledgeable of the data; (3) obtaining supporting data for anomalous data; and (4) reviewing and incorporating, as appropriate, work of other OIG auditors to support the testing performed. Based on these tests and assessments, we concluded the data was sufficiently reliable to address our audit objective.

### Judgmental Data Selection

We judgmentally selected 4 JCCs for data reliability and procurement violation testing that we determined were at greater risk for not complying with ETA's policies. We based our determination of risk on:

- Analysis of 22 Regional Office Center Assessments conducted for the centers where ResCare was the prime contractor or subcontractor in FY 2011 and FY 2012 to identify any anomalies pertaining to the audit objective, including Procurement & Subcontracting, Financial Management, Program Management, Other Issues/Deficiencies Identified;
- Examination of subcontract award dates and subcontract period of performance dates at the 14 centers ResCare operated in FY 2011 through FY 2012 to detect multiple subcontract awards for the same performance period to the same subcontractor; and
- Analysis of changes in the number of subcontracts reported by ResCare from its initial response to OIG's request for subcontracting information to its subsequent response to OIG for clarifying subcontract information.

The JCCs we judgmentally selected were:

Pinellas (Atlanta regional office); Old Dominion (Philadelphia regional office); Guthrie (Dallas regional office); and South Bronx (Boston regional office).

### PO Testing at Judgmentally-Selected JCCs

To identify possible purchases ResCare split to avoid the \$3,000 competitive purchase cap or price analysis, we applied the following criteria to general ledger information provided by the 4 judgmentally selected JCCs:

1. Multiple purchases under \$3,000;

2. Average purchase price for multiple purchases was \$1,000 or greater;
3. The multiple purchases combined exceed \$3,000;
4. The multiple purchases are to the same vendor;
5. Number of purchases that met criteria 1 through 3 above were less than or equal to 6 (any purchase larger than \$18,000 would require 6 or more purchases to avoid the micro-purchase threshold);
6. JCCs made these purchases within 30 days of each other; and
7. The purchases were similar enough for ResCare to categorize them with the same invoice distribution code.

We excluded blanket purchase agreements (to the extent we could determine one existed), 1-time purchases, medical subcontracts (must be approved by ETA), purchases made from government agencies (Job Corps, Department of Health and Human Services, Defense Finance and Accounting Services, etc.), and utility company purchases (electric, gas, water, etc.)

OIG identified 105 invoices, totaling nearly \$182,000, with 41 vendors at the Guthrie, Old Dominion, Pinellas, and South Bronx JCCs that met the above 7 criteria. We requested ResCare provide copies of the POs associated with each invoice that included the date of purchase, vendor name, and purchase description to demonstrate that these were separate purchases. Based on information obtained from ResCare and using the same criteria above, OIG identified 32 invoices related to 30 POs totaling approximately \$61,000 that exceeded the micro-purchase threshold. Specifically, groups of POs that ResCare JCCs submitted to DOL for reimbursement were for the same or similar product, with the same vendor, and within a 30 day or less period of time. In addition, we examined the information ResCare provided for the 105 invoices to determine if JCCs generated any of the POs after the related invoice date. OIG identified 23 POs dated after the receipt of 27 invoices for related purchases totaling approximately \$47,000.

## Criteria

- Federal Acquisition Regulation
- 13 CFR § 121.103(h)(4) (Ostensible Subcontractor)
- 13 CFR § 125.6 (Limitations on subcontracting)
- Small Business Administration *Size Determination No. 6-2011-009, Solicitation # DOLJ11UA00037, Alutiiq Education & Training, LLC* (2010)
- SBA No. SIZ-5192 (2011), *Appeal of Size Determination No. 6-2011-009, Solicitation # DOLJ11UA00037*
- Procedures ResCare (Procurement Policies and Procedures)
- Office of Contracts Management *Compendium for Job Corps Regional Procurements*
- U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government*
- Job Corps *Policy and Requirements Handbook*

- Small Business Act
- Workforce Investment Act of 1998

### Center Operator Adherence to the FAR

Center operators are required to adhere to certain aspects of the FAR by their contracts and Job Corps' PRH:

The center shall establish systems to procure property, services, and supplies in a cost-efficient and environmentally-friendly manner in accordance with government policies. The contractor shall also establish systems to provide procedures for receipt and accountability of government-owned property, material, and supplies, in accordance with PRH 5.6.

Further, Job Corps' PRH, section 5.6, R1 indicated center operators and Outreach and Admissions/Career Transition Services contractors shall follow all applicable procurement regulations, to include those contained in the FAR.

In August 2011, ETA and DOL's Office of the Solicitor indicated only the following sections of the FAR were applicable:

- FAR Part 9—Responsible Prospective Contractors
- FAR Part 44—Subcontracting Policies and Procedures
- FAR Part 52—Solicitation Provisions and Contract Clauses

These sections of the FAR, while not requiring direct compliance with all aspects of the FAR, required center operators to establish procurement policies and procedures that are consistent with the FAR.

### CPSR

The FAR Part 44, Subpart 44.302, requires ETA to determine the need for a CPSR based on, but not limited to, the past performance of the contractor and dollar value of subcontracts (generally \$25 million). The FAR Part 44, Subpart 44.301, states the objective of a CPSR is to evaluate the efficiency and effectiveness with which the contractor spends government funds and complies with government policy when subcontracting. The review provides the CO with a basis for granting, withholding, or withdrawing approval of the contractor's purchasing system.<sup>38</sup> Furthermore, the FAR Part 44, Subpart 44.303, states the considerations listed in the FAR Part 44, Subpart 44.202-2 for consent evaluation of particular subcontracts also shall be used to evaluate the contractor's purchasing system, including the contractor's policies, procedures, and performance under that system. Special attention shall be given to:

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<sup>38</sup> ETA reviews each center operator's procurement systems every 3 years. If ETA "approved" the procurement system, ETA contracting officials reduce their oversight of the center operator's procurement activities.

- (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...;
- (d) Methods of evaluating subcontractor responsibility, including the contractor's use of the System for Award Management Exclusions...;
- (e) Treatment accorded affiliates and other concerns having close working arrangements with the contractor;
- (f) Policies and procedures pertaining to small business concerns...;
- (g) Planning, award, and postaward management of major subcontract programs;
- (h) Compliance with Cost Accounting Standards in awarding subcontracts;
- (i) Appropriateness of types of contracts used; and
- (j) Management control systems, including internal audit procedures, to administer progress payments to subcontractors.

In addition, DOL policy for conducting CPSRs (Section 4.9) states that it is in the government's interest to perform CPSRs when a contractor's total combined business with Job Corps exceeds \$25 million. The policy further clarifies the center operators' responsibility to establish procurement policies and procedures that are consistent with the FAR. The DOL policy states that under the terms of center operator contracts, COs are responsible for ensuring that contractors procure goods and services on behalf of the Job Corps program in conformance with the contract provisions and principles detailed in the FAR. Contracting officers can either review and consent to all subcontracts for the contract, or may approve the contractor's purchasing system. The policy also states that the FAR allows for approval of purchasing systems that demonstrate compliance with the FAR principles after a rigorous review of all purchasing manuals and procedures.

**Appendix B**

**Acronyms**

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AYS	Alutiiq Youth Services, LLC
AET	Alutiiq Education and Training, LLC (subsidiary of AYS)
APS	Alutiiq Professional Services, LLC (subsidiary of AYS)
Bamberg	Bamberg Job Corps Center, Bamberg, SC
CAP	Corrective Action Plan
Cleveland	Cleveland Job Corps Center, Cleveland, OH
CO	Contracting Officer
COR	Contracting Officer’s Representative
CPSR	Contractor Purchasing System Review
DOL	U.S. Department of Labor
EMC	Education Management Corporation
ETA	Employment and Training Administration
FAR	Federal Acquisition Regulation
FY	Fiscal Year
Guthrie	Guthrie Job Corps Center, Guthrie, OK
Homestead	Homestead Job Corps Center, Homestead, FL
JCC	Job Corps Center
Job Corps	Office of Job Corps
Northlands	Northlands Job Corps Center, Vergennes, VT
OASAM	Office of the Assistant Secretary for Administration and Management
OCM	Office of Contracts Management, Employment and Training Administration

OIG	Office of Inspector General
Old Dominion	Old Dominion Job Corps Center, Monroe, VA
Pinellas	Pinellas Job Corps Center, St. Petersburg, FL
PO	Purchase Order
PRC	ResCare Procurement/Property Operations Manual
PRH	Job Corps Policy and Requirements Handbook
ResCare	ResCare, Inc.
SBA	U.S. Small Business Administration
SOP	Standard Operating Procedures
South Bronx	South Bronx Job Corps Center, Bronx, NY
Turner	Turner Job Corps Center, Albany, GA
Westover	Westover Job Corps Center, Chicopee, MA

ETA Response to Draft Report

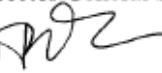
U.S. Department of Labor

Assistant Secretary for  
Employment and Training  
Washington, D.C. 20210



AUG 4 - 2014

**MEMORANDUM FOR:** ELLIOT P. LEWIS  
Assistant Inspector General for Audit

**FROM:** PORTIA WU   
Assistant Secretary

**SUBJECT:** Response to the OIG Audit Report – “Job Corps Contractor and  
DOL Procurement Practices Need Improvement” Report No. 26-  
14-002-03-370

This memorandum responds to the subject audit report, dated June 2014, Office of the Inspector General’s (OIG) Audit Report No. 26-14-002-03-370, “*Job Corps Contractor and DOL Procurement Practices Need Improvement*”

**Audit Summary:**

The OIG’s audit objective was to determine if the practices of ResCare, Inc., (ResCare) and the prime contractors it performed work for comply with federal procurement regulations. The audit was conducted due to the procurement risk associated with a prior Small Business Administration (SBA) determination on the contractor-subcontractor relationship between a small business selected by OASAM for a small business set-aside contract to operate a Job Corps Center with ResCare as its subcontractor. It was also conducted to follow up on a FY 2012 performance audit the Office of the Inspector General (OIG) conducted in response to an anonymous complaint OCM referred to the OIG.

The SBA found that a small business was ineligible for a set-aside contract because it would have allowed ResCare, a large business, to perform primary and vital contract requirements intended for the small business. SBA also found that this small business was unusually reliant on ResCare’s qualifications to win the Job Corps center contract. Further, the weak procurement controls identified during the 2012 hotline complaint audit indicated that the subcontracting deficiencies may be systemic.

The OIG reviewed work in two areas:

- Contractor–subcontractor relationships between Job Corp center (JCC) operators selected by DOL for small business set-aside contracts and ResCare as a subcontractor.
- Subcontracts ResCare awarded as the prime contractor operating JCCs.

OIG ResCare Subcontracting Practices Audit

The OIG found that ResCare and two small business prime contractors appeared to have circumvented the ostensible subcontractor rule. Additionally, the OIG found that ResCare, as a prime contractor, did not comply with the Federal Acquisition Regulation (FAR) and its own procurement policies when awarding subcontracts and purchase orders at the centers it operates.

The OIG also found that gaps in DOL oversight likely contributed to the ostensible relationships due to lack of processes and controls to ensure large businesses were not performing primary and vital requirements of the center contracts.

The OIG's five recommendations and our response follow:

**OIG Recommendation 1:** Refer the four (4) small business set-aside contracts we identified held by Alutiiq Education and Training and Alutiiq Professional Services to SBA for review and guidance on corrective action, if warranted.

**Response:** Management accepts this recommendation.

ETA will refer three of the four identified small business set-aside contracts to SBA for review, as one has since been awarded to another vendor.

We consider this recommendation resolved.

**OIG Recommendation 2:** Develop and implement a mechanism or procedures for ensuring each small business set-aside contract is free of potential violations of affiliation rules.

**Response:** Management accepts this recommendation.

ETA will consult with the Office of the Assistant Secretary for Administration and Management's Procurement Policy Office and the SBA to develop universal procedures to assist DOL procurement staff in ensuring small business set aside contracts are free of potential violations of affiliation rules.

We consider this recommendation resolved.

**OIG Recommendation 3:** Develop and implement a comprehensive training plan for procurement staff, including training on areas as affiliation, ostensible subcontracting, and the scope of privity.

**Response:** Management accepts this recommendation.

ETA will provide additional training to procurement staff on contractor affiliation and will seek support from SBA to help identify warning signs of potential contractor/subcontractor affiliation problems.

OIG ResCare Subcontracting Practices Audit

**OIG Recommendation 4:** Conduct the new Contractor Purchasing System Review (CPSR) planned for ResCare in Fiscal Year 2015 (FY15) or if the new CPSR is cancelled or delayed, follow up on ResCare’s CAP, as well as the procurement weaknesses identified in ETA’s 2012 CPSR report and this OIG audit report.

**Response:** Management accepts this recommendation.

ETA plans to conduct a new CPSR of ResCare in early FY15 and is in the process of developing the FY15 CPSR schedule. Based upon the CPSR rubric, ResCare’s review will consist of site visits to the corporate office and three ResCare operated Job Corps centers. The OIG will be issued a copy of the CPSR report and the purchasing system approval decision.

**OIG Recommendation 5:** Develop and implement procedures to ensure ResCare complies with its center operator contract provisions and its own procurement policies and procedures, such as a memorandum to ResCare reinforcing that the centers it operates receive the required approval and documentation for purchases and that center purchases are free of micro-purchase violations.

**Response:** Management accepts this recommendation.

While procedures and processes for monitoring contract performance are in place, ETA will reemphasize the importance of adequate contract monitoring. Both Contracting Officers/Specialists and Contracting Officer’s Representatives (COR) have responsibility for adequately monitoring contractor performance. ETA has established a quarterly COR training program. Training to provide sufficient oversight of contract terms and conditions will be among the topics offered. In addition, the OCM will develop a COR contract monitoring checklist to assist CORs in providing adequate oversight of the Job Corps center contracts.

We consider this recommendation resolved.

Based upon ETA’s response to the aforementioned audit recommendations, we anticipate the OIG will close all recommendations accordingly. If you have questions concerning this document, please contact Linda K. Heartley, ETA’s Head of the Contracting Activity, Office of Contracts Management at (202) 693-3404.

cc: Linda K. Heartley, Office of Contracts Management  
Lenita Jacobs-Simmons, Office of Job Corps  
Julie Cerruti, ETA Audit Liaison  
Linda Marshall, Job Corps Audit Liaison  
Peni Webster-Lewis, Office of Contracts Management Audit Liaison

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ResCare Response to Draft Report



9901 Linn Station Road  
Louisville, Kentucky 40223-3808

[www.ResCare.com](http://www.ResCare.com)

July 18, 2014

VIA E-MAIL - [lewis.elliott@oig.dol.gov](mailto:lewis.elliott@oig.dol.gov)

Mr. Elliot P. Lewis  
Assistant Inspector General for Audit  
U.S. DEPARTMENT OF LABOR  
90 7th Street, Suite 02-750  
San Francisco, California 94103

**Re: Department of Labor, Office of Inspector General Draft Report 26-14-002-03-370**

Dear Mr. Lewis:

This letter is in response to the Draft Report 26-14-002-03-370 by the U.S. Department of Labor, Office of Inspector General, issued July DD, 2014. In the Draft Report, DOL-OIG asked whether the practices of ResCare and the prime contractors it performed work for comply with federal procurement regulations. The Draft Report stated ResCare's DOL procurement practices need improvement as ResCare did not always comply with the FAR and its own procurement policies. DOL-OIG recommended the Assistant Secretary for Employment and Training require the Regional Job Corps Offices and respective ETA COs follow-up on our corrective action plan and conduct a new CPSR (Contractor Purchasing System Review).

ETA Contracting Office conducted the CPSR in 2012. ResCare submitted a corrective action plan and our Purchasing ResCare (PRC) standard operating procedures that were approved by the cognizant Contracting Officer, E. Thomas Pendleton, on 6/27/2013. CO Pendleton recommended ResCare conduct additional training and auditing of our purchasing system (**Exhibit A**).

ResCare has implemented its PRC standard operating procedures and addressed the remainder of CO Pendleton's recommendations. We strengthened and disseminated our Purchasing ResCare policies in 2013 (**Exhibit B**). Marian Hayes, our Director of Property/Purchasing conducted follow-up training to ensure the revised policies were implemented properly (**Exhibit C**). On the recommendation of Linda Hartley, ETA Contract Management Director, we utilized Management Concepts to provide additional training in this area (**Exhibit C**). Marion Hayes Purchasing/Property Director has conducted unscheduled audits to confirm the revised policies have been effectively implemented (**Exhibit E**). Additionally, we added a Purchasing/Subcontract review to our scheduled Best in Class Audits conducted by the Program Support Team (**Exhibit E**).

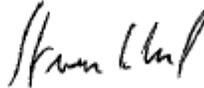
**Respect and Care**

**Assisting People to Reach Their Highest Level of Independence**

Mr. Elliot P. Lewis  
July 18, 2014  
Page 2

We take the recommendations of DOL-OIG very seriously. They have been very instructive. Pursuant to the DOL-OIG's recommendations, we have strengthened our procurement policies and enhanced our practices. We have conducted training and we continually monitor our progress to confirm total compliance across all our Centers. We will accept nothing short of full compliance.

Sincerely,



STEVEN S. REED  
Chief Legal Officer

Attachments

cc: Ray Armada, Audit Director ([armada.ray@oig.dol.gov](mailto:armada.ray@oig.dol.gov))  
Heather Atkins, Audit Manager ([atkins.heather@oig.dol.gov](mailto:atkins.heather@oig.dol.gov))

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**Respect and Care**

**Assisting People to Reach Their Highest Level of Independence**

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AYS Response to Draft Report



Mark G. Jackson  
(206) 486-8904  
mark@jacksonrosen.com

July 17, 2014

Elliot P. Lewis  
Assistant Inspector General for Audit  
Department of Labor  
Office of Inspector General—Office of Audit  
Francis Perkins Building, Room S-5502,  
200 Constitution Avenue, NW  
Washington, DC 20210

Re: Audit Report No. 26-14-002-03-370  
Response by Alutiiq Education & Training, LLC and Alutiiq Professional  
Services, LLC

Dear Mr. Lewis:

I write on behalf of Alutiiq Education & Training, LLC and Alutiiq Professional Services, LLC (collectively, "Alutiiq") to provide Alutiiq's response to the draft of the above-referenced audit report (the "Draft Report"). In this Draft Report, the Office of Inspector General ("OIG") found that Alutiiq "appears" to have violated the ostensible subcontractor rule in four separate contracts awarded to Alutiiq by the Department of Labor's Employment and Training Administration ("ETA"). The Draft Report then recommends that each of the four contracts at issue be referred to the Small Business Administration ("SBA") "for review and guidance on corrective action, if warranted." Alutiiq strongly disagrees with the findings and recommendation contained in the Draft Report for several reasons. First, the audit on which this report is based violates generally accepted government auditing standards. Second, properly performed, an audit would not have found apparent violations of the ostensible subcontractor rule in any of the four contracts at issue. Third, the recommendation to refer these four contracts to SBA for review is improper because such a review will have no practical effect. I address each of these points in detail below.

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2001 Sixth Avenue, Suite 3420 | Seattle, Washington 98121 | (206) 486-8900

Mr. Elliot P. Lewis  
July 17, 2014  
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**I. THE AUDIT ON WHICH THE DRAFT REPORT IS BASED VIOLATES GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS.**

The Draft Report claims to comply with generally accepted government auditing standards. It does not. Instead, the Draft Report violates generally accepted government auditing standards because it uses incorrect and insufficient criteria for the audit.

According to the Government Accountability Office (“GAO”), which establishes generally accepted government auditing standards:

*Auditors should identify criteria. Criteria represent the laws, regulations, contracts, grant agreements, standards, specific requirements, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations included in the report. Auditors should use criteria that are relevant to the audit objectives and permit consistent assessment of the subject matter.*<sup>1</sup>

Obviously, if incorrect criteria are used, the audit will be unable to correctly assess performance. That is precisely what happened here: the findings and recommendations are invalid because the audit relied on incorrect and insufficient criteria.

In this matter, the audit objective was to answer the question: “Did the practices of ResCare and the prime contractors it performed work for comply with federal procurement regulations?”<sup>2</sup> One aspect of that objective — and the primary focus of this audit — was a determination of whether the four contracts awarded by ETA to Alutiiq violated the ostensible subcontractor rule. The Draft Report identifies various statutes, regulations, and agency guidance materials as criteria. However, the sole criterion on which the Draft Report relies for its findings and recommendations regarding purported violations of the ostensible contractor rule is a single decision by the SBA’s Office of Hearings and Appeals (“OHA”), *Size Appeal of Alutiiq Educ. & Training, LLC*, SBA No. SIZ-5192, 2011 LEXIS 21 (2011) (hereinafter “Turner”).<sup>3</sup> By relying solely on that OHA decision, the Draft Report violates generally accepted government auditing standards

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<sup>1</sup> Government Accountability Office, GAO-12-331G, Government Accounting Standards (2011 Revision), ¶ 6.37 (emphasis added).

<sup>2</sup> Draft Report, Appendix A, p. 19.

<sup>3</sup> See Draft Report, pp. 4, 8-9, 11

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July 17, 2014  
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because the *Turner* decision, by itself, is an incorrect and incomplete statement of the law regarding the ostensible subcontractor rule.

There are a number of more recent and relevant OHA decisions addressing the ostensible subcontractor rule that must be considered if the audit is to comply with generally accepted government auditing standards, including, but not limited to: *Size Appeal of InGenesis, Inc.*, SBA No. SIZ-5436, 2013 SBA LEXIS 5 (2013); *Size Appeal of Roundhouse PBN, LLC*, SBA No. SIZ-5383, 2012 SBA LEXIS 75 (2012); *Size Appeal of Alutiiq Educ. & Training, LLC*, SBA No. SIZ-5371, 2012 SBA LEXIS 58 (2012) (hereinafter “*Serrato*”); and *Size Appeal of CymSTAR Servs., LLC*, SBA No. SIZ-5329, 2012 SBA LEXIS 29 (2012).<sup>4</sup> As discussed in detail below, the failure to include these and other OHA decisions as criteria in this audit has a profound impact on the findings and recommendations contained in the Draft Report. Indeed, because the audit failed to apply these criteria to the audit, the audit both fails to achieve its objective and violates generally accepted government auditing standards.

## II. WHEN PROPER CRITERIA ARE APPLIED, ALUTIIQ’S JCC CONTRACTS DO NOT VIOLATE THE OSTENSIBLE SUBCONTRACTOR RULE

The Draft Report wrongly concludes that Alutiiq’s relationship with its subcontractor, ResCare, at the four JCCs named in the Report “appeared” to have violated the ostensible subcontractor rule. In reaching this errant conclusion, the Draft Report not only disregards the current state of established law on the ostensible subcontractor rule but also overlooks the many crucial differences between the JCCs named in the Draft Report and the *Turner* JCC, the subject of the only case the auditors bothers to consult (i.e., *Turner*). The Draft Report presumes that the JCCs at issue are identical in all material respects to the *Turner* JCC, and that OHA’s ostensible subcontractor jurisprudence has not undergone any significant changes since 2011; both of those assumptions, however, are demonstrably incorrect. In fact, despite recent OHA decisions casting serious doubt on *Turner*’s validity, OIG seems oblivious to these important developments and bases its conclusion almost entirely on certain superficial similarities to that lone decision. As discussed herein, the substantial differences between the four JCCs at issue and the *Turner* JCC, especially when viewed in light of OHA’s more recent decisions, demonstrate that Alutiiq unquestionably did *not* violate the ostensible subcontractor rule.

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<sup>4</sup> The substantive impact of the failure to consider these and other relevant OHA decisions is discussed at Section II, *infra*.

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**A. The Draft Report Fails to Recognize a Critical Distinction in Comparing the Alutiiq JCC Contracts With the Turner JCC Contract: Alutiiq Provides Nearly All the Key Employees.**

The Draft Report completely disregards, without explanation, a critical difference between the JCCs at issue and the Turner JCC: that Alutiiq, not ResCare, provides virtually all of the key employees. OHA has “consistently held that among the *main considerations* in ostensible subcontractor analysis are which concern is *managing the contract and will be providing the key employees*.” *Size Appeal of Alutiiq Educ. & Training, LLC*, SBA No. SIZ-5371, 2012 SBA LEXIS 58, \*20 (2012) (hereinafter “*Serrato*”); see also *Protest of Alutiiq Pacific LLC*, No. 12-ODRA-00627, 2013 ODRA LEXIS 4, \*82-83 (2013) (“A primary factor to be considered in determining compliance with the ostensible subcontractor rule is which concern is managing the contract, and will be providing the key employees.”).

Given the importance OHA attaches to a prime contractor’s responsibility for providing key employees, it is therefore a glaring error for the Draft Report to fail even to *mention* this issue within the Report. The following differences between the Turner JCC and the four JCCs — none of which the Draft Report apparently even considered — strongly refute the Draft Report’s determination that Alutiiq likely violated the ostensible subcontractor rule:

- **Overall Percentage of Key Employees.** In *Turner*, OHA observed that “six of ten proposed key employees were employed by ResCare at the time of the proposal.” *Turner*, at \*20. By comparison, Alutiiq employs nearly all of the key employees at each of the JCCs at issue. For example, at the Cleveland JCC, ResCare employed only *one* of the ten proposed key employees at the time of the proposal.<sup>5</sup> Put another way, while ResCare would have accounted for 60 percent of the key personnel at the Turner JCC, ResCare accounted for just 10 percent of the key personnel at the Cleveland JCC, and Alutiiq thus employed the remaining *90 percent* of the key personnel.<sup>6</sup> The Draft Report completely ignores this distinction.

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<sup>5</sup> See Final Proposal for Cleveland JCC, Staff Resources (“SR”) at A2, A5. Alutiiq previously provided to OIG a copy of the cited materials via Alutiiq’s four letters to OIG, each dated January 21, 2014, which responded to OIG’s preliminary Statement of Facts for the contracts at issue and included the referenced documents as attachments.

<sup>6</sup> *Id.* The situation at the other JCCs was comparable, where Alutiiq employed all of the key employees except for the Career Development Services System Director. See Bamberg Final Proposal Revision (“FRP”) at 39; Westover SR at A2; Northlands SR at A2.

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- *Center Director.* One of OHA's main concerns in *Turner* was the fact that the proposed Center Director — the most senior contract position, with responsibility over all Job Corps Center operations — was a ResCare employee and not employed by Alutiiq. By comparison, Alutiiq employs the Center Director at all four of the JCCs at issue.<sup>7</sup> In fact, the employees with the greatest executive responsibility at the JCCs at issue — i.e., Center Director, Executive Assistant, and Deputy Center Director, who together oversee all facets of each contract — are *all* Alutiiq personnel.<sup>8</sup> The fact that Alutiiq provides all of these employees is a key difference between the Turner JCC and the JCCs at issue, but the Draft Report makes no mention of this distinction.
- *Most Highly Compensated Personnel.* In *Turner*, OHA noted that “two of the three most highly compensated proposed personnel (the Center Director and the Social Development director) are current ResCare employees.” *Turner*, at \*20. At all four of the JCCs at issue, on the other hand, the Social Development Director — in addition to the Center Director — is an Alutiiq employee.<sup>9</sup> Thus, unlike at the Turner JCC, these two highly compensated personnel are Alutiiq employees, not ResCare employees. The Draft Report again makes no mention of this important distinction.
- *Social Development Director.* As noted above, the Social Development Director at the JCCs at issue are employed by Alutiiq, not ResCare. Recent OHA decisions underscored the importance of that position. In *Serrato*, for instance, OHA found the prime contractor's employment of the Social Development Director was strong evidence that there was no violation of the ostensible subcontractor rule:

Serrato will also provide the Social Development Director, who will oversee the important residential program. It is clear that the purpose of the [Job Corps] Center is not merely academic training, but, in effect, the operation of a large educational institution providing support services in a safe setting and training the students in life skills as well as technical skills. The Social Development Director is clearly a key position.

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<sup>7</sup> See Cleveland SR at A2; Bamberg FRP at 39; Westover SR at A2; Northlands SR at A2. Although Alutiiq's original choice for the position of Center Director at the Westover JCC was a ResCare employee, he was not approved by Job Corps' Boston Regional Office so Alutiiq instead chose to transfer the Detroit JCC's Center Director (an Alutiiq employee) to the Westover JCC.

<sup>8</sup> Unlike the Cleveland and Westover JCCs, the relatively smaller Northlands and Bamberg JCCs do not have Deputy Center Directors, and Northlands has an Executive Secretary instead of an Executive Assistant.

<sup>9</sup> See Cleveland SR at A2; Bamberg FRP at 39; Westover SR at A2; Northlands SR at A2.

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*Serrato* at \*21. Despite the importance of this role, however, the Report, nonetheless, fails even to mention the fact that Alutiiq employs the Social Development Director at all four of the JCCs at issue.

In short, Alutiiq employs the overwhelming majority of key personnel at all of the JCCs at issue, in marked contrast to the JCC in *Turner*. The Draft Report, however, fails to recognize — let alone rebut — this distinction. Since one of the “main considerations in ostensible subcontractor analysis” is which concern “will be providing the key employees,” *id.* at \*20, this omission is particularly egregious. If the audit had examined the significant differences between the *Turner* JCC and the JCCs at issue, OIG would have come to the correct conclusion: that *Turner* is not factually on point and cannot support a finding that Alutiiq may have violated the ostensible subcontractor rule.

**B. The Draft Report Fails to Recognize Another Critical Distinction in Comparing the Alutiiq JCC Contracts With the *Turner* JCC Contract: Alutiiq’s Past JCC Experience.**

The Draft Report completely disregards — again, without explanation — another key consideration in the ostensible subcontractor rule analysis: Alutiiq’s experience in the subject area of the procurement, and, thus, its ability to perform the contract without undue reliance on the subcontractor. “Generally, a finding that an ostensible subcontractor will perform the primary and vital contract tasks is based upon a determination that the prime contractor lacks the ability to perform those tasks.” *Size Appeal of Logmet, LLC*, SBA No. SIZ-5155, 2010 SBA LEXIS 77, \*22 (2010) (emphasis added). A central issue is thus “whether the prime could not qualify for award of a contract without unusual reliance upon the qualifications or other assistance from a subcontractor.” *Size Appeal of Smart Data Solutions LLC*, SBA No. SIZ-5071, 2009 SBA LEXIS 78, \*50 (2009). The ostensible subcontractor rule generally will not apply unless “the prime has very little experience in the subject area of the procurement and the likely dollar value of the procurement is well outside of the experience range of the prime.” *Size Appeal of C&C Int’l Computers & Consultants, Inc.*, SBA No. SIZ-5082, 2009 SBA LEXIS 93, \*34 (2009). Neither Alutiiq nor the four contracts at issue fit that description. To the contrary, Alutiiq possesses significant experience in the subject area of the procurements, and the dollar value of those contracts is well within Alutiiq’s experience range. The Draft Report overlooked the following relevant experience:

- ***Detroit JCC Experience.*** In *Turner*, OHA found that Alutiiq “relied almost entirely upon the experience of other entities to establish its relevant experience,” and that Alutiiq did not have “sufficient relevant experience to perform this contract.” See *Turner*, \*24. With respect to the four JCCs at issue, however, Alutiiq’s proposal set forth considerable prior relevant experience. All four of Alutiiq’s proposals

Mr. Elliot P. Lewis  
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highlighted AET's prior success at the Detroit JCC, where AET performed *all* of the relevant services. AET has provided academic, career technical, and career transition training at the Detroit JCC since 2008, more than three years before it was awarded any of the four contracts at issue. The work performed by these AET employees encompasses nearly all of the services that ResCare is providing at those JCCs. Although Alutiiq brought this experience to the auditor's attention, the Draft Report makes no mention of it whatsoever.

- *Flint/Genesee JCC Experience.* Alutiiq's proposals for the four JCCs at issue also highlighted its success at the Flint/Genesee JCC, where AET's affiliate, Alutiiq Professional Services, LLC ("APS"), performed all of the relevant services (including those that ResCare would perform under the four JCC contracts at issue).<sup>10</sup> The Draft Report again makes no mention of this experience.

Given Alutiiq's experience at the Detroit and Flint/Genesee JCCs, OHA's finding in *Turner* that Alutiiq "has no experience in most of the services to be provided under the contract" is simply untenable.<sup>11</sup> Any doubts expressed in *Turner* about the extent of Alutiiq's experience should have been dispelled by the past performance information contained in Alutiiq's proposals for the JCCs at issue. Since Alutiiq, in fact, possesses extensive experience in *all* subject areas of the procurement, and the dollar value of the procurement is well within its experience range,<sup>12</sup> the Draft Report's suggestion that Alutiiq was unduly reliant on ResCare is clearly unjustified. *See, e.g., C&C Int'l*, 2009 SBA Lexis 93, at \*34 (stating that it is "difficult to justify a finding of unusual reliance unless . . . the prime has very little experience in the subject area of the procurement and the likely dollar value of the procurement is well outside of the experience range of the

<sup>10</sup> In *Turner*, OHA disregarded Alutiiq's experience at the Flint/Genesee JCC based on the erroneous view that an affiliate's experience is irrelevant for purposes of the ostensible subcontractor rule. *Id.* at \*21-22. In a subsequent decision, however, OHA reaffirmed that an Alaskan Native Corporation—such as AET—may rely on the experience of its parent company and other affiliated entities to show that it possessed the requisite experience without violating the ostensible subcontractor rule, reasoning that such reliance fell within the exception to affiliation found in 13 C.F.R. § 121.103(b)(2). *See Size Appeal of Roundhouse PBN, LLC*, SBA No. SIZ-5383, 2012 SBA LEXIS 75, \*38-41 (2012) (citing *Size Appeal of Alutiiq International Solutions, LLC*, SBA No. SIZ-5098 (2009)).

<sup>11</sup> Notably, during Alutiiq's tenure, the Detroit and Flint/Genesee JCCs have gone from being two of the lowest scoring JCCs in the country to two of highest scoring. Indeed, before Alutiiq took over, the Flint/Genesee JCC was ranked dead last. *See, e.g., Cleveland Past Performance Submission* at 3 ("On March 1, 2004, Alutiiq and its subcontractor, ResCare, began operating the FGJCC. At the time, the center had an OMS ranking of 118 out of 118 centers and an overall rating of 74.5 percent."). Five years later, when Alutiiq submitted its proposal to operate the Cleveland JCC, the Flint/Genesee JCC was ranked 13<sup>th</sup> overall, and was 2<sup>nd</sup> in GED/High School Diploma completion. *Id.*

<sup>12</sup> The contract amounts for both the Flint/Genesee JCC (\$18,838,160) and the Detroit JCC (\$16,540,389) exceeds the base amount for three of the four JCC contracts at issue.

Mr. Elliot P. Lewis  
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prime”). Had the auditors properly examined Alutiiq’s prior experience at the Detroit and Flint/Genesee JCCs, they would have realized that Alutiiq was *not* unusually reliant upon ResCare for the four JCC contracts at issue.

**C. The Draft Report Fails to Recognize Another Critical Distinction in Comparing the Alutiiq JCC Contracts With the Turner JCC Contract: Management, Control & Operation of the JCCs.**

The Draft Report completely disregards yet another critical difference between the JCCs at issue and the Turner JCC: that Alutiiq manages the prime contract, and its subcontractor’s personnel remain firmly under Alutiiq’s supervision and control. Such responsibilities are critical for purposes of ostensible subcontractor analysis. *See, e.g., Size Appeal of InGenesis, Inc.*, SBA No. SIZ-5436, 2013 SBA LEXIS 5, \*43 (2013) (citation omitted) (finding that ostensible subcontractor rule did not apply where prime contractor managed the subcontractor and the subcontractor remained “under the supervision and control of the prime contractor”). Even where the prime contractor utilizes a large number of rank-and-file and even key employees from a subcontractor, that “may be insufficient to establish the existence of an ostensible subcontractor relationship *if other facts show all control and decision making responsibility reside with the prime contractor.*” *Alutiiq Pacific*, 2013 ODRA LEXIS 4, \*83 (emphasis added) (citing *Size Appeal of J.W. Mills Mgmt., LLC*, SBA No. SIZ-5416, at 8 (2012)). Accordingly, OHA holds that the ostensible subcontractor rule is generally not implicated as long as the general contractor controls the procurement and appropriately manages the project as a prime contractor:

[The subcontractor] is performing a majority of the work on these contracts. However, [the prime contractor] is also performing a substantial amount of the work and *does not seem to be merely a ‘front’* for [the subcontractor]. The Board precedents do not indicate that [the prime] must perform a majority of the work *if it is actually controlling the procurement and acting as the prime contractor.*

*See Size Appeal of Swepeco Corp.*, SBA No. 1449, 1981 SBA LEXIS 42, \*6 (1981) (emphasis added).

Alutiiq’s role in the operation and management of the four JCCs differs from its role under the Turner JCC proposal, where ResCare employed the Director of Operation and would have played a considerable role in the operation and administration of the JCC through key personnel. On the other hand, Alutiiq’s proposals for the contracts at issue clearly show that at the four JCCs named in the Draft Report Alutiiq — and not ResCare — is fully in charge: Alutiiq, not ResCare, manages the contracts, and “control and

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decision making responsibility” reside with Alutiiq, not ResCare. At each of the four JCCs, the Center Director — an *Alutiiq employee* — reports directly to the Director of Operations of Alutiiq Youth Services (“AYS”),<sup>13</sup> who in turn reports to AYS’s Vice President of Operations.

The Draft Report neglects to consider Alutiiq’s chain of command or management structure, nor does the Draft Report indicate how ResCare’s participation as a subcontractor under the contracts would allow ResCare to control the performance of the contract or of Alutiiq. Alutiiq — not ResCare — is in charge, with the sole power to exert control over the project itself. Indeed, since its inception, AET’s and APS’s one and only line of business has been to operate Job Corps centers, and the experience they bring is a substantial factor in the success of the Job Corps centers they manage. AET and APS are simply not the passive, pass-through entities that the ostensible subcontractor rule was meant to prevent.

**D. Draft Report Fails to Recognize the Importance of Alutiiq Utilizing a Small Percentage of ResCare Employees for the JCC Contracts.**

The Draft Report fails to recognize another important factor that strongly weighs against an ostensible subcontractor finding: the fact that ResCare provides only a small percentage of the employees under the JCC contracts, with Alutiiq instead employing the vast majority. The ostensible subcontractor rule is generally inapplicable where the subcontractor performs well under half of the contract work. *See InGenesis*, 2013 SBA LEXIS 5, \*33-34 (finding ostensible subcontractor rule inapplicable where subcontractor employed just under half of employees); *Size Appeal of TCE Inc.*, SBA No. SIZ-2008-09-05-119, 2008 SBA LEXIS 152, \*22 (2008) (same). In fact, OHA has held that, even in cases where the subcontractor is performing a greater percentage of the work, this does not in and of itself warrant a determination that the ostensible subcontractor rule has been violated. In *Size Appeal of Pavco, Inc.*, SBA No. SIZ-1542, 1982 SBA LEXIS 15 (1982), 75 percent of the contract was subcontracted and yet no affiliation was found. Similarly, OHA has found no unusual reliance upon a subcontractor, and hence no violation of the ostensible subcontractor rule, where a subcontractor performed up to 80 percent of the contract. *Size Appeal of Swepco Corp.*, SBA No. 1449, 1981 SBA LEXIS 42 (1981); *see also Size Appeal of Contra Costa Elec., Inc.*, SBA No. SIZ-1142 (1978) (no unusual reliance even though subcontractor performed 73 percent of the contract).

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<sup>13</sup> AYS is the division of Alutiiq, LLC that oversees AET’s and APS’s Job Corps contracts. *See* <https://www.alutiiq.com/capabilities/youth-services/>.

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In this regard, it is important to note that, at all four of the JCCs at issue, Alutiiq employs no less than 65% of the employees. At the Bamberg JCC, for example, Alutiiq's proposal indicated that ResCare would fill only 22.49 percent of the positions (23.0/102.27).<sup>14</sup> The percentage of work being performed by ResCare is thus much smaller than the percentage performed in the OHA decisions noted above and in other, similar cases where OHA found that the prime contractor was *not* unusually reliant upon the subcontractor. Furthermore, as discussed previously, Alutiiq both manages and supervises the work performed by its and ResCare's employees. As a result, the Draft Report's conclusion that Alutiiq is unduly reliant upon ResCare — when ResCare is performing a relatively small percentage of the overall work and employs a relatively small percentage of the overall employees — is incorrect.

**E. The Draft Report Fails to Recognize Another Critical Distinction in Comparing the Alutiiq JCC Contracts With the *Turner* JCC Contract: The Presumptive Validity of the Award.**

The Draft Report also fails to consider the fact that, unlike in *Turner*, the contracting officer has already awarded the JCC contracts at issue, and Alutiiq has been performing them for years. Although a contracting officer may take action even after contract award, federal regulations presume the validity of the award once it is made. See FAR 19.302(g)(2) (stating that "if an award was made before the time the contracting officer received notice of the appeal, the contract shall be presumed to be valid"); *Chapman Law Firm v. United States*, 63 Fed. Cl. 25, 36-37 (Fed. Cl. 2004) (noting presumption of validity following contract award). This presumption promotes the recognized interest of allowing contractors "to begin work on a Government project without fear of post-award rescission." See *Taylor Consultants, Inc. v. United States*, 90 Fed. Cl. 531, 544 (Fed. Cl. 2009); see also *Mid-West Constr., Ltd v. United States*, 181 Ct. Cl. 774, 387 F.2d 957, 963 (Ct. Cl. 1967) (recognizing "the serious risk of after-award cancellations resulting from the Government's interpretation of the regulation would not only be detrimental to contractors but would work to the disadvantage of the Government's procurement activities").

The Draft Report fails to account for this presumption of validity. Such a presumption — especially in light of the other key differences discussed above — further refutes the Draft Report's finding that Alutiiq may have violated the ostensible subcontractor rule based on the mistaken impression that that the four JCCs at issue and the *Turner* JCC are sufficiently comparable. They clearly are not.

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<sup>14</sup> Bamberg FRP at 39. ResCare currently fills just 19.56% of the positions at the Bamberg JCC. See 2013 Bamberg Organization Chart.

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**F. The Draft Report Fails to Recognize Significant Developments in the Law Following the *Turner* Decision.**

As discussed above, the Draft Report relies exclusively upon a single OHA decision from 2011 (i.e., *Turner*), which has since been modified by subsequent decisions. Nevertheless, the Draft Report makes no mention of any decisions subsequent to *Turner* and fails to recognize how the applicable law has changed since *Turner* was decided. In fact, several recent OHA decisions have addressed the ostensible subcontractor rule with respect to various Alutiiq entities. See *Alutiiq Pacific*, 2013 ODRA LEXIS 4; *Serrato*, 2012 SBA LEXIS 58. Despite the obvious relevance of such decisions, however, the Draft Report fails even to reference them. As discussed below, these and other OHA decisions demonstrate that the four JCC contracts at issue do not violate the ostensible subcontractor rule.

*1. The Three Factors Required For An Ostensible Subcontractor Finding are Not All Satisfied.*

Since OHA's decision in *Turner*, a number of cases have clarified that many of the factors discussed in *Turner* are no longer relevant, or are at least less important than other factors. As noted in a decision from 2013, an ostensible subcontractor relationship will more likely be found when the facts show a subcontractor will exercise substantial control over the project due to the following:

- (1) the use of the subcontractor's personnel in key positions,
- (2) the use of substantial numbers of subcontractor personnel in rank and file positions,
- and (3) the use of the subcontractor to perform work that is 'primary and vital' to contract performance.

*Protest of Alutiiq Pacific LLC*, No. 12-ODRA-00627, 2013 ODRA LEXIS 4, \*80-81 (2013) (citation omitted). In fact, a recent OHA decision —written by the same judge who decided *Turner* —has clarified that “the holding in [*Turner*] was based upon all three factors, *taken together*, not merely upon the fact that the challenged concern was subcontracting the training function.” *Serrato*, 2012 SBA LEXIS 58, \*25 (emphasis added) (finding that the ostensible subcontractor ruling did not apply because — unlike in *Turner* — “all three factors are not present in this case”).

Another post-*Turner* decision clarified that the ostensible subcontractor is considered inapplicable where, as here, a contractor has previously demonstrated the ability to perform the contract, will handle the majority of the overall work, and will manage the contract. See, e.g., *Size Appeal of CymSTAR Servs., LLC*, SBA No. SIZ-5329,

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2012 SBA LEXIS 29, \*32 (2012) (“Where a concern has the ability to perform the contract, will perform the majority of the work, and will manage the contract, the concern is performing the primary and vital functions of the contract, and there is no violation of the ostensible subcontractor rule.”).

As in *Serrato* — and unlike in *Turner* — all three of the primary factors are not present with respect to the four JCCs at issue: Alutiiq has extensive experience in the subject area of the procurement, and it provides nearly all of the key employees. As a result, at most, only *one* of the three factors noted in *Turner* is even potentially present, which precludes application of the ostensible subcontractor rule.

## 2. *Serrato & The Analysis of Primary and Vital Contract Functions*

The conclusion set forth in the Draft Report that Alutiiq’s relationship with ResCare at the four JCCs may have violated the ostensible subcontractor rule is based almost entirely on the fact that ResCare performs most of the academic and career technical training. According to the Draft Report, Alutiiq did not perform “primary and vital” contract functions because “ResCare personnel would have comprised the majority of the staff for academics and career technical tasks.”<sup>15</sup> The Draft Report, however, takes an overly narrow — and improper — view of the “primary and vital requirements” of the contract, especially in light of recent OHA decisions discussed below. Contrary to the Draft Report’s determination, Alutiiq did indeed perform “primary and vital” functions at the four JCCs at issue; specifically, its operation of the JCCs, its provision of support services in a safe setting, its training of students in life skills, and its performance of the social development component of the contracts.

Among other flaws, the Draft Report’s conclusion overlooks the significance of the OHA’s 2012 *Serrato* decision. In *Serrato*, OHA analyzed a JCC contract proposal and effectively overruled *Turner*’s holding concerning the primary and vital requirements of a JCC. The OHA ruled in *Serrato* — one year after its decision in *Turner* — that “the purpose of the [Job Corps] Center is not merely academic training, but, in effect, *the operation of a large educational institution providing support services in a safe setting and training the students in life skills as well as technical skills.*” 2012 SBA LEXIS 58, \*21 (emphasis added). Contrary to the holding in *Turner* (and the implication of the Draft Report), requirements such as providing training in life skills, support services, and maintaining a safe setting are not mere “ancillary tasks” but are instead primary and vital components of the JCC contracts. Compare *Turner*, 2011 LEXIS 21, at \*35, with *Serrato*, 2012 SBA LEXIS 58, \*21-25. Alutiiq alone is responsible for such services at all four of

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<sup>15</sup> Draft Report at p. 10.

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the JCCs at issue, and there is thus no reason to believe that OHA would today hold that Alutiiq is not performing the contract's primary and vital requirements.

As discussed previously, Alutiiq manages, controls, and operates the JCCs with its own employees; the role of ResCare, in contrast, is quite limited with respect to the overall management and operation of the JCCs. Further, the JCCs are *residential* centers, and the residential living component of the contract — as provided by Alutiiq, not ResCare — is vital to the operation of the contracts. Additionally, Alutiiq, not ResCare, provides the “support services” essential to the operation of such a large educational institution, and it is Alutiiq that ensures the safety of that setting.<sup>16</sup> Alutiiq, not ResCare, also provides training in “life skills” to the students at the JCCs in order to complement their newly-acquired technical skills.<sup>17</sup> Indeed, although the Draft Report focuses entirely on the academic and career technical training, the solicitation for the JCC contracts identifies various other vital components (all of which are performed by Alutiiq):

- Provide social, employability and independent living skills training.
- Provide health care, counseling, and other support services on an individualized needs basis.
- Conduct program operations in a setting that is clean, well maintained, and safe.
- Provide support that prepares graduates to maintain long-term attachment to the labor market or educational opportunities.
- Integrate center operations with the local workforce development systems, employers, the business community, and community-based organizations.<sup>18</sup>

The Draft Report, however, provides no consideration of Alutiiq's operation of the JCCs, its performance of the foregoing components, or how such services compare to the services provided by the prime contractor in *Serrato*. Such consideration is critical for purposes of analyzing the “primary and vital” functions of the JCCs, and the Draft Report's exclusive focus on academic and career technical training to the exclusion of other equally vital functions performed by Alutiiq is clearly improper in light of *Serrato*.

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<sup>16</sup> See Cleveland SR at A2; Bamberg FRP at 39; Westover SR at A2; Northlands SR at A2.

<sup>17</sup> *Id.*

<sup>18</sup> See, e.g., Contract No. DOLJ10QA00002 at 6 (Westover JCC Contract).

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Furthermore, the Draft Report’s analysis overlooks another “primary and vital” function Alutiiq provides: Alutiiq is also solely responsible for the social development component of the contract, which OHA has held to be no less important than the academic and career technical training components. In *Serrato*, OHA expressly rejected the argument that a prime contractor that had subcontracted the academic training portion of a JCC contract would not be performing the contract’s primary and vital requirements. OHA observed:

Serrato [the prime contractor] will be performing entirely the Social Development portion of the contract, not merely providing a clean and safe facility, but teaching students to become stable, contributing and productive employees. Most of the students will be residential students and receive, while residents, *comprehensive training to learn self-management, personal responsibility, and community and independent living skills*. The counseling from the Resident Advisors, and the recreational activities are all designed to assist the students in their career and personal development. *This is an important part of the contract*, and Serrato will provide 50 employees to perform it. Accordingly, it is not true that HYS’s performing the academic training means that Serrato is not performing the primary and vital functions of the contract.

*Id.* at \*24-25 (emphasis added). OHA thus does not consider the Social Development component of a JCC contract to be ancillary; on the contrary, *Serrato* makes it clear that such services are primary and vital contract functions — yet the Draft Report neglects them entirely in analyzing the JCC contracts at issue.

Since Alutiiq, like the prime contractor in *Serrato*, is not only providing support services at the JCCs but also “performing entirely the Social Development portion of the contract,” Alutiiq is unquestionably performing primary and vital contract functions. Indeed, Alutiiq also operates and manages the JCCs, provides the key employees, provides the overwhelming majority of the employees, performs support services, runs the residential program, and provides other important services under the JCC contracts. In light of the breadth of its role, it is clearly erroneous for the Draft Report to find that Alutiiq appears unusually reliant on its subcontractor and may not be performing primary and vital functions. Instead, a complete analysis of Alutiiq’s role under the contracts at issue and recent OHA jurisprudence results in a clear and obvious conclusion: there is no legal or factual support for the Draft Report’s finding that ResCare may be an ostensible subcontractor under any of the four JCC contracts reviewed, and the Draft Report errs in so finding.

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**III. REGARDLESS OF THE OUTCOME, A POST-AWARD DETERMINATION BY THE SBA REGARDING THE OSTENSIBLE SUBCONTRACTOR RULE WILL HAVE NO PRACTICAL EFFECT AND IS THUS IMPROPER.**

The Draft Report recommends that ETA approach the SBA “for review and guidance” regarding a potential violation of the ostensible subcontractor rule. SBA regulations state that post-award protests are rarely considered and are only appropriate where a protest would have “a practical effect” or be “meaningful.” As set forth by SBA’s regulations, in pertinent part:

SBA will not normally consider a post award protest. SBA may consider a post award protest in its discretion *where it determines that a protest decision after award would have a practical effect (e.g., where the contracting officer agrees to terminate the contract if the protest is sustained).*

13 CFR 124.1008; *see also* 48 CFR 19.305(d) (“SBA may consider a postaward protest in its discretion where it determines that an SDB determination after award *is meaningful* (e.g., where the contracting officer agrees to terminate the contract if the protest is sustained).”) (emphasis added).<sup>19</sup> The Draft Report’s recommendation, therefore, is premature and omits a preliminary question that ETA should address before it requests a determination from the SBA: whether an ostensible subcontractor violation, if found, will actually have any practical effect. Even if the JCC contracts violated SBA size requirements, such outcome will prove inconsequential (and a waste of time and resources) if the ETA Contracting Officer nevertheless elects not to terminate the contracts and/or the Government is unable to recover any resulting damages. In fact, under such circumstances, post-award involvement of the SBA is not only a wasteful endeavor but may also be legally improper.

Accordingly, before recommending that ETA involve the SBA in a post-award ostensible subcontractor determination, the Draft Report should have recommended that ETA first consider whether its contracting officers would actually elect to terminate the JCC contracts in the event that any filed protests are ultimately sustained, or whether the Government has any reasonable means to potentially collect damages from Alutiiq if a violation is found. If not, a post-award protest is of no practical effect and, as discussed below, would be wasteful and improper for ETA to pursue (or for the SBA to consider).

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<sup>19</sup> Although this provision is specific to Small Disadvantaged Business (“SDB”) determination, the “no practical effect” rule is equally applicable to size protests and other similar SBA protests.

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**A. Regardless of Any Ostensible Subcontractor Violation, the Contracting Officer Has Discretion in Whether to Terminate an Ongoing Contract.**

Before filing a post-award protest with the SBA (or otherwise requesting a determination from the SBA regarding potential size issues), ETA should consider whether — even if the SBA believes that the JCC contracts may have violated the ostensible subcontractor rule — its contracting officers would actually consider terminating the JCC contracts at issue. Regardless of whether the JCC contracts were improperly awarded, SBA regulations set forth that the Contracting Officers have discretion to terminate the contracts or allow the contracts to proceed according to their terms:

When a concern is found to be other than small under a protest concerning a size status representation made in accordance with the clause at 52.219-28, Post-Award Small Business Program Representation, a contracting officer may permit contract performance to continue, issue orders, or exercise option(s), because the contract remains a valid contract.

48 CFR 19.302(k). In light of the fact that the JCC contracts will be nearly or fully complete by the time that any final determination is reached (by the SBA and/or OHA), the Contracting Officer may decide that — irrespective of the outcome — the JCC contracts are already too far along to warrant termination and solicitation of a new contractor. Similarly, the Contracting Officer may determine that, because Alutiiq has performed well under the contracts and a change at this stage of the contracts will disrupt the JCCs, termination is not advisable. Under either scenario, the outcome of a post-award protest to SBA would thus be of no consequence, rendering any such protest or post-award determination of no practical effect.

Indeed, post-award protests filed by a contracting officer are exceedingly rare, especially where the concern has already begun performance under the contract. In the last 30 years, OHA decisions reflect that there have been only 17 post-award protests filed by contracting officers involving the ostensible subcontractor rule, and *none* of these protests were filed more than a few days after contract award (whereas, by comparison, Alutiiq has been performing the JCC contracts for *years*). A decision by ETA to effectively pursue a protest at this stage of the contracts at issue would thus not only be unwarranted but also unprecedented.

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**B. Regardless of Whether ResCare Was an Ostensible Subcontractor, the Government Cannot Recover Any Damages Against Alutiiq In Light of Applicable Safe Harbor Provisions.**

Section 1341 of the Small Business Jobs Act of 2010 creates the so-called “Presumed Loss Rule,” which establishes “a presumption of loss to the United States based on the total amount expended on the contract, . . . whenever it is established that a business concern . . . willfully sought and received the award by misrepresentation” of size status. Although the Draft Report does not expressly refer to the Presumed Loss Rule, the Draft Report implies that the Rule is potentially applicable by making the following statement: “[i]f SBA determines any of these 4 contracts-subcontracts violated the ostensible subcontractor rule, up to \$126.5 million in government funds set aside for small businesses were not used as intended.” (Draft Report at p. 5.) The Presumed Loss Rule, however, is *not* applicable to any of the JCC contracts; to the extent that the Draft Report asserts that the Government may recover damages against Alutiiq under the Presumed Loss Rule, such belief is false in light of recently-enacted SBA regulations that effectively create a safe harbor for contractors such as Alutiiq.

On August 27, 2013, the SBA issued regulations implementing a limitation of liability provision that sets forth various exceptions under which the Presumed Loss Rule would not apply. According to these recently-enacted regulations, the Presumed Loss is inapplicable in cases of “*unintentional errors, technical malfunctions, and other similar situations that demonstrate that a misrepresentation of size was not affirmative, intentional, willful or actionable.*” 13 C.F.R. § 128.108(d) (emphasis added). As a result, even where a contractor is found to violate the ostensible subcontractor rule, the Presumed Loss Rule would have no effect where the contractor’s violation was neither intentional nor willful.

Here, there is no evidence whatsoever that Alutiiq intentionally misled the Contracting Officer, or that Alutiiq had any indication when it submitted its proposals for the contracts in question that it might be in violation of the ostensible subcontractor rule. The lack of any such recognition seems readily apparent considering that (i) the decision in *Turner* was issued after Alutiiq had already submitted its proposals, and (ii) Alutiiq fully (and accurately) disclosed the role of ResCare under each and every proposal. In fact, the evidence cited in the Draft Report contradicts any finding that Alutiiq’s willfully violated this rule. As noted specifically in the Report, Alutiiq fully disclosed to ETA the proposed subcontracting relationship with ResCare in all four of the JCCs at issue.

Accordingly, the evidence and factual background identified by the Draft Report can support only the following two possibilities: (1) that Alutiiq interpreted the

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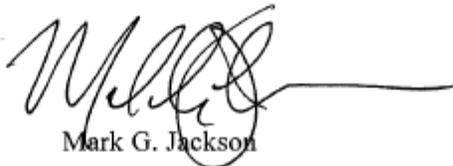
requirements of the ostensible subcontractor rule differently than does the Draft Report; and/or (2) that even though the *Turner* decision had not yet been issued, Alutiiq reasonably believed that no matter how *Turner* was decided the relationship it proposed with ResCare with respect to the four JCCs at issue was substantially different than its relationship with ResCare under the *Turner* proposal. Either way, neither of these two possibilities supports application of the Presumed Loss Rule, and the Presumed Loss Rule is thus inapplicable and irrelevant to the JCC contracts regardless of whether an ostensible subcontractor violation occurred.

Since the Government is therefore unable to recover any damages from Alutiiq, irrespective of any size violation, filing a protest with the SBA on this issue would be of no consequence and a waste of time and resources. Moreover, as noted previously, the SBA generally does not consider or recommend post-award protests that would be of no “practical” or “meaningful” effect. *See* 13 CFR 124.1008; 48 CFR 19.305(d). Absent the potential recovery of any damages, there is simply no “practical” or “meaningful” reason for ETA to seek a determination from the SBA concerning potential ostensible contracting violations. The Draft Report recommendation that ETA seek such a post-award determination is therefore ill-advised.

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In conclusion, the Draft Report violates generally accepted government auditing standards, and, for that reason alone, should be ignored. Indeed, even if properly performed, an audit would not have found apparent violations of the ostensible subcontractor rule in any of the four contracts in light of the current state of the law and the salient differences between the four JCCs at issue and the *Turner* JCC. Moreover, the recommendation to refer these four contracts to SBA for review is improper because such a review will have no practical effect. For any and all of those reasons, as discussed above, the findings and recommendations of the Draft Report are improper and incorrect — and should be ignored.

Sincerely,



Mark G. Jackson

cc: Amy Shimek, Afognak Native Corporation & Alutiiq, LLC

**Appendix F**

**Acknowledgements**

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Key contributors to this report were Ray Armada (Audit Director), Heather T. Atkins (Audit Manager), Jesse G. Blatz and Michael A. Towne (Auditors), and Carolyn Cayode-Gorman (OIG Assistant Counsel).

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