

January 2009

EMBASSY CONSTRUCTION

Additional Actions Are Needed to Address Contractor Participation





Highlights of [GAO-09-48](#), a report to congressional committees

Why GAO Did This Study

To provide safe and secure workplaces for overseas posts, the Department of State (State) has built 64 new embassy compounds (NEC) and other facilities since 1999, has 31 ongoing projects, and plans to build at least 90 more. In 2007, State reported the U.S. contractor pool for building NECs had reached its limit and proposed legislation to amend the criteria to qualify for NEC awards. GAO was asked to examine (1) how contractor participation in the NEC program changed in recent years, (2) the degree to which State assessed the need for and potential outcomes of its proposed amendment, (3) factors contractors consider when deciding to participate in the program, and (4) actions State has taken to address reported declines in contractor participation. GAO examined two indicators of contractor participation; reviewed State documents and proposed legislation; and interviewed State officials and U.S. firms that won NEC awards from 2001-2007.

What GAO Recommends

GAO recommends the Secretary of State systematically review the adequacy of the NEC contractor base, the benefits and risks of its proposed legislation, and how it would mitigate the risks. State commented that the contractor base is adequate but could benefit from expansion, and that a recent revision of its legislative proposal removes the need for a cost-benefit analysis. GAO believes the recommendation is still valid.

To view the full product, including the scope and methodology, click on [GAO-09-48](#). For more information, contact Jess T. Ford at (202) 512-4128 or fordj@gao.gov or Terrell G. Dorn at (202) 512-6923 or dornr@gao.gov. To view the e-supplement online, click on [GAO-09-47SP](#).

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What GAO Found

State received at least two bids—the legislatively specified minimum for adequate competition—for 60 of the 61 NEC projects it awarded from 1999-2008, and received three or more bids for at least 49 of the 61. Nonetheless, there was a statistically significant decline in the number of bids per NEC project from 2002 to 2008. GAO also found that the number of firms prequalified to bid on NEC projects also declined during this period. While many factors could affect contractor participation, GAO found the declines in the number of prequalifying firms and bids received were due, in part, to rising construction costs, which made it more difficult for some firms to meet qualification criteria. In addition, officials from five firms cited insufficient profits and State management practices as reasons for their recent withdrawals from the program.

State has not systematically assessed the need for, or the possible outcomes of, its legislative proposal that would open competition for NEC awards to construction firms that cannot meet current qualification criteria. Although State identified several factors it believed reduced contractor participation, it has not assessed whether a sufficient number of contractors capable of meeting current requirements exists or how its legislative proposal would affect the NEC program. Specifically, State has not assessed the potential benefits or identified the potential risks of its legislative proposal, and has not stated how the risks would be mitigated. Absent these analyses, it is unclear whether the proposed amendment, including its December 2008 revision, would benefit State's embassy construction program.

Contractors interviewed by GAO cited various incentives and challenges that affected their decision to participate in the NEC program. Although making profits was cited as the primary incentive for participating, contractors reported losing money on 42 percent of the contracts they performed. Contractors also cited several significant challenges that affected their decisions to submit contract proposals, including meeting State's shortened construction schedules, supplying labor and material to remote locations, finding and retaining cleared American workers, managing financial constraints, and dealing with foreign governments. Firms also expressed concerns with State's processes, including unclear solicitation documents and contract requirements, laborious design reviews, and State's 2001 decision to end formal partnering relationships with contractors.

State has made several recent efforts to encourage contractors' participation in the NEC program. State has begun new outreach efforts to improve relations with contractors, and undertaken several changes to its management practices and organizational structures, including lengthening project schedules, improving clarity of contract requirements, and establishing a project management group to provide coordination and oversight throughout each phase of a project. While these changes address some contractor complaints, their full effects may not be apparent for a number of years.

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Abbreviations

| | |
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| AGC | Association of General Contractors of America |
| CAC | compound access control |
| COR | Contracting Officer's Representative |
| ENR | Engineering News Record |
| FAC-P/PM | Federal Acquisition Certification for Program and Project Managers |
| FAR | Federal Acquisition Regulations |
| FE/BR | forced entry/ballistic resistant |
| GSM | gross square meters |
| IOB | interim office building |
| LROBP | Long-Range Overseas Buildings Plan |
| MSGQ | Marine Security Guard Quarters |
| NAB | newly acquired building |
| NCC | new consulate compound |
| NEC | new embassy compound |
| NOB | new office building |
| NOX | new office annex |
| OBO | Bureau of Overseas Buildings Operations |
| OMB | Office of Management and Budget |
| PDC | Project Development and Coordination Division |
| PCS | Office of Program Coordination and Support |
| PRE | Office of Planning and Real Estate |
| REA | request for equitable adjustment |
| RFP | request for proposals |
| SED | Standard Embassy Design |
| SSMC | Standard Secure Mini Compound |
| USAID | U.S. Agency for International Development |

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United States Government Accountability Office
Washington, DC 20548

January 16, 2009

The Honorable John F. Kerry
Chairman
The Honorable Richard G. Lugar
Ranking Member
Committee on Foreign Relations
United States Senate

The Honorable Howard L. Berman
Chairman
The Honorable Ileana Ros-Lehtinen
Ranking Member
Committee on Foreign Affairs
House of Representatives

Following the 1998 terrorist bombings of the U.S. Embassies in Nairobi, Kenya, and Dar es Salaam, Tanzania, which killed 220 people and injured thousands more, the Department of State (State) began an unprecedented effort to replace more than 180 overseas diplomatic facilities. From 1999-2008, State awarded contracts worth approximately \$5.8 billion to construct new embassy and consulate compounds (NEC) and diplomatic annexes at 79 overseas posts, with the majority of these facilities being built under management and construction reforms first implemented in 2001.¹ State reported that, as of December 2008, it had constructed 64 new embassies, consulates, and annexes; had another 31 projects under way; plans to construct 90 more facilities from 2009 to 2023; and, after 2023, would need to replace facilities at approximately 50 overseas posts. However, in the summer of 2007, State's Bureau of Overseas Buildings Operations (OBO) told several congressional committees that the current pool of American contractors qualified and able to carry out diplomatic construction projects overseas had nearly reached its capacity and that the subsequent reduced competition for contracts would result in increased contract costs. To increase competition for NEC contracts, State proposed legislation to amend the Omnibus Diplomatic Security and Antiterrorism Act of 1986 to give State the discretion to allow more participation by

¹GAO, *Embassy Construction: State Department Has Implemented Management Reforms, but Challenges Remain*, [GAO-04-100](#) (Washington, D.C.: Nov. 4, 2003).

construction firms which currently cannot meet the qualifying criteria for NEC awards.²

At your request, this report addresses the status of the contractor base for State's embassy construction program, including: (1) how contractor participation in the NEC program has changed in recent years, (2) the degree to which State has assessed the need for or potential outcomes of its proposed amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986, (3) factors that affect contractors' decisions to participate in the program, and (4) actions State has taken to address the reported decline in the number of contractors willing to participate in the program.

To complete our review, we examined two indicators of contractor participation in the NEC program: (1) the number of companies prequalifying to bid on projects per year from 2002-2008 and (2) the number of firms that submitted bids on NEC projects from 2002-2008.³ These two indicators help to measure contractors' willingness to participate in State's program since both prequalifying for and bidding on contracts require active efforts on the contractor's part. We also reviewed State's proposed amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986, reviewed documents and interviewed State officials on analyses the agency conducted in support of the proposed amendment, and researched ongoing overseas construction operations of the 100 largest U.S. design-build construction firms.⁴ We determined that the data used to complete these analyses were sufficiently reliable for our purposes. To determine factors affecting contractors' decisions to participate in the program, we completed structured interviews with 17

²Where adequate competition exists, construction projects estimated at over \$10 million or that include technical security require that firms meet the definition of a U.S. person or U.S. joint-venture person to bid on a project. See 22 U.S.C. 4852.

³State utilizes a two-phase process for awarding construction contracts. In the first phase, prequalification, State certifies that companies interested in bidding for construction awards meet the legal, technical, and financial requirements associated with such projects. In the second phase, State reviews contract proposals from companies that submitted bids and awards the contract. Only companies certified as prequalified in the first phase may submit bids in the second phase.

⁴Ranking is based on 2007 revenues from design-build contracts where the project is designed and constructed by employees of the company in whole or in joint-venture partnership with other firms and subcontractors. See McGraw-Hill Construction, *Engineering News Record*, (June 9, 2008).

U.S. contractors awarded NEC or diplomatic annex construction contracts from 2001 to 2007 to obtain information about State's construction process and the incentives that encourage contractors to participate in the program.⁵ These contractors had completed, or were in the process of completing, a total of 78 separate construction contracts valued at approximately \$4 billion dollars.⁶ Finally, to assess actions State has taken to expand its NEC contractor base, we reviewed (1) reports on State's embassy construction program issued by GAO and State's Office of the Inspector General; (2) OBO's past six annual *Long-Range Overseas Buildings Plans*; (3) relevant laws and regulations, including the Omnibus Diplomatic Security and Antiterrorism Act of 1986, federal acquisition regulations, and State reports and decision memos; and (4) delivery methods and partnering policies employed by other federal agencies and supported by leading industry groups. We also attended OBO's quarterly Industry Advisory Panel meetings, met with State staff familiar with contracting and construction processes, and spoke with representatives of the Associated General Contractors of America and the American Council of Engineering Companies. This report does not contain all of the responses to our interview questions. The full responses to our questions can be viewed at [GAO-09-47SP](#).

We conducted this performance audit from October 2007 to January 2009, 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief

State documents show, and State officials reported, that from 1999 to 2008, the department received at least two bids for all but one of the 61 NEC projects awarded through a competitive process, and three or more bids

⁵We interviewed 17 of the 21 U.S. contractors awarded contracts to construct major diplomatic facilities from 2001-2007. See appendix I of this report for further details on our methodology.

⁶Although our census included only companies winning a NEC award from 2001 to 2007, some of these companies had received NEC contracts dating back to 1999. The contractors in our census represent more than 81 percent of the total value for NEC and related construction projects awarded from 1999 to 2007.

for at least 49 of the 61 awards.⁷ Despite generally having adequate competition for NEC projects, we found a statistically significant decline in the number of bids State received per NEC contract from 2002 to 2008. We also found that the number of firms per project prequalified to bid also declined during this period. Noticeable fluctuations occurred in both the annual average numbers of firms per project that prequalified to bid on NECs and bids received from 2002-2008, including a 69 percent decline (from 13 to 4) from 2006 to 2008 in the annual average number of prequalifying firms per project, and a 38 percent decline (from 5 to 3) from 2006 to 2008 in the annual average number of bids received per project.⁸ Many factors could have influenced the decline in contractor participation. Among them, we found that as State's estimated project costs increased, both the actual numbers of firms prequalifying for NEC awards and the actual number of bids received decreased. In addition, from 2006 to 2008, five firms—which, combined, built a total of 27 embassies, consulates, and annexes—reported they would no longer bid for OBO projects, citing as reasons insufficient profits and State's overall management of the program.

State has not systematically assessed the need for or possible outcomes of its proposed amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986. According to State, the proposed amendment is intended to expand competition for NEC awards to companies that currently cannot meet financial, technical, and security requirements prescribed by the Act. In October 2007, State identified for Congress several factors it believed discouraged contractors from participating in the program, such as the profitability of State's projects compared with other clients, the challenging and sometimes dangerous locations of NEC projects, the high cost of skilled American workers with security clearances, dissatisfaction with firm, fixed-priced contracts, and the then

⁷Data on the number of bids received were unavailable for the Baghdad, Iraq; Kabul, Afghanistan; and Luanda, Angola; projects. The Dushanbe, Tajikistan, project was excluded from the analysis because it was originally awarded as a sole source contract.

⁸These analyses focus only on projects labeled as NECs, new consulate compounds (NCC), and new office buildings (NOB). We excluded projects labeled by State as interim office buildings (IOB), newly acquired buildings (NAB), new office annexes (NOX), and standard secure mini compounds (SSMC). In addition to excluding the NEC projects for Baghdad, Iraq; Dushanbe, Tajikistan; Kabul, Afghanistan; and Luanda, Angola; we excluded 9 additional NEC projects awarded from 1999-2001 and the 2002 NEC projects for Abidjan, Cote d'Ivoire, due to unreliable or missing data on the number of prequalifying firms per NEC project or the number of bids submitted per NEC project. As a result, there were 48 total projects included in these analyses.

relatively robust domestic construction market. However, State has completed no systematic analyses that demonstrate whether a sufficient number of contractors capable of meeting current requirements exist or how its legislative proposal would affect the NEC program. Specifically, State has not assessed the potential benefits or identified the potential risks of its legislative proposal, and has not stated how the risks would be mitigated. Absent these analyses, it is unclear how the proposed amendment would affect State's embassy construction program.

Contractors we interviewed cited various incentives and challenges that affect their decision to participate in the NEC program, including the potential for profits, the risks associated with NEC projects, and State's overall management of the program.⁹ Most contractors indicated that making a profit was the strongest incentive for participating in State's NEC projects; however, most contractors we interviewed stated that their profits on State projects were not commensurate with the risks of building in challenging overseas locations. For example, contractors reported they lost money on 22 of the 53 completed NEC and annex projects and broke even on two other projects. In addition, more than three-quarters of the contractors reported they lost, or expected to lose, money on at least one project. Contractors also cited several significant challenges that affect their decisions to submit contract proposals, including meeting OBO's shortened construction schedules; supplying material to remote locations; finding and retaining cleared workers; managing financial constraints, such as currency fluctuations, material cost escalation, and performance bonding; and dealing with foreign governments. In addition, although State has made a number of changes to the construction processes, resulting in a greater number of projects being completed in less time than in past embassy construction programs,¹⁰ these reforms may have diminished incumbent contractors' willingness to continue participating in the NEC program. For example, firms indicated that they cannot meet the reduced construction schedules due to unclear solicitation documents and contract requirements, laborious design reviews, and State's 2001 decision to end formal partnering with contractors.¹¹ As a result, 14 of the 17 firms we

⁹See appendix I for details of our methodology.

¹⁰GAO, *Embassy Construction: State Has Made Progress Constructing New Embassies, but Better Planning Is Needed for Operations and Maintenance Requirements*, [GAO-06-641](#) (Washington, D.C.: June 30, 2006).

¹¹Partnering is an agreement in principle between a contractor and the government to share risks, promote favorable attitudes, and create a cooperative environment.

interviewed rated State's management of the NEC program as poor or fair, and 10 of the firms rated State as a poor or fair business partner.¹²

In recent months, State has acted to encourage contractors' participation in the NEC program by working to improve communications with contractors, refining its management practices by implementing process reforms and mitigating project risks, and reorganizing OBO's management structure. State has taken steps to improve communications with the contractor community in an effort to repair strained relations that stemmed from its management of the program. For example, State engaged with industry groups and individual contractors to solicit specific concerns about its management practices. Although State indicated it would examine whether it should reestablish partnering agreements with contractors, it has made no decision if or how such agreements would be implemented. In addition, State has made procedural changes to improve its construction and project management processes and to mitigate project risks. For example, State lengthened the schedules for NEC projects and has begun to address conflicts within project documents that define requirements. State also recently announced changes to its design-build delivery method that would, upon awarding an NEC contract, provide the contractor with a "bridging" design, which provides greater detail and incorporates critical requirements to expedite the contractor's final design. State believes this new approach would enable contractors to complete the project's design and begin construction in less time than under State's previous process. However, OBO has not yet reached agreement with State's Bureau of Diplomatic Security on how the bridging design would address critical security requirements so that congressionally-required security certifications will be met and preserved through the course of construction. Finally, to improve its project management and enhance its accountability to contractors and other stakeholders, State established a new project management group. According to OBO, the role of the new Project Development and Coordination Division is to coordinate and provide oversight throughout each phase of the project, from planning through construction and commissioning; however, it remains to be seen whether this division will provide continuity throughout project phases, as intended. Moreover, while the actions State has taken address a number of contractors' complaints and could improve contractor participation, the full effects of

¹²Firms were asked to rate State's management of the program on a four point scale. Response categories included poor, fair, good, and excellent.

these changes on the NEC construction process may not be apparent for a number of years.

We are recommending that the Secretary of State conduct a systematic review of the embassy construction contractor base that (1) demonstrates whether the U.S. contractor base that is both capable of meeting current requirements and willing to participate in the NEC program is adequate; (2) estimates the expected benefits and identifies the potential risks associated with State's legislative proposal; and (3) details how the risks would be mitigated.

In commenting on a draft of this report, State said it believes its contractor base is adequate, but could benefit from expansion. It also commented it plans to revise its legislative proposal by opening competition for NECs only to U.S. companies that meet the specified security requirements. State also said that, since full and open competition is a central principle for Federal acquisitions, a cost-benefit analysis is unnecessary. We disagree with State's view. State initiated a process to revise the qualifying criteria for NEC awards, but it has provided no compelling analytical support for why the criteria should be amended, how such an amendment would be implemented, or the expected benefits and potential risks associated with the changes. Absent such support, it is unclear how the proposed changes would affect State's program. We, therefore, believe our recommendation remains valid. State's comments, along with our responses to specific points, are reprinted in appendix III. State also provided technical comments which were incorporated into the report, as appropriate.

Background

From 1987-1997, U.S. diplomatic facilities overseas were attacked on more than 200 occasions. On August 7, 1998, terrorist bombings of the U.S. embassies in Dar es Salaam, Tanzania, and Nairobi, Kenya, killed 220 people and injured thousands more. Subsequent investigations into these attacks and on the conditions of U.S. overseas facilities determined that U.S. embassies and consulates worldwide were insecure, unsafe, overcrowded, deteriorating, and "shockingly shabby." Unless security

vulnerabilities were addressed, employees and the public using these facilities would remain at risk of terrorist attacks.¹³

In the wake of these reports, State embarked on an unprecedented effort to construct diplomatic facilities at 214 overseas posts. The goal of this effort is to replace insecure, dilapidated, and dysfunctional embassies, consulates, and other overseas diplomatic office buildings with safe, secure, functional, and modern facilities as quickly as possible. As of December 2008, OBO had completed construction for 64 new embassies, consulates, and annexes and had relocated more than 19,500 U.S. employees into these new facilities. State has 31 additional ongoing construction contracts for new facilities and plans to build approximately 90 more facilities from 2009 to 2023. Beyond this effort, State officials said that after 2023, OBO would need to replace facilities at approximately 50 posts. The total award value for all construction contracts for new office facilities awarded since 1999 is approximately \$5.8 billion.¹⁴

Efforts to Speed Construction and Contain Costs

In 1986, in response to terrorist threats, State began an embassy construction program, known as the Inman program, to better protect U.S. personnel and facilities overseas. However, due to systemic weaknesses in program management, as well as subsequent funding limitations, State completed only 24 of the 57 construction projects planned under the Inman program. Following the demise of the Inman program in the early 1990s, State initiated very few new construction projects, until the 1998 embassy bombings in Africa prompted additional funding for security upgrades and the construction of secure embassies and consulates.

In response to the performance problems experienced under the Inman program, State implemented numerous reforms to its management structure and contracting, planning, and construction processes. These reforms were designed to speed completion of projects, reduce costs, and standardize processes, and they had the cumulative effect of reducing the

¹³Department of State, *Report of the Accountability Review Boards on the Embassy Bombings in Nairobi, Kenya and Dar es Salaam, Tanzania on August 7, 1998* (Washington, D.C.: January 1999); and Admiral William J. Crowe, Press Briefing on the Report of the Accountability Review Boards on the Embassy Bombings in Nairobi and Dar es Salaam (Washington, D.C.: Jan. 8, 1999).

¹⁴This value represents the sum of the original contract awards for each project. Actual total values typically change through the course of construction.

average construction cycle time by 2 years and 9 months.¹⁵ Among the most prominent reforms were

- elevating the former Office of Foreign Buildings Operations to OBO;
- relying on the design-build delivery method, which reduces the number of solicitation, proposal, and award processes from two to one and allows contractors to begin basic construction before the design process is completed;
- convening the Industry Advisory Panel on a quarterly basis to advise OBO on industry best practices in the construction sector;¹⁶ and
- holding an annual industry day event to solicit a broader pool of contractors.¹⁷

Starting in 2002, OBO also implemented the Standard Embassy Design (SED) to expedite the planning, awarding, design, and construction of NECs. The SED is a series of documents that outline site and building plans, specifications, and design criteria, and explain how to adapt these specifications to a particular project and contract requirements. The SED is not an actual building design but rather a template that standardizes the basic plans for the structural, spatial, safety, and security requirements for each NEC, including the following:

- main office buildings and annexes;
- security features, such as the Compound Access Control (CAC) buildings and perimeter walls;
- utility buildings, warehouses, and General Services annex;

¹⁵See [GAO-06-641](#).

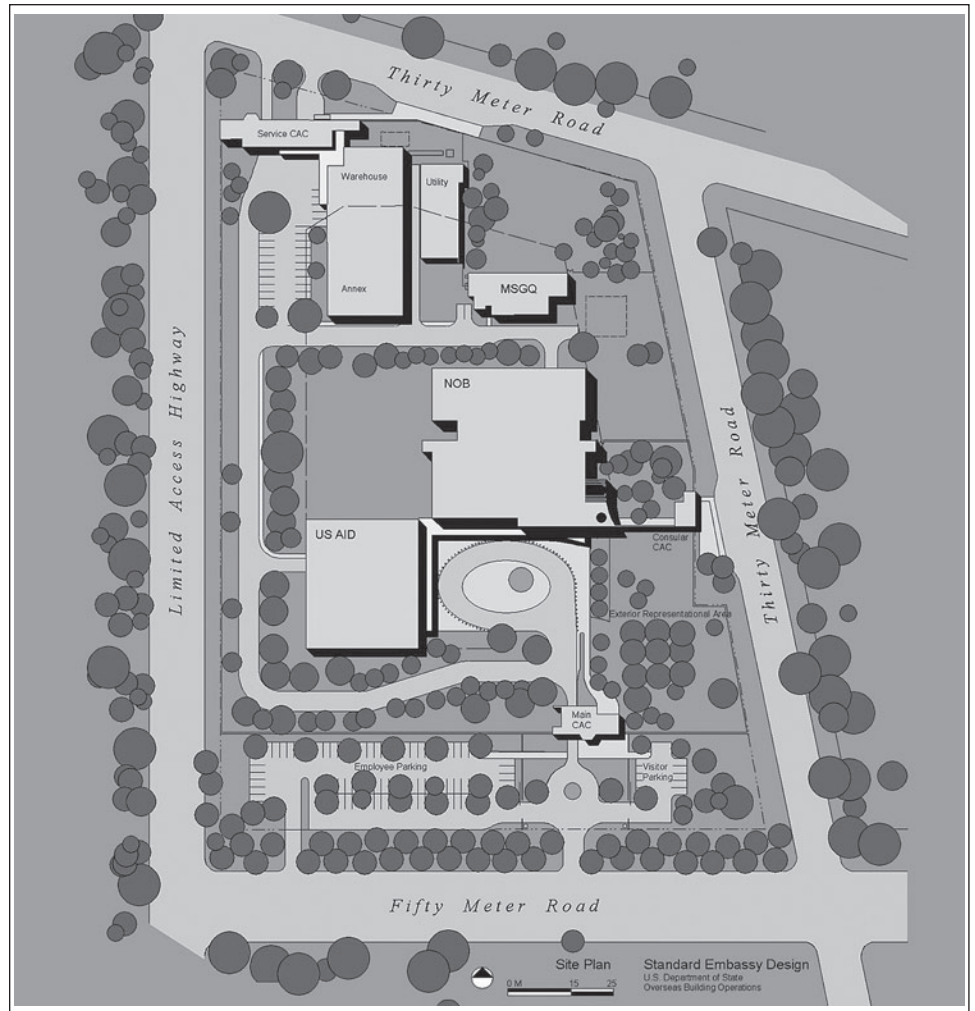
¹⁶OBO hosts a quarterly Industry Advisory Panel meeting that brings together private sector and State design, construction, and facilities management experts to discuss leading practices applicable to OBO's embassy construction and management responsibilities. OBO assigns both government and industry leads for each of the panel discussion topics for the purpose of discussing challenges and issues, examining how industry may be managing similar issues, and integrating lessons learned into OBO policies and procedures, as appropriate.

¹⁷See [GAO-04-100](#) and [GAO-06-641](#).

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- living quarters for Marine Security Guards (MSGQ); and
 - employee and visitor parking.

The SED also identifies ways to allow for future building expansion on the site; establishes minimum permissible baseline standards for materials and interior finishes; and factors in environmental concerns such as temperature, humidity, dust, rain, and air quality when designing and selecting mechanical equipment. Figure 1 shows the general features for a standard design NEC.

Figure 1: Features of Notional New Embassy Compounds Constructed Under Standard Embassy Design



Source: State Department.

Since 2002, there have been three primary classes of standard design embassy and consulate compounds—small, medium, and large—based on the size and cost of the facility, each of which have predefined construction schedules and total project durations associated with them. In 2004, State introduced a fourth class of SED, called Extra Large or Special SEDs, which generally exceed the size and cost of large SEDs. Finally, in 2007, State introduced the Standard Secure Mini Compound, which is generally smaller and less costly than a small SED. In addition, OBO has developed standard designs for MSGQs, and stand-alone

unclassified annexes. Table 1 shows the allowable size and construction time frames for each of the five classes of NECs constructed using the standard embassy design.

Table 1: Size and Construction Time Frames for the Five Classes of Standard Design Embassies^a

| Class | Size, cost, and time frames |
|-------------------------------|---|
| Standard Secure Mini Compound | Size: 3,000 gsm ^b and 45 desks Construction duration: 24 months |
| Small | Size: 3,001 - 4,300 gsm Construction duration: 28 months |
| Medium | Size: 4,301 - 7,400 gsm Construction duration: 30 months |
| Large | Size: 7,401 - 11,300 gsm Construction duration: 32 months |
| Extra large and special | Size: greater than 11,300 gsm Construction duration: 36 months |

Source: OBO.

^aConstruction duration, inclusive of design, includes the period of time between the issuance of the Limited Notice to Proceed with Construction to the date that construction is certified as substantially complete.

^bGross square meters.

Qualifications for Submitting Contract Proposals

The Omnibus Diplomatic Security and Antiterrorism Act of 1986 states that, where adequate competition exists, only U.S. persons and qualified U.S. joint-venture persons may (1) bid on diplomatic construction or design projects with estimated total project values exceeding \$10 million and (2) bid on diplomatic construction or design projects involving technical security, unless the project involves low-level technology, as determined by the Secretary of State.¹⁸ The act defines adequate competition as the presence of two or more qualified bidders submitting responsive bids for a specific project. In this context, a U.S. person is defined, in part, as a company that

¹⁸22 U.S.C. § 4852.

-
- is incorporated or legally organized under the laws of the United States;
 - has its principal place of business in the United States;
 - has performed within the United States or at a U.S. diplomatic or consular establishment abroad administrative and technical, professional, or construction services similar in complexity, type, and value to the project being bid;
 - has total business volume equal to or greater than the value of the project being bid in 3 years of the 5-year period before the specified date;
 - employs U.S. citizens (1) in at least 80 percent of its principal management positions in the United States and (2) in more than half of its permanent, full-time positions in the United States;
 - will employ U.S. citizens in at least 80 percent of the supervisory positions on the project site; and
 - has the existing technical and financial resources in the United States to perform the contract.

Contracts for construction projects that do not involve technical security requirements may be awarded to foreign firms. However, the Percy Amendment to the Foreign Buildings Act of 1926 enables American firms to be more competitive with foreign firms by reducing the evaluated price of offers from American firms by 10 percent for such projects expected to exceed \$5 million.¹⁹

State's Proposed Amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986

In 2007, State proposed an amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986 that would allow the Secretary of State to waive financial, U.S. citizenship, and other requirements for NEC awards, when necessary and appropriate. According to State, the proposed amendment was necessary because “the current pool of American contractors qualified and able to carry out diplomatic construction projects overseas has nearly reached its capacity” and the

¹⁹The reduction is applied only to determine competitive status of American firms. It does not affect the value of an offer should the reduction result in a winning bid for an American firm. See 22 U.S.C. § 302 (b)(2). These requirements do not apply if the foreign country's laws prohibit the use of U.S. contractors on the project.

subsequent reduced competition for contracts would result in increased contract costs. When proposing the amendment, State argued that amending the law would increase competition for NEC awards by opening the contractor pool to smaller U.S. construction companies and to foreign companies that previously could not qualify for NEC projects. Congress did not act on the proposed amendment. In December 2008, State officials told us the department plans to revise the 2007 proposal by opening competition for NECs only to U.S. companies that meet the specified security requirements.

State's Contracting and Construction Processes

State uses a two-phase solicitation process for awarding contracts for NECs.²⁰ In the first phase, the prequalification of offerors, contractors submit documentation attesting how they meet the legal, technical, and financial qualifications for each project on which they wish to bid. State then reviews this documentation to certify whether contractors do, in fact, meet the criteria. Once State completes these reviews, it issues a list of contractors eligible to bid for each contract award. Only companies that State certifies as prequalified under the first phase receive, and may respond to, subsequent requests for proposals (RFP) for major construction awards. In the second phase, RFPs, State solicits and evaluates contractors' bids for construction awards, including technical and price proposals. Contractors bid a firm, fixed price for a project; therefore, the winning contractor will deliver the defined scope of the project for the price of the contract.

After State awards a design-build contract, the contractor must develop a project design and work plan that incorporates all construction and security features outlined in the RFP and contract documents. During this design phase, the contractor must also begin preparing for construction by obtaining local building permits, buying or ordering materials, and mobilizing workers. In addition, under the design-build delivery method, contractors can begin construction of some buildings and systems that do not require security clearances—such as perimeter walls, warehouses, and mechanical support buildings—before the full design is approved. However, construction of the main office building—the chancery or consulate—generally does not proceed until the design is approved and

²⁰Contracts for overseas construction, including capital improvements, alterations, and major repairs, may be excepted, where necessary, from the provisions of the Federal Acquisition Regulations (FAR), with the approval of the OBO Director.

State certifies to Congress that it meets all security requirements.²¹ During the construction phase, OBO monitors contractors' schedules, inspects and reviews contractors' work, and certifies that construction is substantially complete once contractors meet all requirements of the contract.²² Once construction is certified as being substantially complete, State conducts final commissioning to ensure that building systems—such as fire protection, electrical, and mechanical—were installed properly and operate according to design criteria and manufacturer specifications. Once all systems pass the commissioning process, the building is certified to be occupied and post staff may move in.

State Reports That NEC Costs Are Rising

In September 2008, State reported that construction costs had increased dramatically since 2001 and that the trend was likely to continue. State reported that from 2001-2008 total construction costs for new embassy and consulate compounds increased, on average, 9 percent per year, from approximately \$5,000 per gross square meter in 2001 to more than \$13,000 per gross square meter in 2008.²³ In an earlier analysis, State attributed the overall cost increases to two factors: inflation for construction materials and the decrease in the value of the dollar. State reported that, overall, prices for construction materials rose 44 percent from December 2003 to July 2008. In addition, State reported that the significant decline in the value of the dollar resulted in additional construction-cost increases of approximately 2 percent per year since 2003.

²¹Section 160 of the Foreign Relations Authorization Act, Fiscal Years 1988 and 1989, as amended, requires that, before undertaking a new construction project intended for the storage of classified materials, State shall certify to the Committee on Foreign Relations, U.S. Senate, and the Committee on Foreign Affairs, House of Representatives, that appropriate steps have been taken to ensure the security of the project to include: (1) protection of classified information and national security-related activities, (2) protection for the personnel working in the facility, and (3) a plan for the continued evaluation and maintenance of security at such facility. See 22 U.S.C. § 4851 note, Pub. L. No. 100-204, § 160 (Dec. 22, 1987), 12 FAM 360 "Construction Security Certification Program," and 15 FAM 1012.3 "Construction Security."

²²Although State certifies that a contractor has met all requirements of the contract, minor items may still need completion.

²³We did not independently verify State's methodology or conclusions.

State Has Generally Met the Adequate Competition Requirement for Awarding NEC Contracts, but the Level of Contractor Participation Has Declined

Although State has generally received at least two bids for NEC projects since 1999, which meets the adequate competition clause, the number of contractors participating in the State's program has declined. State documents show, and State officials reported, that from 1999 to 2008, the department received at least two bids for all but one of the 61 NEC projects awarded through a competitive process, and three or more bids for at least 49 of the 61 awards. Table 2 shows the number of firms prequalifying to bid on NEC projects and the number of bids submitted for each NEC project from 2002 to 2008.²⁴ Despite having adequate competition for all but one NEC award, we found a statistically significant decline in the number of bids State received per NEC contract from 2002 to 2008. We also found that the number of firms per project prequalified to bid also declined during that period. These results demonstrate that the level of contractor participation in the NEC program has declined.

Table 2: Number of Prequalifying Firms and Number of Bids Received for NEC Projects, Fiscal Years 2002-2008^a

| Year | Project | Number of prequalifying firms | Number of bids received |
|----------------------------|-------------------------|-------------------------------|-------------------------|
| 2002 | Abuja, Nigeria | 5 | 3 |
| | Cape Town, South Africa | 9 | 6 |
| | Conakry, Guinea | 6 | 4 |
| | Phnom Penh, Cambodia | 9 | 4 |
| | Tashkent, Uzbekistan | 10 | 6 |
| | Tbilisi, Georgia | 10 | 4 |
| | Yaounde, Cameroon | 6 | 3 |
| Per project average | | 7.9 | 4.3 |
| 2003 | Astana, Kazakhstan | 7 | 5 |
| | Bamako, Mali | 6 | 3 |
| | Beijing, China | 4 | 3 |
| | Freetown, Sierra Leone | 8 | 3 |

²⁴State did not provide data on the number of prequalifying firms and bids submitted for 13 NEC projects, including the 10 projects awarded from 1999 to 2001, the 2002 NEC projects for Abidjan, Cote d'Ivoire, and Kabul, Afghanistan, and the 2006 project for Baghdad, Iraq. Although State documents and State officials indicated that two or more bids were submitted for all 13 of these projects, and three or more bids were received for at least 8 of the 13 projects, we could not confirm the actual numbers; thus, they were excluded from the table. The Dushanbe, Tajikistan, NEC project was also excluded because it was awarded as a sole-source contract.

| Year | Project | Number of prequalifying firms | Number of bids received |
|----------------------------|--------------------------------|-------------------------------|-------------------------|
| | Kingston, Jamaica | 7 | 4 |
| Per project average | | 6.3 | 3.5 |
| 2004 | Accra, Ghana | 5 | 5 |
| | Algiers, Algeria | 5 | 2 |
| | Belmopan, Belize | 10 | 6 |
| | Berlin, Germany | 5 | 4 |
| | Kathmandu, Nepal | 5 | 4 |
| | Lome, Togo | 4 | 4 |
| | Managua, Nicaragua | 7 | 5 |
| | Panama City, Panama | 7 | 4 |
| | Rangoon, Burma | 4 | 4 |
| Per project average | | 5.8 | 4.2 |
| 2005 | Ciudad Juarez, Mexico | 9 | 4 |
| | Khartoum, Sudan | 5 | 2 |
| | Kigali, Rwanda | 5 | 4 |
| | Mumbai, India | 8 | 4 |
| | Port-au-Prince, Haiti | 6 | 4 |
| | Quito, Ecuador | 8 | 5 |
| | Skopje, Macedonia | 6 | 3 |
| Per project average | | 6.7 | 3.7 |
| 2006 | Johannesburg, South Africa | 14 | 4 |
| | Libreville, Gabon | 12 | 4 |
| | Surabaya, Indonesia | 15 | 6 |
| | Suva, Fiji | 12 | 6 |
| Per project average | | 13.3 | 5.0 |
| 2007 | Addis Ababa, Ethiopia | 6 | 3 |
| | Antananarivo, Madagascar | 8 | 3 |
| | Brazzaville, Republic of Congo | 12 | 4 |
| | Jeddah, Saudi Arabia | 6 | 3 |
| | Karachi, Pakistan | 6 | 2 |
| | Ouagadougou, Burkina Faso | 6 | 2 |
| | Riga, Latvia | 7 | 3 |
| | Sarajevo, Bosnia | 5 | 3 |
| | Tijuana, Mexico | 10 | 1 |
| | Valletta, Malta | 9 | 5 |

| Year | Project | Number of prequalifying firms | Number of bids received |
|----------------------------|-----------------------------|-------------------------------|-------------------------|
| Per project average | | 7.5 | 2.9 |
| 2008 | Bucharest, Romania | 5 | 3 |
| | Djibouti, Djibouti | 5 | 4 |
| | Dubai, United Arab Emirates | 5 | 4 |
| | Guangzhou, China | 3 | 2 |
| | Kyiv, Ukraine | 2 | 2 |
| | Lusaka, Zambia | 5 | 4 |
| Per project average | | 4.2 | 3.2 |

Source: GAO analysis of State data.

^aThe table includes only projects labeled by State as NECs, NCCs, and NOBs.

In addition, from 2002 to 2008, noticeable fluctuations occurred in both the annual average numbers of firms per project that prequalified to bid on NECs and bids received. From 2002 to 2005, the annual average number of firms that prequalified to bid ranged from approximately 6 to approximately 8 (see table 2). In 2006, the average increased to more than 13, then declined by 69 percent to about 4 in 2008. The average number of bids submitted per project from 2002 to 2005 ranged from 3.5 to approximately 4, increased to 5 bids per project in 2006, then decreased by 38 percent, to approximately 3 bids per project in 2008.

Although the declines in contractor participation can be attributed to many factors, we found that project costs partly explained the declines. In statistical analyses, we found that State’s estimated NEC project cost is a strong predictor of the actual number of firms that prequalify to bid on projects, such that higher estimated costs result in fewer prequalifying firms and lower estimated costs result in more prequalifying firms. We also found that the actual number of prequalifying firms per project showed a strong positive correlation with the number of bids submitted per project. Thus, estimated project costs directly affect the number of prequalifying firms and indirectly affect the number of bids submitted.²⁵

To illustrate these relationships, we compared the annual average estimated costs for NECs with the annual average numbers of prequalifying firms and bids submitted. As noted previously, State reported that NEC costs have more than doubled from 2001 to 2008.

²⁵See appendix I for a description of these analyses.

Although there were yearly variations between 2002 and 2005 in the average estimated costs for NECs and the average numbers of prequalifying firms and bids submitted, the changes during these years were not large. However, from 2005 to 2006, the average estimated costs for NECs declined by 28 percent from \$69 million to \$50 million. Because the financial criteria in 2006 were lower than in 2005, it was easier for firms to demonstrate the capacity to meet those requirements. As a result, the number of prequalifying firms per project rose from approximately 7 in 2005 to more than 13 in 2006, and the number of bids per project increased from 3.7 to 5. However, from 2006 to 2008, the average estimated NEC project cost more than doubled, rising to approximately \$110 million per project. This increase made it more difficult for firms to meet the financial requirements to bid for and win NEC awards. As a result, fewer firms prequalified for and bid on NEC projects in those years.

The profitability of NEC projects for contractors and State's overall management of the NEC program may also have affected contractor participation, particularly in recent years. For example, the decline in the prequalification rate also reflects five firms, which, combined, built a total of 27 embassies, consulates, and annexes for a total value of \$1.63 billion, withdrawing from the NEC program from 2006 to 2008. Although each of these five firms prequalified to bid on NECs in 2005, none of them chose to prequalify for 2008 projects, with one company withdrawing in 2006, two in 2007, and the remaining two in 2008. Officials from these companies cited insufficient profits and disagreements with State's management of the program as factors contributing to decisions to withdraw. However, three of the firms indicated they would consider participating in future years but would base such decisions on the resolution of outstanding issues with current and past contracts and State's willingness to reform its management practices.²⁶

²⁶See the third and fourth sections of this report for discussion of factors affecting contractors' decisions to participate in the program and State's efforts to improve contractor participation.

State Has Not Systematically Assessed the Need for or Possible Outcomes of Its Legislative Proposal

State has conducted no systematic analyses in support of its proposed amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986, including whether such legislative changes are needed to maintain an adequate contractor base or how such changes would affect the program. Although State asserts that the declining contractor base has created a less competitive and less cost-effective program, the department reported no systematic efforts to analyze the relationship between competition for NEC contracts and actual contract awards. State officials did report that from 1999-2008, the department received at least two bids—the legislatively defined minimum number for adequate competition—for all but one NEC project solicited as an open competition. However, they did not comment on whether this minimum standard was sufficient to receive optimal prices for the government.

In support of its initial legislative proposal, in October 2007, State identified several factors that it believed discouraged contractors from participating in the program, including: (1) working with State was not as profitable as working with private companies or with other federal agencies, (2) the challenging and sometimes dangerous locations of NEC projects, (3) the high cost of skilled American workers with security clearances, (4) dissatisfaction with firm fixed-price contracts for NECs, and (5) the relatively abundant domestic construction market. However, State did not provide any detailed analyses in support of these conclusions.

State's initial legislative proposal indicates that the number of U.S. companies capable of meeting the current requirements to qualify for NEC awards is nearing capacity. However, State has not systematically analyzed the extent to which the U.S. contractor community can meet these requirements. Therefore, we reviewed the degree to which some of the largest U.S. construction companies have participated in the NEC program. We compared the list of the top 100 U.S. design-build firms for 2008 compiled by *Engineering News Record* with the list of firms that have either prequalified for or won NEC awards since 2002.²⁷ The ranking is based on companies' total 2007 revenues from design-build contracts where the projects were designed and constructed by employees of the company in whole or in joint-venture partnership with other firms and

²⁷See footnote 4, p. 2.

subcontractors. The total revenues for these firms ranged from \$104 million to \$11.2 billion.²⁸

We found that only 14 of the top 100 companies prequalified for NECs in at least one year from 2002-2008, and only 7 won at least one NEC award. In addition, only 3 of the top 100 companies prequalified for 2008 NEC projects—B.L. Harbert International, LLC; Caddell Construction Co. Inc.; and Weston Solutions Inc. While not all of the 100 companies may be interested in pursuing overseas construction, some firms not currently engaged in the NEC program are capable of working in overseas locations. For example, the top 100 list shows that 34 of the 100 firms derived income from overseas construction contracts. Ten of these 34 firms prequalified to bid on at least one occasion from 2002-2008, and two of these 34 firms prequalified to bid for 2008 NEC projects.

In addition, we examined company Web sites and conducted Lexis-Nexis searches to determine the extent to which companies listed among the top 100 design-builders for 2008 and that have never won NEC awards have experience in countries where State plans to build NECs in 2009.²⁹ We found that at least 16 of the 93 companies that have not received NEC contracts under the current program have ongoing operations in eight of the nine locations planned for 2009 (see table 3).³⁰ However, none of those 16 companies prequalified to bid on State's 2008 projects, and only two of those companies prequalified for projects in past years.

²⁸In this analysis, we assume that companies on the top 100 list would meet the total business volume requirements to prequalify to bid on NECs, given the magnitude of their 2007 revenues and given that Weston Solutions Inc., the 96th ranked firm with 2007 total revenues of \$108 million, prequalified for at least three of the 2008 NEC projects with estimated award values ranging from \$80 million to \$120 million. We note that at least four companies not on the top 100 list prequalified for these same 2008 projects. However, our analysis is based solely on whether a company was certified as prequalified to bid for at least one NEC award in any year from 2002 to 2008. We did not confirm how many, if any, of the companies applied for, but were denied, prequalification.

²⁹The analysis excludes the seven companies that previously won at least one NEC award.

³⁰Planned projects include those outlined in OBO's *Long-Range Overseas Buildings Plan, FY 2008-2013*. In technical comments on a draft of this report, State reported that projects listed in the *Long-Range Overseas Buildings Plan* are subject to change. State also said that while the projects used in the analysis were current at the time of the analysis, table 3 does not reflect the current list of 2009 planned projects. State suggested inserting this qualification, rather than redoing the analysis with the current list.

Table 3: Number of Top 100 Design-Build Firms with Existing Operations in Planned 2009 NEC Project Countries

| 2009 project country | Number of top 100 firms operating in the country |
|-----------------------------|---|
| Afghanistan | 6 |
| Azerbaijan | 3 |
| Dominican Republic | 4 |
| Equatorial Guinea | 2 |
| Mauritania | 1 |
| Mozambique | 4 |
| Senegal | 0 |
| South Africa | 6 |
| Thailand | 8 |

Source: GAO analysis of State data and company Web sites.

A greater reliance on foreign firms, as specified in State's 2007 legislative proposal, could increase security risks for NECs. Currently, foreign companies may not bid on projects that involve technical security unless it involves only low-level technology. State's initial legislative proposal would provide the Secretary with discretion to waive the preference for U.S. contractors so long as the Secretary determined that it is more economical or efficient to do so and that the security of the project would not be compromised in doing so. However, State has not yet reported how it would ensure project security would not be compromised, including providing a clear explanation of how the controlled access areas would be securely constructed and identifying the additional safeguards needed to oversee construction.

Finally, amending the requirements to allow greater access to small U.S. companies and foreign companies could also affect construction management on site. However, because small firms may not have the technical capacity to construct all facets of NECs and, because foreign firms cannot currently construct controlled access areas of embassies and consulates, it is unclear how construction of highly technical areas would be accomplished. Although State has not yet determined how to resolve these items, it could choose to award multiple contracts to complete targeted areas of work. State has taken an approach somewhat similar to this for some NEC contracts, to date, by awarding small projects, primarily annexes, to small U.S. and foreign construction firms, which sometimes proceed simultaneously with a larger NEC project previously awarded to other companies. State has also awarded separate contracts to construct

unclassified and classified areas of some NECs, such as for the Baghdad, Iraq, and Suva, Fiji, embassies. OBO officials noted that this multiple contracting is inefficient and leads to frequent conflicts between contractors over precedence of work. Relying on small contractors in a similar approach, with multiple contracts, to complete a typical NEC project may multiply these problems, and State has not yet reported how it would mitigate this concern.

In December 2008, State informed us that it has drafted a revised legislative proposal to allow for more U.S. firms to qualify as U.S. persons, noting that all U.S. companies that can meet the specified security requirements should be permitted to bid for and win NEC contracts. In addition, State said that it would no longer pursue greater access to NEC contracts for foreign firms. State's revised proposal would, in effect, open competition for NEC awards to smaller U.S. firms.³¹ However, according to State officials, the projects planned through the remainder of the program are expected to be more complex and more costly, in general, than the projects awarded to date. Given that State's experience with multiple contractors working independently at a construction site has not worked well, it is unclear how State could increase smaller firms' participation without significantly increasing the government's risk. However, as of the date of its comments, State had conducted no analyses in support of its proposal, including on the benefits and risks of a greater reliance on smaller firms.

³¹As of December 2008, State was reviewing the draft language of this modified proposal, and planned to submit it for consideration for its next authorization bill.

Financial Incentives, Risks of Overseas Construction, and State’s Management Practices Affect Contractors’ Willingness to Participate in the NEC Program

U.S. contractors we interviewed ranked financial incentives as the most important factor in determining their participation in the construction program; however, many contractors told us they were not making as much profit as anticipated. Once participating in the program, all contractors reported encountering significant challenges, such as the logistics of getting labor and materials to a construction site, meeting State’s construction schedules, coping with currency fluctuations and price increases, finding skilled American workers with security clearances, and handling relations with foreign governments. In addition, a majority of contractors favored using the combination of design-build delivery and the standard embassy design, and stated that neither firm fixed-price contracting nor the domestic and international construction markets affect their participation in the program. Most contractors also expressed concerns about State’s on-site project directors, the implementation of the design-build process, and the project guidance provided by State.

Financial Incentives Ranked as Highest Factor in Decision to Participate in the NEC Program, but Profits Did Not Meet Expectations

Most of the 17 contractors we interviewed cited most often the potential to make money, the expectation that State would be a reliable customer, and the steady continuity of State’s building projects, even during difficult economic times, as the top three incentives to participate in the program (15 of the 17 contractors for each incentive). The desire to serve the United States and the prestige of building for the United States were also cited as strong incentives for some contractors (see table 4).

Table 4: Rank-Ordered Incentives to Participate in the NEC Program, as Reported by 17 Contractors.

| Incentives | Major or moderate incentive | Minor or not an incentive |
|---|-----------------------------|---------------------------|
| State projects allow us (the contractor) to make money | 15 | 2 |
| State is a reliable customer | 15 | 2 |
| State projects continue through difficult times in the rest of the economy | 15 | 2 |
| Desire to serve our country | 12 | 5 |
| Prestige of building something for our country | 10 | 7 |
| Challenge of building to high standards in often difficult environments | 9 | 8 |
| Experience with State projects may improve access to other government contracts | 7 | 10 |

| Incentives | Major or moderate incentive | Minor or not an incentive |
|--|------------------------------------|----------------------------------|
| Working with State provides opportunities to train project managers in challenging situations | 6 | 11 |
| Potential for generating new business in overseas markets | 6 | 11 |
| Experiences learning about and using different construction methods or materials in different parts of the world | 5 | 12 |

Source: GAO.

In spite of the importance of reliably earning money as an incentive for program participation, many contractors said that making a profit had become difficult under the NEC program.³² The contractors defined profit as the monetary returns received after all charges have been paid, including regular salaries.³³ Ten of 14, or 71 percent of the contractors also said that, in general, State projects were less profitable than their other construction projects.³⁴ Specifically, contractors told us that 22 of the 53 total contracts they completed lost money, and two more did not earn a profit; they expected to lose money or break even on 11 of the 26 projects that were being built at the time of our fieldwork. In all, 13 of the 17 contractors, or more than 76 percent, reported they lost money or expected to lose money on at least one contract.³⁵ Some contractors noted, however, that depending on the resolution of open requests for contract modifications—also called requests for equitable adjustment (REA)—some of the projects that lost money or broke even could show a profit.³⁶

³²We did not attempt to confirm contractor claims of profits and losses.

³³Some contractors told us they do not determine profits until after the one-year warranty period following construction.

³⁴Three contractors reported having no basis to judge.

³⁵However, 71 percent of the contractors reported earning money or expecting to earn money on at least one contract.

³⁶REAs are requests by contractors for compensation for expenses or delays incurred due to the actions or lack of action of the owner or other occurrences. If approved, REAs result in changes to the contract price or duration.

Contractors Cite Major Challenges Including Logistics and Time

Although contractors have potentially meaningful incentives to participate in the program, they each reported facing significant challenges once in the program and when building the facilities.³⁷ Contractors ranked the greatest challenges as (1) the logistics of getting labor and material to the construction sites, which are often in very remote locations; (2) meeting State’s construction schedules; (3) financial considerations, such as managing currency fluctuations; (4) labor issues, such as finding qualified workers with security clearances (cleared workers); and (5) relations with foreign governments (see table 5). These challenges reflect contractors’ comparatively greater risk when constructing facilities for State, compared to other clients. Thirteen of 16 contractors, or over 80 percent, said that their firms’ profits from the NEC program have not been commensurate with the risks involved.³⁸

Table 5: Contractor-Reported Challenges to Completing State Construction Projects

| Challenges | Major or moderate challenge | Minor or not a challenge |
|--|-----------------------------|--------------------------|
| Logistics (getting labor and materials to the site) | 16 | 1 |
| Meeting State construction schedule | 16 | 1 |
| Currency fluctuations | 16 | 1 |
| Finding qualified workers with security clearances | 15 | 2 |
| Dealing with foreign governments (permitting issues, clearing materials through customs, paying tariffs) | 11 | 6 |

Source: GAO.

Logistics and Location

Twelve of 17 contractors said handling the logistics of getting labor and materials to the construction site was a major challenge while four said it was a moderate challenge. Many of the construction sites are in relatively remote locations and are difficult to access from the United States. However, despite logistics being cited by contractors as a challenge and, in many cases, a consideration to bid for specific projects, none of the contractors cited it as a determining factor when considering whether to participate in State’s construction program. Contractors did not report

³⁷In our discussions with contractors, we asked both closed-ended questions, the responses to which could be easily counted, and open-ended questions, which generated many useful comments.

³⁸One contractor who did not know was not included in the analysis.

project locations as a disincentive to participate in the program. On the contrary, the challenge of building to high standards in often difficult environments was cited by 12 of the 17 contractors as an incentive for participating in the program. Contractors did confirm that location can be a factor in deciding to bid on specific projects, but it also was a consideration generally for the purpose of assessing the competition for projects. For example, a company may avoid bidding on projects in locations where it believes another company has a clear competitive advantage, such as by already being mobilized in the country or having extensive experience in a given region.

Schedule

Fourteen of the 17 contractors viewed meeting State's construction schedules for new embassies as a major challenge. The two contractors who rated meeting the schedules as a moderate challenge, and the one contractor who said the schedules were a minor challenge had not yet completed a building project for State. Even a successful contractor, whose entire business model is built around meeting State's schedules, said they are a major challenge. Contractors described the building schedules as unrealistic, a "problem," "absolutely insane," "warped," and "ridiculous."

Some of the contractors stated that completing the design of the facilities, together with building the facilities took more time than was allowed by State. The goal of the NEC program is to get U.S. government employees overseas out of hazardous, insecure buildings and into safe and secure buildings as quickly as possible. From 2002 to 2007, State aggressively shortened the time allowed to complete the buildings. The contractors raised concerns that State reviews designs in greater detail and later in the process than is typical for design-build construction. Nearly all the contractors said that they were challenged to meet State's shortened project schedules, considering, among other factors, the difficulty of producing an approved design that will enable State to provide the necessary security certification to Congress. According to these contractors, designs were often certified for construction significantly later than planned due to complex and extensive project requirements, the application and delivery of which had to be validated through State's design reviews. According to several contractors, much of the allowed construction time is spent obtaining approval of the completed design, leaving less time for the actual construction of the facility, and increasing the contractors' risk of not meeting project completion dates. A few contractors said that if they were building in cities of the high-income countries in the world, they could more reliably meet the schedules. However, most of the NEC locations are in lower-middle and lower-

income countries where finishing a design acceptable to State, getting materials and equipment to remote locations, and actually building the structure may take more time than State allows. If anything goes wrong, according to contractors, they are likely to miss the deadlines.

Financial Considerations

Financial considerations, including currency fluctuations, rising costs for construction materials, and the need to obtain performance bonds to fulfill U.S. government requirements provide another set of challenges to contractors. As previously noted, in September 2008, State reported that the price increases for construction materials and the weakening of the dollar more than doubled NEC construction costs since 2001. A few contractors referred specifically to rising costs for construction materials as a concern. Contractors reported on strategies to mitigate inflation, such as factoring inflation into their contract proposals or purchasing materials in advance. Moreover, given that labor and materials procured overseas generally must be paid in local currencies, and that the dollar has weakened against many other world currencies, managing currency fluctuations has become a significant challenge, according to contractors with whom we spoke. As with inflation, contractors regularly manage this risk by including a contingency for potential dollar devaluation in their bids. Several contractors also seek protection from currency fluctuations by purchasing exchange rate futures to lock in a rate. However, these measures can not fully ease the effect of wider-than-expected currency swings. Ten contractors told us that currency fluctuations are a determining factor in their decision to compete for State building contracts. Five others said that currency fluctuations had not been a factor that determined whether or not to compete for a given contract in the past. However, currency fluctuations could become a factor in the future, given the relative strength or weakness of the U.S. dollar.³⁹

Obtaining performance bonds was seen as either a major or moderate challenge by 9 of the 17 contractors we interviewed, and its importance may be growing.⁴⁰ Factors determining whether a contractor needs performance bonding include the contractor's revenues and State's experience with the contractor. Larger contractors, in general, can more easily obtain a performance bond than smaller contractors. Also, there

³⁹When we conducted the interviews in May and June 2008, the dollar was at a low point in relationship to other currencies.

⁴⁰In qualifying for NEC projects, U.S. contractors must demonstrate they are backed by a bonding agency.

have been instances where State has waived the need for a performance bond for contractors with whom it has extensive, successful experience, according to the contractors.⁴¹ As of the date of this report, no bonding company has ever had to assume responsibility for a contractor's failure to perform on an NEC project. Nonetheless, smaller contractors told us about problems obtaining performance bonds for State contracts, and State told us that at least one bonding company had begun refusing to provide performance bonds to State contractors. If State succeeds in changing the law to allow smaller contractors to prequalify for competition, the availability of performance bonds could become a more prevalent concern.

Labor Issues

Labor issues, in general, were rated high on the list of challenges. Contractors said that finding and keeping workers willing to work overseas poses a challenge. In particular, contractors explained that "cleared" workers—those with security clearances—who are willing to live overseas in often unappealing locations are in relatively short supply. Moreover, because of the low supply and high demand, these cleared workers command the labor market. For example, several contractors complained that cleared workers will frequently move to another contractor for a higher salary or a more appealing location, even if their current project is not finished. To complete work, contractors must sometimes match or exceed competing offers from other contractors to keep the cleared workers on site. Contractors also rated finding and retaining workers who do not have clearances as a challenge, though not as critical a challenge as finding and retaining cleared workers.

Relations with Foreign Governments

Contractors also cited problems dealing with foreign governments as a challenge. Understanding and dealing with issues related to obtaining building permits, clearing materials through customs, or paying tariffs on imported goods, as well as obtaining reliable information about the local country, are challenges and risks of building overseas. However, contractors generally accept these challenges and a majority of contractors said they believe that State could provide more helpful information about the locality. For more challenges faced by contractors, see appendix II.

⁴¹The Miller Act permits the waiver of bonding requirements for contracts performed overseas. See 40 U.S.C. § 3131 (d). According to State officials, contracting officers have the option to waive the performance bond at their discretion.

Majority of Contractors Favored Design-Build Delivery and Standard Embassy Design

We asked contractors to characterize State's approach to the design-build delivery of NECs, using the standard embassy design and firm fixed-price contracts, in terms of effectiveness and economy.⁴² With many caveats, 11 contractors favored the combination of design-build delivery and the standard embassy design as a good method for building new embassies. Although contractors cited problems with aspects of the design-build delivery method and SED, they generally expressed support for both. Two contractors stated that bidding on the completed NEC design would improve the accuracy of bids and allow contractors to better predict how long building would take. Having contractors bid on a completed design would be essentially using a design-bid-build process, a delivery method that separates design and construction activities into two distinct contracts.⁴³ The majority of contractors did not raise concerns about firm fixed-price contracts, and only one contractor reported not bidding on one occasion because of the type of contract.

Domestic and International Construction Markets Have Little Effect on Contractor Participation

Neither a relatively robust domestic construction market nor an active international construction market were cited as factors causing contractors to leave the program. We asked contractors how much the activity level of the construction industry in the United States affects firms' decisions to compete for State building projects. Ten of the 17 contractors said the domestic construction market had some or no effect on their decisions to participate in overseas construction, in general, or compete for State projects, specifically. A few contractors added that their firms were either primarily international or that they worked in the international division of their firms and that they would be in the international market regularly, regardless of domestic market conditions. Some of the contractors agreed that the domestic market affected their decisions to bid for State projects but only because important resources, such as performance bonding capacity or staff, were already allocated to domestic projects and, therefore, not available for competition in the international market. Thus, it was these firms' current commitments for domestic-based work, rather than the U.S. construction market in general, that influenced their firms' decisions to bid on State projects. We also asked contractors how much the activity level of the construction industry

⁴²In our discussions with contractors, we asked both closed-ended questions, the responses to which could be counted, and open-ended questions, which generated many useful comments.

⁴³See 48 C.F.R. 36.102.

overseas affects firms' decisions to compete for State building projects. In this case, 13 of the 17 contractors said the international construction market had some or no effect on their decisions to compete for State projects. For a few contractors, State projects are their preference in overseas work.

State's Management Practices Also Affect Contractors' Decisions

Fourteen contractors characterized State's management of its embassy construction program as fair or poor. Several management practices adopted after the 1998 bombings may have contributed to problems cited by the contractors, including (1) strengthening the role of the project director and limiting access to State management by contractors, (2) the design-build project delivery method as implemented by State, and (3) unclear project guidance within various documents that detail construction requirements.⁴⁴ Moreover, contractors reported these practices inhibit their ability to complete projects on time and with a profit.

Project Director

Beginning in 2001, State took measures to limit partnering with contractors as it had existed, including strengthening the role of the on-site project directors.⁴⁵ However, the action may have had unanticipated effects on the NEC program. A few long-standing contractors reported that the customer-client atmosphere at State changed and that distrust between contractors and State's staff, particularly project directors, frequently resulted in adversarial relationships. Overall, 10 of the 17 contractors we interviewed rated State as a poor or fair business partner—6 rated State as poor, 4 as fair. In addition, 4 of the 7 contractors who rated State as a good or excellent business partner had not completed a construction project as of the dates of their interviews.

Project directors are the targets of many contractors' concerns about the State process. Most contractors we spoke with said that, because of the project director's role in providing information to and from Washington

⁴⁴In our discussions with contractors, we asked both closed-ended questions, the responses to which could be counted, and open-ended questions, which generated many useful comments.

⁴⁵OBO assigns a full-time, on-site project director and technical support staff for capital construction projects. The project director is responsible for the construction management and engineering oversight of the project and is the Contracting Officer's Representative (COR). The project director also coordinates all project-related communications between the construction site and Washington.

and making or, at least, conveying project execution decisions, project success is greatly dependent on the project directors. The contractors provided mixed views on their levels of satisfaction with individual project directors. Contractors also expressed concerns about the professional qualifications of project directors and their experience managing construction and said they would like project directors to have significant construction experience.⁴⁶ In discussing relationships with project directors, two contractors noted they will avoid bidding on projects they know will be headed by a particular project director with whom they or other contractors have had past troubles.

We asked contractors a number of questions regarding their experiences with various State bureaus and offices. Contractors were asked to what extent they had experienced project delays because of various State officers and entities, and they responded that project directors are the greatest source of delays. Contractors also rated the State project directors on the timeliness of their decisions in a variety of areas and on the level of authority that project directors currently have for making certain types of decisions. A majority of contractors reported that project directors are generally timely in responding to requests for information, and contractors were about evenly split on whether project directors are timely in providing answers to work approvals and general decision making. However, for timeliness on contract modifications or REAs, project directors were perceived by the majority of contractors to be only sometimes, rarely, or never timely.

Even as project directors are the targets of many contractors' concerns, they often have no authority to make decisions in specific areas cited by contractors. Contractors rated project directors' decisions and authorities for a number of types of contract modifications. For example, a majority of the contractors, typically 10 to 12, rated project directors' decisions as fair or poor in areas such as modifications exceeding \$25,000, technical changes, and changes that require more time.⁴⁷ In fact, project directors do not have the authority to make decisions on changes above \$25,000 for any

⁴⁶State generally requires its project directors to have an engineering degree and at least one full year of specialized professional engineering experience so that they are equipped with the particular knowledge, skills, and abilities to successfully perform the duties of a construction engineer. These individuals are typically first hired as construction engineers and, as they gain experience, can advance into a project director position.

⁴⁷In contrast, contractors generally approved of project directors' decisions on no-cost changes.

single modification,⁴⁸ on accepting technical changes, or on providing more time, as each of these decisions must be made in Washington. However, according to what contractors told us, as many of them were satisfied as were not with the authority given project directors on changes above \$100,000, material substitutions, or accepting technical changes. State officials said that, under the former director's policy of limiting contractors' access to various offices at State, all requests had to be communicated to the project director. The project director would then either take individual action, or seek assistance or approvals from Washington and, subsequently, deliver and enforce decisions made by others. As a result, it appears that project directors, rightly or wrongly, bear the brunt of contractors' concerns and disapproval of decisions that negatively affect contractors.

Design-Build Delivery Process

A majority of the 17 contractors also said that State's implementation of the design-build process is flawed, and some said that the time required to complete design and design reviews significantly affects the project delivery schedule. Eleven contractors had favorable views of the design-build process in general because it is supposed to erect buildings more quickly, and some indicated the method can result in lower construction costs. In addition, as previously noted, contractors thought design-build delivery worked well with the standard embassy design. However, during our interviews, contractors offered the following concerns about State's implementation of the design-build method:⁴⁹

- State's protracted design phase is lengthier than that of their other government clients (four contractors);
- State becomes too heavily involved in the project design (three contractors);
- State's design review comments—which range from 500 to 1,000 comments per project, each of which must be addressed—are excessive (four contractors);

⁴⁸Project directors may approve up to \$25,000 per modification and up to \$250,000 in modifications per year.

⁴⁹These comments arose from explanatory answers to closed-ended questions. The comments were unstructured and wide-ranging.

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- Some contractors feel unable to proceed with construction until they have received a fully approved, 100 percent design from State (six contractors); and
 - Contractors do not have sufficient time to actually build once State has finally approved a design, given the time limits on completing the projects (four contractors).

Project Guidance

In addition, 13 contractors expressed concerns about unclear and contradictory guidance and information within and among critical components of State solicitation and design documentation. Eight contractors reported a number of problems with the RFPs, including sections where information and requirements were unclear, inconsistent, or in conflict with other sections and, in some cases, incorrect. Five contractors cited examples of poor project documentation, including inaccurate space plans, and incomplete information provided on existing site conditions related to local utility service layouts and soil conditions. In addition, 2 of the 11 contractors said State's answers to contractors' technical questions about specific RFPs were not incorporated as amendments to the solicitations, even though those answers were considered binding.

Finally, contractors told us that guidance often conflicts with actual practice. Most contractors raised specific complaints about being unable to substitute local materials for U.S. or U.S.-standard materials. Although the RFP states that local materials may be substituted for U.S. materials; however, in practice, this occurs only after State has approved the specific substitution, based on the contractor's documenting that the substitute meets U.S. standards.⁵⁰ According to what 13 contractors told us and what we have reported in the past,⁵¹ obtaining approval to use substitute material is difficult. Six of these 13 contractors told us that the process for obtaining approval is too onerous and time-consuming to be worth the effort—for example, one said that money saved through using local materials is essentially lost by the time spent getting the approval. In a specific example of guidance on another issue conflicting with practice, according to contractors, the SED allows contractors to install either a

⁵⁰OBO generally requires that U.S. materials be used; however, substitute products and materials that are locally sourced may be economically advantageous for contractors if necessary approvals can be achieved in a timely manner.

⁵¹[GAO-06-641](#).

wedge barrier or a sliding gate at the vehicle entrance. (See fig. 2 for an illustration of a wedge barrier.) Although State prefers to have the wedge barrier, contractors prefer the sliding gates because they are less expensive. However, State routinely overrules this choice and requires wedge barriers, even though the sliding gate meets the requirement. State officials reported they are attempting to reconcile the guidance and practice on vehicle barriers.

Figure 2: Wedge Barrier at Entrance to a U.S. Facility



Source: GAO.

State Has Acted to Encourage Incumbent Contractors' Continued NEC Program Participation

In recent months, State has reached out to the contractor community in an effort to repair strained relationships and to encourage contractors' continued participation in the NEC program. To support improved relationships with contractors, State has implemented, or is in the process of implementing, several procedural changes to increase the effectiveness of its project delivery and contract management processes and to mitigate project risks. In addition, State has created a new project management

group within OBO to improve internal coordination and communication and enhance its accountability to contractors and all other project stakeholders.

State Is Reaching Out to Contractors

State has taken steps to reach out to the contractor community to improve relationships. In February 2008, for example, State officials met with the president of the Associated General Contractors of America (AGC), along with a group of five contractors who had completed NEC projects to discuss specific concerns of the industry. The discussions sought to identify reasons for contractors ending their participation in the NEC program and covered several industry concerns with technical and administrative aspects of State's contractor prequalification, contract procurement, and project management practices. At the conclusion of the meeting, the parties identified several follow-up items and agreed to hold future task force meetings to discuss the issues.

In another outreach effort, State reported it intends to examine partnering concepts and to consider the extent to which they may be reintroduced to future contracts. While State discussed its intent to examine partnering in September 2008, it has not yet drafted guidance or policy on how partnering would be reintroduced into its processes in general or applied to specific projects. Prior to 2001, State had used partnering on some contracts and found that it generally contributed to project success. State's use of partnering agreements on these contracts helped facilitate the government and contractors working together as a cohesive team to complete projects on time and in accordance with State requirements, while providing contractors opportunity to earn a fair profit. In particular, partnering agreements were used to ensure such outcomes as timely decisions and the resolution of problems at the lowest level possible. As previously discussed, OBO's Director eliminated the formal use of partnering in 2001, in part because he thought contractors had taken advantage of partnering to gain access to OBO's upper management, which served to bypass the project directors and undermined their ability to effectively manage projects. During OBO's September 2008 Industry Advisory Panel meeting, OBO and AGC began a preliminary discussion on partnering and how its principles could be incorporated into contracts and used to foster better collaboration between State and contractors on current projects. At the conclusion of the discussion, OBO's Director acknowledged that State needed to do more work and obtain a better understanding of how partnering could be applied in contracts.

State Is Making Procedural Changes to Improve Its Management Processes and Mitigate Project Risks

To respond to contractors' concerns identified through its outreach efforts, State has implemented, or is in the process of implementing, several procedural changes to increase the effectiveness of its project delivery and contract management processes and to mitigate project risks. The changes being made by State—which are influenced by recommendations of an internal working group that was established in July 2008 to review State's capital project acquisition process⁵²—include

- improving design-build project delivery,
- adjusting project schedules,
- streamlining RFPs and staggering their issue dates so contractors have more time to respond to each solicitation,⁵³
- developing a database of non-U.S. materials that meet project requirements, and
- being more responsive to contractors' requests for equitable adjustments.

OBO began implementing some of these changes in its fiscal year 2008 NEC program. Other changes are ongoing, and improvements will not be achieved until fiscal year 2009 and later.

Improving Design-Build Project Delivery

At the recommendation of its internal working group and after discussions with its industry advisors,⁵⁴ State intends to modify its approach to design-build project delivery. Because of security concerns, State requires that its projects pass a rigorous design review prior to being certified for

⁵²In response to industry feedback and reports from State's Office of the Inspector General and GAO concerning operational problems affecting the bureau, the OBO Director established a working group on July 24, 2008, to review the capital projects acquisition process. Subject matter experts in programming, planning, design, contracting, and construction management comprised the 29-person team. The team reported its findings and recommendations in September 2008. OBO's Director immediately approved some organizational and procedural changes and deferred decisions on other recommendations to allow for further study of underlying issues.

⁵³Previously, RFPs—which contractors have 45 days to respond to—had been released on back-to-back days, making it difficult for contractors to effectively respond to multiple solicitations.

⁵⁴Industry groups that OBO coordinated with include AGC, Design-Build Institute of America, American Institute of Architects, and the American Council of Engineering Companies.

construction. Under State's former approach to design-build delivery, contractors needed to complete design, respond to review comments—which typically numbered several hundred—and await State's certification of the design for construction. As previously discussed, some contractors said that they expended comparatively more time completing a design for State and having it certified for construction than on a design for other owners' projects, which precluded them from beginning construction as early as they wanted and prevented State from fully realizing the time-saving potential of design-build delivery.

In its revised approach, State will use the “bridging” design method to provide more focused design detail to construction contractors.⁵⁵ By providing more design detail up front, State expects to more effectively translate project requirements to contractors, speed the design certification process, and enable construction to begin sooner. Under the bridging method, State would first contract with a design firm—referred to as either the bridging architect, criteria architect, or the owner's design consultant—to develop an initial design that incorporates critical requirements and that can be certified for construction. State would then contract with a design-build contractor to complete the design for the project—which should take less time than it did under State's former process because more up-front design work will have been completed—and carry out its construction. According to industry experts, the advantage to this approach is that an owner, in this case, State, can initiate design sooner and ensure critical requirements are incorporated into a bridging design. Moreover, because the bridging architect will have developed the project to the point of being ready for construction certification, and because contractors can begin construction activities shortly following contract award, rather than having to wait for State to certify the project for construction, design-build contract durations can be shorter. In addition, industry experts indicate that an owner may potentially receive a better price for design-build services by using this method. Because there would be fewer unknowns regarding the owner's intent as a result of requirements being more clearly delineated in the bridging design, contractors' proposals should contain fewer allowances for uncertainties.

⁵⁵The bridging method provides a high level of design for those requirements that are the most important to the owner and provides the design-build contractor flexibility for the design associated with less critical project requirements.

Prior to implementing this approach to its fullest effect, OBO must reach an agreement with the Bureau of Diplomatic Security on how this bridging design approach would address the security requirements associated with NEC facilities and construction—such as building setback, Forced Entry/Ballistic Resistant (FE/BR) requirements, and technical security systems, among others—and whether the bridging designs would be certified to Congress as meeting all security requirements. Moreover, State’s working group noted that State must also ensure that the portions of the design that are certified as meeting all security requirements are contractually binding and preserved through the continuation of design and completion of construction by the design-build contractor. Keeping the bridging architect involved with the project through the design-build phase, for example, is one option that State may consider using to ensure the integrity of security features, upon which certifications made to Congress are preserved during the final design and construction by the design-build contractor.

Adjusting Schedules

Starting with the fiscal year 2008 contract awards, State is generally extending the time frame within which projects must be built. Instead of basing a project’s schedule on its SED size classification, State’s new approach will set the schedule based on a variety of factors. In particular, this approach will draw upon recent experience from completed projects of similar scope and size, as well as project-specific considerations such as geographic location and host country conditions to tailor schedules for new projects. As a result of having more time to complete projects, contractors are more likely to meet contract completion dates and will bear less risk of having to pay liquidated damages for delayed completion.

Streamlining RFPs and Staggering Their Issuance

At the recommendation of its internal working group, State is examining options to streamline its RFPs to better integrate requirements and convey information to contractors that respond to them. A typical RFP consists of over 6,000 pages and contains elements such as the Space Requirements Program, which details square footage space needs of planned occupants, and test-fit drawings, which provide a notional layout of floor space. Because of their sheer size, RFP documents are difficult to maintain and often contain conflicting information that can inhibit contractors’ understanding of requirements and increase project risks. For example, the Space Requirements Program and the blocking and stacking documents—the latter providing a notional vertical stacking and floor-by-floor layout of office suites—provided in the RFP for the Managua NEC project misrepresented the actual size of the building. As a result of this discrepancy, State settled with the contractor on a \$4.3 million modification that included a 165-day time extension.

The working group also recommended that State establish a single RFP coordinating entity to maintain a “model RFP,” with appropriate document change control mechanisms from which project-specific RFPs would be developed. Individual model RFPs specific to certain project types and delivery methods may also be developed. In addition, State intends to leverage technology by using automated applications to consolidate, update, and maintain its RFP documents—creating what it terms an “e-RFP.” State officials believe that the majority of improvements may not be seen until State’s fiscal year 2010 RFPs are issued because implementation will require enhancements to State’s information technology processes and applications. In the longer term, State intends to explore ways to make greater use of evolving Building Information Modeling (BIM) technologies—to include the migration of all RFP design and criteria data into a structure conducive to these technologies—to allow for more integration and exchange of project-specific information between State and contractors throughout every stage of the project.⁵⁶

In addition, State established a goal to stagger the RFPs for its fiscal year 2008 projects so that contractors would have more time to respond to each solicitation. For its fiscal year 2008 projects, State staggered RFP issuance between May and July. In addition, when contractors asked for additional time, State generally granted their request by providing a 10-day extension to the standard 45-day response time.

Developing a Database of Acceptable Local Materials

State is working to develop a database of acceptable materials from foreign sources that contractors could use in construction. We first reported on this effort in 2006.⁵⁷ State construction contracts require contractors to use U.S. materials and products unless contractors can demonstrate the proposed substitute meets U.S. performance standards. Benefits to contractors of using materials available within the country include, for example, reduced shipping costs. However, to maintain schedule, contractors must obtain a timely approval from State to use and to procure materials within that schedule. A few contractors we spoke

⁵⁶BIM uses computer-based models to increase the efficiency of exchanging information such as design drawings, “as-built” construction details, and building systems’ operations and maintenance instructions among all project stakeholders. BIM supports both the initial design and construction, as well as the follow-on operation and maintenance of a facility. Within the federal government, its use is led by the General Services Administration, with input and support from the National Institute of Building Sciences and private industry partners.

⁵⁷[GAO-06-641](#).

Being More Responsive to
Requests for Equitable
Adjustment

with note that State neither consistently approves the use of substitutes, nor consistently provides timely decisions, even in cases where certain products or materials have been approved for use on another State project. While State reports it is continuing with its efforts to develop such a database, contractors have yet to see evidence that State's approach to approving substitutions is more efficient and timely.

In 2006, State issued policy and procedures for processing a contractor's request for equitable adjustments (REA). State reports it has recently implemented a new centralized system of receiving, processing, and tracking all REAs at OBO headquarters. REAs are visible to senior managers—REA status is reviewed monthly at Program Performance Review meetings—who hold project directors accountable for providing a timely response. Under this process, State seeks to receive, assess the merits of, and respond to contractors' REAs within 55 days. However, if State requires additional information following the receipt of an REA, the time needed for the ensuing information exchange and related discussions may affect State's ability to achieve final resolution within 55 days. Given that State may, in certain instances, be unable to address an REA within 55 days, some contractors with whom we spoke said that State still takes too long in responding to REAs. In addition, one contractor indicated that State purposely defers its decisions on REAs so that it can use them as leverage in future negotiations. For example, State might negotiate waiving or reducing liquidated damages that it could assess for a contractor's late completion in exchange for the contractor withdrawing its REA. While we did not examine the merits of these allegations, contractors' concerns suggest that State's continued attention to REA management is needed.

State Is Making Organizational Changes to Improve Internal Coordination and Communication and Enhance Accountability

In September 2008, State created a dedicated project management group responsible for providing coordination and oversight from planning through construction and commissioning. State initiated this effort based on a recommendation of its internal working group that was based, in part, on State's Office of the Inspector General's finding that OBO's former organizational structure—in which project management responsibility passed sequentially from a planning office⁵⁸ to an executing office⁵⁹—allowed for marginally effective coordination, communication, and accountability. Under the former organizational structure, project executives responsible for construction and commissioning were not heavily involved in planning efforts conducted by planning managers. Similarly, planning managers who typically spent at least a year developing project requirements prior to the contract award were normally not involved in design and construction oversight efforts managed by project executives. As a result, no one in OBO maintained comprehensive knowledge of a project from start to finish, which may have contributed to accountability gaps when a project passed from one office to the next.

The new project management group, the Project Development and Coordination (PDC) Division, resides within the Office of Program Development, Coordination, and Support—formerly called the Office of Project Execution.⁶⁰ Project managers in the PDC Division—who will be required to obtain project management certification, in accordance with

⁵⁸The project planning and RFP development process resided within the Office of Planning and Real Estate. The planners within that office were the principal project proponents responsible for gathering and formulating the planning information required to support the RFPs. These planners coordinated with stakeholders at the post and regional bureau and with other interested agencies. The planning manager was the effective accountable person for this front-end project planning and RFP development phase.

⁵⁹Construction and commissioning efforts were managed by the Construction and Commissioning Division within the Office of Project Execution. Two OBO staff members—the project executive in Washington and the project director at post—worked jointly to manage the project from design-build contract award through construction and commissioning.

⁶⁰Some of the new positions in the PDC Division may be staffed by former planning managers who have been transferred from the Office of Planning and Real Estate (PRE) to the new Office of Program Coordination and Support (PCS). The organizational realignment effectively moves detailed project development and coordination functions from PRE to PCS. PRE will retain responsibilities for strategic planning functions, such as the development of the Long-Range Overseas Building Plan (LROBP).

Office of Management and Budget (OMB) requirements⁶¹—will lead a multidisciplinary team of subject matter experts in performing project management functions. During the project’s planning and design phases, project managers will be responsible for efforts such as developing the RFP, overseeing procurement of the design bridging contract, chairing design review meetings, and approving design changes. During the construction phase, project managers will coordinate with construction executives from the Office of Construction, Commissioning, and Maintenance to support on-site project directors in administering NEC construction contracts. The working group noted that during construction the three individuals—project director, project manager, and construction executive—must have clearly defined roles that are properly coordinated to avoid confusion and to ensure that resources are being used efficiently. Under the new organizational structure, the project director is State’s on-site representative who routinely interfaces with the contractor and serves in the key role of contracting officer’s representative.⁶² The construction executive is the Washington-based focal point for all communications from the project director and performs key functions, such as serving as the alternate COR, and processing invoices and project change requests. At the same time, the project manager serves as leader of the Washington-based team and is responsible for tasks such as leading integrated design reviews; managing contract documents; and, in conjunction with the construction executive, reporting to senior management on project performance at monthly review meetings. However, because the organizational change was only recently implemented, it is too early to determine whether it enables project directors, project managers, and construction executives to effectively coordinate efforts and optimize project management efficiencies.

⁶¹OMB Circular No. A-11, Part 7, *Planning, Budgeting, Acquisition, and Management of Capital Assets* (June 2008) requires that project managers meet training and experience requirements defined by Federal Acquisition Certification for Program and Project Managers (FAC-P/PM) guidelines. Agencies must be compliant with FAC-P/PM beginning in fiscal year 2008. OBO staff performing project management functions in the PDC Division will hold the title of “project coordinator” until they meet the OMB requirements to be designated as a “project manager.”

⁶²The COR directly supports the Contracting Officer. The COR is typically involved in coordinating the development of project requirements, certifying that funds are available for contract award, participating in preaward negotiations with prospective contractors, and performing other activities to support the contracting officer in soliciting offers from contractors and making an award. Following the contract award, the COR, among other activities, monitors a contractor’s cost and schedule performance, advises on contract change requests, conducts quality assurance inspections, approves contractor invoices for payment, and accepts completed work.

Conclusions

From 1999 to December 2008, State constructed 64 new embassies, consulates, and annexes and relocated more than 19,500 U.S. government employees to safe, secure, and functional state-of-the-art office buildings. In 2007, State concluded that “the current pool of American contractors qualified and able to carry out diplomatic construction projects overseas has nearly reached its capacity.” In 2007, State proposed amendments to the Omnibus Diplomatic Security and Antiterrorism Act of 1986 that would allow smaller U.S. companies and foreign companies to compete for projects for which they currently would not qualify. Congress did not act on the proposed amendment. In December 2008, State indicated it would modify that proposal to extend greater opportunities only to U.S. construction firms that currently cannot meet the U.S. persons definition. However, State has completed no systematic analysis in support of its conclusion and legislative proposal, including assessments of the significance and cause of changes in contractor willingness to participate in the NEC program, how these changes have affected its construction program, how its proposed amendments would address those causes and effects, the risks associated with its proposed amendments, or how it would mitigate those risks. In addition, State has not assessed the extent to which companies comprising the U.S. construction sector are capable of meeting the current criteria. Absent such support, it is unclear how State’s proposed amendment would affect the NEC program.

In our analysis, we found that contractor participation declined in recent years for two reasons. First, increasing construction costs have made it more difficult for some firms to qualify for awards. Second, contractors reported that State management and construction processes undermine their ability to turn a profit, which is their primary incentive for participating in the program. State has recently implemented a number of changes to its management of the NEC program by improving communications with the contractor community, refining some of its management practices by implementing process reforms and mitigating some of the risks associated with NEC projects, and reorganizing its management structure. These efforts are designed to improve State’s overall management of the NEC program, including increasing the number of firms willing to participate in the program, and they address some of the important factors contractors reported as affecting their decisions to participate in the NEC program. While these changes may increase contractor participation, their full effects on the NEC construction process may not be apparent for a number of years, and State will need to monitor their effectiveness.

Recommendations for Executive Action

We recommend that the Secretary of State conduct a systematic review of the embassy construction contractor base that (1) demonstrates whether the U.S. contractor base that is both capable of meeting current requirements and willing to participate in the NEC program is adequate; (2) estimates the expected benefits and identifies the potential risks associated with the legislative proposal; and (3) details how the risks would be mitigated.

Agency Comments and Our Evaluation

In written comments on a draft of this report, State said that although the contractor base has been adequate in the fact that it has met the legislatively specified minimum level of competition, the program could benefit from expanding competition. Additionally, State said it would revise its proposed amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986 by opening competition for NECs only to U.S. companies that meet the specified security requirements for a project, rather than requiring them to meet the current statutory definition of a U.S. person. State also said that since full and open competition is a central principle for federal acquisitions, a cost-benefit analysis is unnecessary. We disagree with State's view. State initiated a process to revise the qualifying criteria for NEC awards, but it has provided no compelling analytical support for why the criteria should be amended, how such an amendment would be implemented, the expected benefits and potential risks associated with the changes, or how any identified risks would be mitigated. Absent such support, it is unclear how the proposed changes would affect State's program. We, therefore, believe our recommendation remains valid.

In a draft of this report, we had a second recommendation that State assess how its efforts to improve communication with contractors, implement process reforms and mitigate project risks, and reorganize its organizational structure affect contractor participation. In a December 2008 meeting with State officials and in State's written comments, the department noted that it would continue to actively engage with contractors and assess its performance. However, State also noted that it may take a number of contract cycles for its recent outreach efforts and procedural and organizational reforms to achieve their full impact. We agree that it may take time before the overall effectiveness of State's recent efforts can be fully assessed. Therefore, we decided to delete the recommendation.

State's comments, along with our responses to specific points, are reprinted in appendix III. State also provided technical comments, which were incorporated into the report, as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, sending copies of this report to interested congressional committees and the Secretary of State. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact Jess T. Ford at (202) 512-4128 or fordj@gao.gov, or Terrell G. Dorn at (202) 512-6923 or dornt@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.



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Appendix I: Scope and Methodology

To address the first objective—how the contractor participation in the NEC program changed in recent years—we assessed the number of firms that prequalified and the number of contract proposals (bids) submitted for each new embassy compound (NEC), new consular compound (NCC), and new office building (NOB) awarded from 2002 to 2008. Collectively, we refer to this class of projects as NECs. Data for prequalifying firms were derived from the Department of State’s (State) Office of Logistics Management and were cross-referenced with prequalification records derived from the Federal Business Opportunities Web site (<http://www.fbo.gov>). Data for the number of bids were also derived from State’s Office of Logistics Management and, to the extent possible, were corroborated with contract information and State analyses obtained during previous GAO work. In cases where discrepancies occurred between the two sources, or where we could not confirm the data, we used the data provided by State. Data for the number of prequalifying firms and number of bids submitted for all 10 NECs awarded from 1999 to 2001, as well as for three projects from 2002 onward, were unavailable; thus, they were excluded from the analyses. Non-NEC projects, including those labeled by State as interim office buildings (IOB), newly acquired buildings (NAB), new office annexes (NOX), and Standard Secure Mini Compounds (SSMC), were also excluded from the analyses. Table 2 shows the NEC projects included in our analyses, and the numbers of prequalifying firms and bids submitted for each NEC award (see page 16 of this report). We determined that these data on the numbers of prequalifying firms and bids received were sufficiently reliable for our purposes.

To determine how contractor participation has changed over time, we tracked the variations in the yearly average number of firms per project that prequalified to bid for NECs and the yearly average number of bids submitted per NEC project. We also compared these averages with the yearly average estimated NEC project costs. Data for estimated costs derive from two sources. For fiscal years 2005 to 2008, the estimated costs for NECs derived from notices of solicitations for contractors to submit prequalification packages. In cases where a range was provided for the estimated cost, we used the maximum estimated value for our analysis. Estimated costs for 2002 to 2004 were calculated based on (1) a 2005 OBO analysis of variances between contractor bid prices and the government estimated prices for each NEC project and (2) the actual original value of the contract award. We determined that these cost data were sufficiently reliable for our purposes.

We also developed two regression models to understand the factors that influence contractor participation. Each model was based on the individual NEC contracts (NEC, NOB, and NCC) that were awarded from 2002 to 2008 (see table 2 on page 16 of this report). The first model used fiscal year and estimated project cost as independent variables to predict the number of firms that prequalify to bid per NEC project. We found a statistically significant inverse relationship between the estimated NEC project cost and the number of prequalifying firms (coefficient estimate = -0.09, p-value = 0.000), such that higher estimated costs result in fewer prequalifying firms, and lower estimated costs result in more prequalifying firms. However, the relationship between fiscal year and the number of prequalifying firms was not statistically significant (coefficient estimate = 0.34, p-value = 0.108). In the second model, we used the fiscal year and the number of prequalifying firms for each NEC project as dependent variables to predict the number of bids received per NEC project. We found a statistically significant inverse relationship between fiscal year and the number of bids per project (coefficient estimate = -0.19, p-value = 0.020), such that the number of bids per NEC project declined significantly from 2002 to 2008. We also found that the number of prequalifying firms per project are significant predictors of the number of bids received (coefficient estimate = 0.18, p-value = 0.002), such that more bids are received when more firms prequalify to do so. In our modeling, we considered statistical significance to help specify the variables to include in our models.

To address the second objective—the degree to which State has assessed the need for or potential outcomes of its proposed amendment to the Omnibus Diplomatic Security and Antiterrorism Act of 1986—we reviewed State documents on legal requirements to qualify for NEC awards, State’s proposed amendments to these legal requirements, and State’s contract solicitation and award processes. We also conducted interviews with State staff on the level of analyses State completed in support of the proposed amendment, the likely benefits that would be gained, how risks to the government would change, and how those risks would be mitigated. To test State’s assertion that sufficient capacity no longer exists among the U.S. contractor base to complete NEC awards, we compared the extent to which firms listed by *Engineering News Record* (ENR) in its compilation of the top 100 U.S. design-build firms for 2008 had prequalified for NEC awards from 2002 to 2008, and received awards from 2002 to 2008.¹ The

¹See footnote 4, p. 2.

top 100 list is determined by ranking companies' total 2007 revenues derived from design-build contracts where those construction projects are designed and built by its own workforce or in conjunction with joint-venture partners and subcontractors. We also searched Web sites of, and conducted Lexis-Nexis searches on, the top 100 companies to determine whether these firms have ongoing operations in countries where State's Bureau of Overseas Buildings Operations (OBO) plans to build NECs in 2009, as listed in OBO's *Long-Range Overseas Buildings Plan, FY 2008-2013*. Underlying these analyses is our assumption that the companies on this list could meet at least the financial criteria, as outlined in the Omnibus Diplomatic Security and Antiterrorism Act of 1986, to qualify for NEC awards since (1) the 96th-ranked firm prequalified to bid for NEC awards in fiscal year 2008 that were in excess of its 2007 revenues² and (2) at least four other firms not on the list—American International Contractors Inc. (Special Projects), Aurora LLC, Environmental Chemical Corporation International, and Framaco International—prequalified for the 2008 awards. We did not independently confirm the validity of *ENR's* methodology for developing its top 100 ranking, nor did we independently verify the accuracy of information derived from the company Web sites or Lexis-Nexis searches. However, because our analysis was designed to illustrate a potential for untapped contractor capacity, we determined that the data we used were sufficiently reliable.

To address the third objective—factors that affect contractors' decisions to participate in State's construction program—we identified the universe of 21 U.S. construction firms that won awards to build U.S. embassies, consulates, and diplomatic annexes since 2001. Foreign firms and U.S. firms awarded only contracts for construction other than office buildings, such as Marine Security Guard quarters, staff housing, and other construction projects were not included in our census. Three of the 21 U.S. firms were excluded from our interviews for various reasons—one company is no longer in business, while two others received sole-source contracts that would make them unable to respond to a number of the competitiveness questions in our interview instrument. A fourth company was excluded because we could not arrange a meeting with that company. As a result, we interviewed 17 U.S. contractors from March-June 2008 (see table 6). From 2001 to 2007, these 17 companies were awarded 78 NEC

²Our analysis is based solely on whether a company was certified as prequalified to bid for at least one NEC award in any year from 2002 to 2008. It is unclear whether the companies that have not prequalified to bid have shown interest in participating in the NEC program, or whether some companies, if any, were denied prequalification in some years.

and related contracts with original values totaling approximately \$4 billion. This latter value represents 81 percent of all embassy, consulate, and annex construction contracts awarded through 2007.

Table 6: U.S. Construction Firms Participating in GAO Structured Interviews

Dollars in millions

| Firm | Location | Number of awards | Total original award value: 2001-2007 |
|---|---------------------|------------------|---------------------------------------|
| B.L. Harbert International, LLC | Birmingham, Ala. | 17 | \$941.4 |
| Fluor Intercontinental, Inc. | Greenville, S.C. | 17 | 773.1 |
| Caddell Construction Co., Inc. | Montgomery, Ala. | 14 | 768.7 |
| H. B. Zachary Company | San Antonio, Tex. | 5 | 462.9 |
| Aurora, LLC | Rockville, Md. | 3 | 221.7 |
| Kellogg, Brown & Root, Inc. | Arlington, Va. | 2 | 178.4 |
| American International Contractors (Special Projects), Inc. | Arlington, Va. | 2 | 173.3 |
| Hensel Phelps Construction Co. | Greeley, Col. | 2 | 126.1 |
| Framaco International | Rye Brook, N.Y. | 4 | 87.9 |
| W. G. Yates & Sons Construction Co. | Philadelphia, Miss. | 1 | 86.9 |
| Telesource International, Inc. | Lombard, Ill. | 1 | 42.6 |
| Gilford Corporation | Beltsville, Md. | 2 | 26.2 |
| Contracting, Consulting, Engineering, LLC | Annapolis, Md. | 2 | 23.3 |
| Desbuild, Inc. | Hyattsville, Md. | 2 | 23.0 |
| Dynamic Corp. | Hyattsville, Md. | 1 | 21.2 |
| HITT Contracting | Fairfax, Va. | 1 | 14.8 |
| Montage, Inc. | Washington, D.C. | 2 | 6.8 |

Source: GAO.

To obtain consistent information from the contractors, we developed a structured interview instrument that included approximately 70 closed- and open-ended questions designed to assess contractor views and experiences on a wide range of construction-related topics, including, (1) construction experience and experience with State and other federal agencies; (2) State’s program-level and on-site construction management policies and processes; (3) incentives for pursuing construction awards; (4) challenges in completing NEC and related construction projects; and (5) profitability of NEC and related projects. To ensure that respondents understood the questions in the same way, that we had phrased the questions appropriately for this population, and that we had covered the most important issues, we pretested our instrument with three contractors and made revisions based on their input. Prior to fully implementing the

instrument, it was reviewed by the staff from the U.S. Naval Facilities Engineering Command and State's Office of the Inspector General. In addition, we briefed staff from OBO and State's Office of Logistics Management on the instrument's content, implementation schedule, and intended respondents.

To address the fourth objective—actions State has taken to address the reported decline in contractors willing to participate in the NEC program—we reviewed documentation and conducted interviews with knowledgeable State officials on (1) rules and regulations outlining the embassy construction process, including public laws, Federal Acquisition Regulations, the *Foreign Affairs Manual*, and State reports and decision memos; (2) delivery methods and partnering policies employed by other federal agencies and supported by leading industry groups; (3) State's efforts to improve communications with the contractor community, including meetings with industry groups and individual contractors; (4) State's reorganization of planning offices, including the development of a new project management group and project manager positions; and (5) State efforts to improve construction processes, including lengthening project schedules, streamlining the contract solicitation process, and clarifying contract documents. We also attended State's monthly program performance meetings, its quarterly Industry Advisory Panel meetings, and its annual Industry Day meeting, at which information about contract opportunities was presented to firms who attended the event. Finally, we reviewed past GAO work on embassy construction and met with and reviewed the report of a State Inspector General inspection team reviewing OBO operations.

We conducted this performance audit from October 2007 to January 2009, 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Contractor-Reported Challenges to Completing State Construction Projects

Contractors rated 24 challenges as “Major,” “Moderate,” “Minor,” or “Not a Challenge.” Then, they rank-ordered their major challenges. We created the challenge categories to facilitate analysis and discussion. Table 5 in the main text shows the rank-ordered major challenges. Table 7 displays how contractors rated all the challenges.

Table 7: Contractor-Reported Challenges to Completing State Construction Projects

| Challenge category | Challenges | Major challenge | Moderate challenge | Minor challenge | Not a challenge |
|------------------------------|---|-----------------|--------------------|-----------------|-----------------|
| Logistics | • Logistics (getting labor and materials to the site) | 12 | 4 | 1 | 0 |
| | • Obtaining housing for workers | 0 | 5 | 10 | 2 |
| Schedule | • Meeting State/OBO’s construction schedule | 14 | 2 | 1 | 0 |
| Financial | • Currency fluctuations | 12 | 4 | 0 | 1 |
| | • Obtaining performance bonds | 5 | 4 | 2 | 5 |
| | • Timeliness of payment | 0 | 2 | 5 | 9 |
| Labor | • Finding qualified workers (cleared) | 10 | 5 | 1 | 1 |
| | • Keeping qualified workers (cleared) | 10 | 4 | 2 | 1 |
| | • Finding qualified workers (noncleared) | 8 | 6 | 3 | 0 |
| | • Keeping qualified workers (noncleared) | 2 | 8 | 7 | 0 |
| Foreign government relations | • Dealing with foreign governments (permitting issues, clearing materials through customs, paying tariffs) | 6 | 5 | 6 | 0 |
| | • Obtaining reliable information about local country conditions (e.g., requirements to register firm, value added tax reimbursement, availability of local workers and materials) | 5 | 6 | 5 | 1 |
| | • Obtaining visas for contractor employees | 3 | 7 | 6 | 1 |
| State approvals | • Obtaining approval to use substitute materials | 5 | 8 | 2 | 1 |
| | • Obtaining timely design reviews from OBO or the Bureau of Diplomatic Security | 7 | 4 | 5 | 1 |
| | • Obtaining timely response from State/OBO on accepting site changes | 5 | 6 | 3 | 2 |
| | • Obtaining timely response from State/OBO staff on material submittals | 4 | 5 | 7 | 0 |
| | • Excessive changes requested by State/OBO | 4 | 5 | 5 | 3 |
| | • Obtaining timely response from State/OBO on final commissioning inspections | 3 | 4 | 2 | 6 |
| | • Obtaining timely response from State/OBO staff on requests for information | 2 | 5 | 8 | 1 |
| | • Obtaining timely responses from State/OBO on progress inspections | 1 | 3 | 7 | 4 |

**Appendix II: Contractor-Reported Challenges
to Completing State Construction Projects**

| Challenge category | Challenges | Major challenge | Moderate challenge | Minor challenge | Not a challenge |
|---------------------------|---|------------------------|---------------------------|------------------------|------------------------|
| SED/design requirements | • Resolving instances of differing site conditions | 6 | 4 | 6 | 1 |
| | • Conforming to the standard embassy design | 6 | 3 | 7 | 1 |
| | • Adapting the standard design to accommodate site conditions | 3 | 5 | 6 | 3 |

Source: GAO.

Appendix III: Comments from the Department of State

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States Department of State

*Assistant Secretary for Resource Management
and Chief Financial Officer*

Washington, D.C. 20520

Ms. Jacquelyn Williams-Bridgers
Managing Director
International Affairs and Trade
Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548-0001

DEC 31 2008

Dear Ms. Williams-Bridgers:

We appreciate the opportunity to review your draft report, "EMBASSY CONSTRUCTION: Actions Are Needed to Address Contractor Participation," GAO Job Code 320560.

The enclosed Department of State comments are provided for incorporation with this letter as an appendix to the final report.

If you have any questions concerning this response, please contact Christina Maier, Program Management Analyst, Bureau of Overseas Buildings Operations at (703) 875-5752.

Sincerely,

A handwritten signature in black ink, appearing to read "S. Kaplan".

Sid Kaplan (Acting)

cc: GAO – Sam Bernet
OBO – Richard Shinnick
State/OIG – Mark Duda

Department of State Comments on GAO Draft Report

**EMBASSY CONSTRUCTION: Actions Are Needed to Address Contractor
Participation**
(GAO-09-48, GAO Code 320560)

Introduction

The Department of State appreciates the opportunity to review the subject draft report. Overall, the report is informative and supportive of OBO's on-going initiatives to increase participation in the Embassy Construction Program and facilitate contract execution. We will use the findings and information to further our efforts to improve the efficiency and effectiveness of OBO's operations and increase the participation of contractors. We offer the following comments:

- The Department of State asks that the title of the report be changed to "**Additional** Actions Are Needed to Address Contractor Participation." The report highlights a number of actions previously initiated by State to reduce contractor risk by streamlining the contract documents, adjusting the contract period of performance, and to improve outreach to the contractor community. State agrees that the addition of more interested, responsible bidders for State projects would benefit the program and continues to strive towards enlarging the contractor pool, but the conclusions drawn in the report regarding a reduced number of bidders and a need for many of the actions recommended in the body of the report are not currently supported by the facts presented. We would like the "history" to be separated from the present.

Comments on Text

Construction Schedules

The report states "firms indicated that they cannot meet the reduced construction schedules due to unclear solicitation documents and contract requirements, laborious design reviews ..." (Page 6); [State notes that these schedules have already been extended.]

- The Department would like to emphasize that the period of performance for contracts were explicitly spelled out in the Request for Proposals (RFPs) and the contractors considered that when preparing the proposals that ultimately

See comment 1.

See comment 2.

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became contracts. Consequently, the RFP and the subsequent contract include the requirements for design reviews and provide an established timeframe within which the US Government is to perform this function. If the government exceeds this timeframe, it is liable for the delay assuming no culpability on the contractor's part (i.e. an incomplete design submission). As a result, the Department's initiative to streamline the RFP documents and use bridging should reduce the conflicts within the contract documents, any confusion of interpretive requirements, and perhaps reduce the number of design comments. We have reviewed the historical performance of the projects completed between 2001 and 2007 and increased the durations for future projects to more closely align with both historical averages and our trend towards better performance. We have developed a standard form to use to develop the duration for each of our design/build projects, however, as starting points, we give an unclassified annex or an SSmC 24 months, a small SED 28 months, a medium 30 months, a large 32 months, and a extra large/special 36 months for design and construction.

Cleared Workers

The report states "contractors explained that "cleared" workers – those with security clearances – who are willing to live overseas in often unappealing locations are in relatively short supply." (Page 31)

- OBO can provide the GAO with additional information on how OBO captures risk and increase in salaries to demonstrate that the "estimating" is not arbitrary but rather a calculation based on a demonstrated financial criteria. Less competition arguably results in higher pricing, however, higher pricing results in fewer firms meeting the financial criteria. Perhaps, a solution would be to draw in larger contractors that have the financial capacity for the work, in accordance with GAO's recommendations. We have reached out to one of the largest U.S. construction contractors, and will continue outreach efforts to other large U.S. construction firms.

Project Location

The report suggests "contractors believe that State could provide more helpful information about the locality."

- The Department welcomes the opportunity to work with the contractor community to identify information that would be helpful to them and

See comment 3.

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structure our initial planning phase to collect and package information for their use. However, it will ultimately be our contractors' responsibility to establish the local conditions upon which they base their bids.

Recommendations for Executive Action

The GAO recommends that the Secretary of State take two actions:

- Conduct a systematic review of the embassy construction contractor base that (1) demonstrates whether the US contractor base that is both capable of meeting current requirements and willing to participate in the NEC program is adequate, (2) estimates the expected benefits of State's legislative proposal to allow greater participation by foreign and smaller US firms, including how such an expanded contractor base would affect actual NEC awards, and (3) identifies the potential risks associated with the proposal and details how they would be mitigated; and [*N.B.* – as explained below, State will not pursue legislative action to allow more participation by foreign firms.]
- Assess how State's actions to improve communications with contractors, implement process reforms and mitigate project risks, and reorganize its organizational structure affect contractor participation.

Construction Contractor Base

- Recognizing the continuing need to ensure NEC project security, we have reconsidered our pursuit of the legislative proposal to allow foreign firms greater levels of participation in our projects. We would, however, propose to seek amendment of Section 402 of the Omnibus Diplomatic Security and Antiterrorism Act of 1986 to allow more U.S. firms to qualify as a "United States person" for work on diplomatic construction projects overseas in order to increase competition and decrease costs. All responsible U.S. firms who can meet the specified security requirements should be permitted to bid, rather than requiring firms to meet the current complicated statutory definition of "U.S. person." Since competition on such a basis would follow the full and open competition principles central to Federal acquisition, we do not think it should be necessary to present a cost-benefit analysis justifying such a change.
- We believe that the contractor base has been adequate, in that it has consistently met the legislatively specified minimum level of competition. However, we agree with the GAO's findings that the

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program would benefit from expanding the pool of participating contractors, thereby increasing the level of competition. We will continue to work actively towards expanding our bidding pool, and we are reaching out to industry for recommendations. For example, we have recently held a series of meetings with one of the largest American contractors, who is not currently bidding our projects, to review our contract documents and solicit feedback to reduce and/or properly apportion risk in our contracts. This review is ongoing.

- We agree that it is important to improve communications with contractors and will continue to actively engage our contractors and assess our performance in these areas. We believe it may take several contract cycles for the recent changes at OBO to achieve their full impact.

The report says that State has met the legislatively required minimum number of bidders for all but one of 61 of its NEC projects from 1999 – 2008.

- State is not pleased that one of its projects received only one bid, but in this particular case, the project had 10 pre-qualified firms. This is more than most of the other projects in the same year (2007) and the contractors may have lost interest due to the perceived level of competition.
- It is important to note that although there is apparently a decrease in the number of bids for OBO capital projects, this is likely also due to the deteriorating condition of the global economy and its impact on the construction industry. State understands that many owner organizations have seen similar, or worse, levels of decreased competition for their work.
- State questions why GAO, in the executive summary, chose to highlight the dramatic change in the number of pre-qualifying firms between 2006 and 2008, while also stating in Appendix 1 that “the relationship between fiscal year and the number of pre-qualifying firms was not statistically significant?” State believes that 2006 may be an anomaly and that it could be misleading to draw any conclusions based on a spike in a single year.

According to GAO in Appendix 1, one of our contractors was excluded from the population of contractors interviewed because “significant legal issues between it and OBO that we deemed would likely inject bias into the results.”

See comment 4.

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See comment 5.

- Presumably this was a particular smaller firm, who is in litigation with State over a \$3.7M claim. One of our former large contractors was not excluded from the contractors interviewed despite the fact that this contractor currently has more than \$96M in claims against State, comprising 92% of all of State's current certified claims. Note that this former large contractor has performed 19.5% of the work listed in GAO table 6. State has no access to the actual responses made by this large contractor and cannot determine whether bias has been introduced, but does ask that the consideration of bias be consistently applied.

Assessing State's Actions and Reforms

GAO has characterized State's poor performance with the Inman program projects and the reasons for this poor performance, to include "systemic weaknesses in program management." GAO has also highlighted some of the reforms made by OBO to its management structure and contracting, planning and construction processes as the current construction program was initiated just after the bombings of the Embassies in East Africa. Comparison of the Inman era project performance and the project performance during the 2001-2008 by any measure strongly validates the effectiveness of these reforms.

See comment 6.

- Two of the most important aspects of these reforms were the elimination of formal partnering and of the project management function as they existed during the Inman era. This does not mean that the principles of partnering or project management were eliminated, but that the lines of communication, responsibility, authority, and accountability within the organization were improved and clarified. Partnering, as it was then implemented, tended to undermine the Project Directors' ability to manage the projects in the field. The project management function, as implemented by the Project Management Division at the time, had become ineffective.
- State does not agree with many of the comments included in the latter part of the report regarding the recent creation of the Project Development and Coordination Division (PDC) and the role of the new Project Coordinators/Managers. State believes that the creation of PDC will bring much needed leadership to the development phase of our projects and result in better bidding documents – a constant complaint cited by the contractors both directly and as part of this survey. State's convinced that Project Coordinators will help ensure that the project

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teams in planning and design functions stay engaged on the project throughout the entire execution cycle. Project Coordinators are not intended in any way to replace existing oversight during the construction phase as stated in the report, but to stay engaged in Washington to the extent necessary to provide effective support to the Project Director in the field, and ensure that lessons learned can be brought into future projects quickly. State believes that the roles established for the Project Coordinators, Construction Executives, and Project Directors will prove effective, eliminate accountability gaps, and bring improvements to a program that results demonstrate is already performing well in moving foreign affairs staff to safer facilities. Only by maintaining distinct lines of accountability between the Project Coordinators responsible for the RFP and the Project Director/Contracting Officer representative responsible for executing the contract in the field can the accountability for errors be maintained.

See comment 7.

- State has noted the contractor's responses regarding their level of satisfaction with the Project Directors. Interestingly, they appear satisfied with the Project Directors on issues within the Project Directors' authority and ability to control. State believes that the Project Coordinators will help by providing improved support from Washington. State will also review the current level of the standard contracting officer's warrant provided to the Project Directors. It is currently set at \$25,000 per change, \$250,000 per year for most of our Project Directors (as it has been for more than 20 years) and it is possible that raising this amount would be beneficial to execution of the projects.
- State is somewhat surprised at the level of the losses being reported by our contractors on our projects. However, State believes, and has received confirmation from some of its contractors, that the primary reasons for these losses are the devaluation of the dollar and the inflation of construction material costs over the last few years. State has seen significant increases in bid costs over the last two years that reflect these market changes.
- State reiterates its request for copies of the contractors' responses to the open-ended questions. State has received the multiple choice responses, but has reason to believe that there may be valuable insights in the actual comments made by the contractors and is very interested in reviewing them to glean lessons learned.

The following are GAO's comments on the Department of State's letter dated December 31, 2008.

GAO Comments

1. We have adjusted the title of this report to reflect State's comments that although State has taken actions designed, in part, to increase contractor participation, the addition of more interested, responsible bidders for State projects would benefit the program.
2. State notes that it has recently increased the construction schedules for each class of SED, and streamlined the RFP process and reformed some design processes to help contractors better understand requirements and begin construction more quickly. State also said that contractors should be aware of the period of performance when preparing bids for State projects. We acknowledge in the body of the report that State has increased the time allotted to construct the various categories of SEDs. We agree with State that, based on the RFP documents, contractors should be aware of the planned construction time frame and the associated risk prior to submitting contract proposals. The report acknowledges State's efforts to streamline RFP documents and improve the design process; however, it may take a number of years and completed projects to determine how the changes affect contractors' ability to complete construction according to schedule.
3. State said that its methodology for estimating risk and salary increases is not arbitrary, but rather based on demonstrated financial criteria. Since we did not analyze how risks and salaries are estimated, we make no explicit or implicit statement on the validity of the methodology used. State also said that a solution to less competition for NEC awards could be to draw in larger U.S. firms that have the financial capacity for the work, in accordance with GAO recommendations. As a result, it has recently reached out to one of the largest U.S. construction contractors and would continue outreach efforts with other large firms. Although we do present an analysis that shows a significant number of large contractors with overseas experience have not been part of the NEC program, we do not recommend that State rely solely on large contractors.
4. State questioned why we chose to highlight the declines in the number of firms prequalifying to bid on NECs from 2006 to 2008 when that decline was not statistically significant. We explain within the text that there was an overall decline in the number of firms prequalified to bid on NEC projects from 2002 to 2008. We also state that the large

number of firms that prequalified in 2006 is likely explained by the relatively low cost for the projects awarded that year. We also note that from 2006 to 2008, the average number of firms prequalified per project decreased by 69 percent from 13 to 4. When considered with the declines in the number of firms bidding on projects, these declines indicate a decrease in contractor participation, especially in recent years.

5. State commented that the results of our contractor interviews could be biased from our exclusion of a small contractor with a limited-sized claim and our inclusion of a large contractor with current claims of more than \$90 million. We do not believe our analysis was affected by contractor bias. The draft report incorrectly stated the reason for excluding the first contractor State cited from the structured interviews. The contractor was excluded primarily because its only contract from 2001 to 2007 was awarded as a sole-source contract. Because the contractor received a sole-source contract, we believed it could not address many of the questions involving competition for NEC awards. We have made this correction in appendix I. We note this same contractor was terminated from its contract for nonperformance and subsequently filed for and received bankruptcy protection as a result of the termination. As a result, we felt its inclusion could risk biasing our work, but the contractor was not excluded for this reason. The second contractor State cited was a major participant in the NEC program, having completed 17 NEC and other projects from 1999 to 2008. We are aware of the claims the contractor has filed for a number of projects it performed, but we do not believe the existence of those claims biased our discussions with that firm or our findings, in general.
6. State disagreed with many of our comments in a draft of this report on the role of the new project manager positions. In particular, State commented that project managers are not intended in any way to replace existing oversight during the construction phase as stated in our report. Our draft report did not, in fact, indicate that project managers should replace existing oversight. Rather, our intent was to question whether the project manager's effectiveness in performing lifecycle oversight of a project could be compromised by sharing reporting responsibilities with the construction executive during construction phase. Nonetheless, in light of State's comments, and to avoid confusion, we deleted the paragraph on which State's comments are based.

-
7. State clarified that project directors could approve contract modifications of up to \$25,000 per change and up to \$250,000 per year. Changes were made to the text based on State's comment.

Appendix IV: GAO Contacts and Staff Acknowledgments

GAO Contacts

Jess T. Ford, (202) 512-4128 or fordj@gao.gov,
Terrell G. Dorn, (202) 512-6923 or dornt@gao.gov.

Staff Acknowledgments

In addition to the individuals named above, Michael Courts, Assistant Director; Michael Arnes; John Bauckman; Sam Bernet; Eugene Beye; Paola Bobadilla; and Joseph Carney made key contributions to this report.

Ashley Alley, Martin De Alteriis, Colleen Candrl, Jonathon Fremont, Elizabeth Helmer, Cardell Johnson, Dae Park, and William Tuceling provided key technical support to this report.

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