



Report to the Ranking Member,
Permanent Subcommittee on
Investigations, Committee on
Homeland Security and Governmental
Affairs, U. S. Senate

January 2015

FEDERAL CONSTRUCTION SUBCONTRACTING

Insight into
Subcontractor
Selection Is Limited,
but Agencies Use
Oversight Tools to
Monitor Performance

GAO Highlights

Highlights of [GAO-15-230](#), a report to the Ranking Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

In fiscal year 2014, the federal government obligated almost \$32 billion for construction projects using primarily competitive, fixed-price contracts. In these contracts, the government holds the prime contractor fully responsible for project delivery at the agreed-to price and schedule. Once a construction contract is awarded, the prime contractor must manage subcontractors that typically perform 60 to 90 percent of the work on a construction project. Bid shopping—whereby a prime contractor uses one subcontractor’s price in its proposal but negotiates a lower price with a subcontractor after the contract award for the purpose of retaining the difference for its benefit—is considered an unethical business practice by the construction industry. Subcontractors have alleged that bid shopping leads to poor quality construction.

GAO was asked to review the government’s insight into subcontractor selection and oversight of subcontractor performance on federal construction contracts. This report covers (1) what is known about the prevalence of bid shopping on federal construction projects and (2) what tools the federal government has to monitor and address contractor performance.

GAO judgmentally selected and reviewed construction contracts from three of the four federal agencies that obligated the most funds for construction contracts in fiscal year 2013. GAO also interviewed agency and state contracting officials and construction industry representatives. GAO is not making recommendations in this report. The agencies in this review did not provide comments on this report.

View [GAO-15-230](#). For more information, contact Marie A. Mak at (202) 512-4841 or makm@gao.gov.

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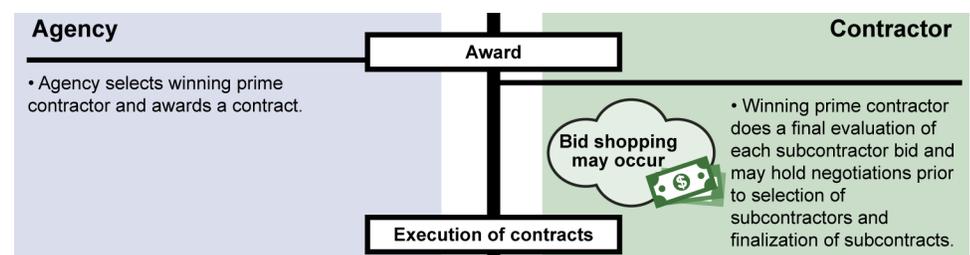
FEDERAL CONSTRUCTION SUBCONTRACTING

Insight into Subcontractor Selection Is Limited, but Agencies Use Oversight Tools to Monitor Performance

What GAO Found

GAO was not able to determine if bid shopping occurs or does not occur when prime contractors select subcontractors on federal construction projects, but found that the selection process could lead to subcontractors’ perceptions of bid shopping. GAO’s review of selected contract files did not reveal evidence of bid shopping. Further, officials at the agencies GAO reviewed stated they were not aware of bid shopping occurring on their contracts. Many of the construction contractors that GAO spoke with said that bid shopping occurs, but could not furnish evidence of specific instances. Negotiation procedures between prime contractors and subcontractors may create the impression of bid shopping among subcontractors that submit bids. Specifically, prime contractors explained that they receive multiple subcontractor bids for each trade (e.g., electrical, plumbing) up to minutes before their proposal is submitted to the government; and they typically do not use a specific subcontractor’s price in their proposal, but a price informed by the subcontractors’ bids. After award, the prime contractor negotiates and selects a subcontractor for each trade during the “buyout process,” as shown below.

Construction Prime Contractor’s Buyout Process



Source: GAO review of Federal Acquisition Regulation and interviews. | GAO-15-230

To hold the prime contractor accountable for a project’s work quality and progress, selected agencies use oversight tools such as

- agency representatives deployed on site,
- daily progress reports, and
- periodic inspections.

When performance is unsatisfactory, agencies use a number of methods to address or correct deficiencies. For example, agencies can withhold progress payments to the prime contractor or report poor contractor performance in government databases. Further, the government can be protected from poor quality construction if it appropriately uses the oversight tools at its disposal. To address bid shopping, some states are using bid listing, which requires the prime contractor to name certain subcontractors in its proposal to the state government. But the benefit of requiring bid listing in the proposal solely for the prevention of bid shopping is not certain, as past analyses of its use in the federal government have found it adversely affects the timeliness and cost of contract performance, and increases the government’s administrative expenses.

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Abbreviations

COR	contracting officer's representative
CPARS	Contractor Performance Assessment Reports System
FAR	Federal Acquisition Regulation
GSA	General Services Administration
NAVFAC	Naval Facilities Engineering Command
PPIRS	Past Performance Information Retrieval System
SBA	Small Business Administration
USACE	U.S. Army Corps of Engineers
VA	Department of Veterans Affairs

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January 29, 2015

The Honorable Claire McCaskill
Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Dear Senator McCaskill:

In fiscal year 2014, the federal government obligated almost \$32 billion for construction projects with 82 percent being awarded through competitive, fixed-price contracts. In these contracts, the federal government holds the prime contractor (also known as the general contractor in construction projects) fully responsible for project delivery. This means the prime contractor assumes the risk of meeting contract requirements, including quality assurance, at the committed price and completion date, regardless of whether the contractor's actual total cost falls short or exceeds the contract price. Once a construction contract is awarded, the prime contractor is responsible for managing its subcontractors.¹ According to government officials and construction industry representatives, typically 60 to 90 percent of the work on a construction project is subcontracted to other companies with building expertise in specific trades (e.g. plumbing, electrical, mechanical). We have found in past work on major defense weapon systems that government contracting officers are hesitant to seek information on what work is subcontracted and to monitor and manage subcontractors because the government's contractual relationship is with the prime contractor.²

Bid shopping—a business practice considered by certain construction associations to be unethical—has been a long-standing, recurrent complaint by construction subcontractors against prime contractors.³

¹The Federal Acquisition Regulation (FAR) emphasizes this responsibility. See FAR § 42.202(e)(2).

²GAO, *Defense Acquisitions: Additional Guidance Needed to Improve Visibility into the Structure and Management of Major Weapon Systems Subcontracts*, [GAO-11-61R](#) (Washington D.C.: Oct. 28, 2010).

³These associations represent construction prime contractors and subcontractors.

Generally, in both the federal and commercial construction industry, a prime contractor is considered to be bid shopping when it solicits bids from prospective subcontractors as a basis for its proposal on a construction project, wins the contract, and subsequently solicits subcontractors to seek lower prices for the purpose of retaining the difference for its benefit. Subcontractors have suspected use of bid shopping for years and point to its potential negative effects, including poor subcontractor performance, which leads to cost overruns and schedule delays. We were asked to review the government's insight into subcontractor selection and oversight of subcontractor performance on federal construction contracts. This report covers (1) what is known about the prevalence of bid shopping on federal construction projects and (2) what tools the federal government has to monitor and ensure quality of subcontractor performance on federal construction contracts and, if necessary, take action to address unsatisfactory performance.

Scope and Methodology

To conduct this work, we first identified the top four federal construction agencies based on the amount of funds obligated during fiscal year 2013 using data from USASpending.gov. We selected three of the top four agencies for further review. These agencies were the Departments of Defense—specifically the Departments of the Army (Army) and the Navy (Navy)—and Veterans Affairs (VA), and the General Services Administration (GSA).⁴ The Army, Navy, VA and GSA accounted for almost 75 percent of the total \$28 billion obligated for construction contracts in fiscal year 2013.

To identify what is known about the prevalence of bid shopping on federal construction projects, we interviewed agency contracting officials, prime contractor and subcontractor trade associations, prime contractors and subcontractors; and reviewed GAO reports, articles, academic literature, and congressional testimonies addressing bid shopping. To identify possible cases of bid shopping, we used the Contractor Performance

⁴ We did not select the Department of State, which was third in terms of funds obligated in fiscal year 2013, because of the high probability that the construction projects—and thus the prime and subcontractors—would be located overseas.

Assessment Reports System (CPARS)⁵ information to identify construction contracts where the prime contractors received low performance rating in subcontractor management. From these contracts, we judgmentally selected two contracts from each of the selected agencies for in-depth review, based on contract award amount, type of contract, and project location. At the Department of Defense, we selected two contracts awarded by the U.S. Army Corps of Engineers (USACE) and two awarded by the Naval Facilities Engineering Command (NAVFAC). The contracts were awarded between fiscal years 2009 and 2011, and in total were valued at about \$760 million. We also performed a high-level review of two additional GSA contracts during our design phase to get a sense of what contract documentation (e.g. subcontracting plan) to request that may identify subcontractors on a construction project.

To address how the federal government monitors subcontractor performance under federal construction contracts and if necessary, takes action to address unsatisfactory performance, we reviewed the FAR, which identifies tools available to the agencies to monitor and take actions to address or correct deficiencies. We also obtained and reviewed pertinent agency guidance and supplements to the FAR, Small Business Administration (SBA) regulations, and the Office of Management and Budget-Office of Federal Procurement Policy guide to best practices for contract administration. To determine if the federal agencies use these tools on construction contracts where there were subcontracting issues, we obtained information from the same eight construction contracts identified above to determine how agencies monitor prime contractor and subcontractor contract performance and address unsatisfactory performance. We reviewed documentation in the contract files such as the solicitation, proposals (including the technical evaluation), inspection reports, contractor performance reports, and other key documents for identification, monitoring and compliance purposes. We reviewed selected change orders for the contracts in our review to identify some of the reasons for cost increases and schedule delays. We also interviewed agency contracting officials, prime contractors and subcontractors about

⁵The Contractor Performance Assessment Reports System (CPARS) is a web-enabled application that collects and manages the library of performance information for contracts, including construction projects. The responsible agency official assesses a contractor's performance and provides a record, both positive and negative, on a given contractor during a specific period. The CPARS reports are then fed into a shared government-wide database called the Past Performance Information Retrieval System (PPIRS).

their experience in the contracting process. We contacted all eight prime contractors associated with the contracts in our sample to obtain information on their process to select subcontractors; three responded to our request. We also contacted 67 subcontractors for those eight contracts and received responses from eight. Our results from the analysis of these construction contracts are not generalizable agency- or government-wide. For the agencies and contracts we reviewed, our approach provided greater depth and insight into subcontractor selection. However, we did not determine whether agencies' construction contract oversight was effective.

Further, to address this objective, through interviews and literature searches, we identified 12 states that took actions through regulation that could mitigate bid shopping. We contacted these states and from the five responses received, we obtained information from officials responsible for construction contracting on bid shopping and the actions taken to mitigate its use. In addition, we spoke with officials from SBA about its requirement that for contracts over certain dollar thresholds, a large prime construction contractor notify the contracting officer in writing if it does not subcontract to a small business subcontractor that was used in preparing its proposal. We also spoke with officials at the Smithsonian Institution about its practices to require the listing of subcontractors to ensure that those selected can adequately perform the work.⁶

We conducted this performance audit from February 2014 to January 2015 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.

Background

After a prime contractor is awarded a construction contract, it negotiates with subcontractors on the scope of work and price before awarding

⁶We learned of the Smithsonian Institution's practice of requiring subcontractor listing in proposals from an interview with one prime contractor who told us it had submitted multiple proposals to the Smithsonian. We decided to meet with them because it was the only agency we learned of that regularly required potential prime contractors to list subcontractors in its proposals.

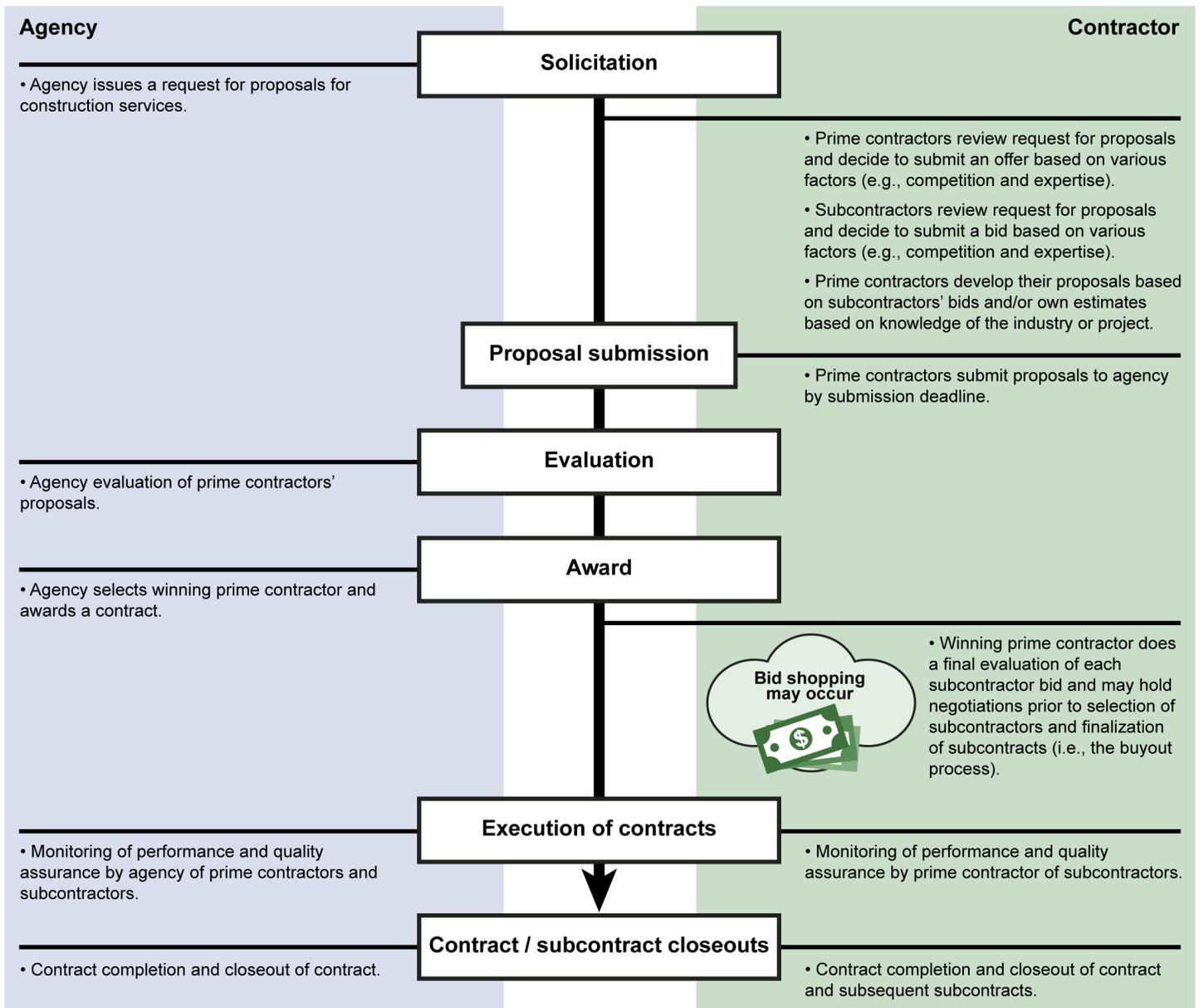
subcontracts. This period is known as the buyout process—if a prime contractor were to practice bid shopping, it would shop the original subcontractor’s bid to other subcontractors at this point.⁷ See figure 1 for a general description of the process to obtain federal construction services. For the purposes of this report, we refer to the prime contractor’s offer to the government as a proposal; we refer to the subcontractor’s offer to the prime contractor as a bid.⁸ We reported on the topic of bid shopping in 1971 and again in 1981. In those reviews, although bid shopping was generally acknowledged by government contracting personnel, state officials, and individuals in the construction industry to be a prevalent practice and recognized as a longstanding recurrent complaint by subcontractors, we were not furnished evidence of any specific cases of bid shopping having occurred.⁹

⁷While the FAR addresses ethical behavior in contracting, it does not specifically identify the practice of bid shopping. Further, the federal government does not have an official policy addressing bid shopping. See FAR Part 3—Improper Business Practices and Personal Conflicts of Interest.

⁸Contracting methods available under the FAR include sealed bids and competitive negotiated proposals. If the award will be based on price and other price-related factors and it is not necessary to conduct discussions, contracting officers generally require sealed bids. Competitive proposals may be requested if sealed bids are not appropriate, such as when it is necessary to conduct discussions.

⁹GAO, *Allegations of Unethical Bidding Practices on Federal Construction Contracts*, PLRD-81-64 (Washington, D.C.: Sept. 9, 1981); and *Correspondence to the Chairman, Committee on the Judiciary, House of Representatives*, B-109181 (Washington, D.C.: Apr. 7, 1971).

Figure 1: Contracting Process for Obtaining Federal Construction Services



Source: GAO review of Federal Acquisition Regulation and interviews. | GAO-15-230

Post-award Contract Administration

Contract administration is the management of all actions after award through the closing of the contract to assure that contractors comply with contract terms. Contract administration includes all dealings between parties to a contract from the time one is awarded until the work has been completed and accepted or the contract terminated, payment has been made, and disputes have been resolved. After a construction contract is awarded, the federal government is represented in the contracting process by a contracting officer, who has authority to modify or terminate contracts on behalf of the government. The contracting officer receives support from his/her onsite representative—the contracting officer’s representative (COR) who is the liaison between the government and the prime contractor.¹⁰ The responsibilities of the COR may include contract administration tasks and directing daily operations within the scope of the contract, and monitoring contractor and subcontractor performance to help ensure that requirements meet the terms of the contract.

No Conclusive Evidence Exists on the Use of Bid Shopping on Federal Construction Projects

We were not able to determine if bid shopping occurs or does not occur on federal construction projects, and thus were not able to determine the prevalence of bid shopping. Officials at the selected agencies we reviewed were not aware of instances of bid shopping on their construction projects, and we could not find evidence of bid shopping in the contract files we reviewed. However, many contractors in the construction industry that we spoke with told us that bid shopping does, in fact, occur. Our discussions with prime contractors as well as subcontractors indicated that some subcontractors may have a perception of bid shopping during the buyout process between prime contractors and its subcontractors.

Only Evidence of Bid Shopping Is Testimonial and Inconclusive

We found no conclusive evidence of bid shopping in our reviews of contract files, and government officials furnished no evidence of bid shopping. Government officials at the agencies we reviewed stated that they were not aware of bid shopping occurring on their construction projects. These officials also stated that the government in most cases does not have insight into how the prime contractors select their subcontractors, and if bid shopping were to occur, a contracting officer

¹⁰In construction, the COR is generally the resident engineer. The resident engineer is a person with extensive training and construction experience.

would not be aware of it unless a subcontractor filed a complaint. The selected contracts that we reviewed all showed evidence of prime contractors' performance issues with the management of subcontractors—such as untimely replacement of defective work—yet none presented evidence or complaints of bid shopping.

Although none of the prime contractors, subcontractors, and construction industry associations we spoke with were able to provide current evidence of bid shopping on federal projects, they all told us that, based on their knowledge of the industry, it does in fact occur. Most of the subcontractors stated that they had not experienced it for themselves. The industry associations we spoke with were not in agreement on the prevalence of bid shopping—one thought it was very prevalent, while the others thought it was happening in only selected circumstances or was not sure how often it was occurring. Almost all of the prime contractors and subcontractors we spoke with told us that a prime contractor that practiced bid shopping would alienate subcontractors, and a few added that prime contractors would eventually not be able to find subcontractors willing to work with them.

Subcontractor Buyout Process May Create Impression of Bid Shopping

In our discussions with prime contractors, we found that the process used to develop a proposal and the subsequent selection of subcontractors may lead to a perception of bid shopping by subcontractors. Prime contractors told us that in preparing their proposals, they try to obtain multiple subcontractor bids from each trade (e.g., electrical, plumbing, mechanical). They then use the multiple subcontractors' bids to prepare their own estimates to include in their proposal to the government. The prime contractors we spoke with stated that they generally do not use a specific price bid by one subcontractor, but use the bids to benchmark their own estimates. One prime contractor representative we spoke with stated that the company tries to obtain three bids for each trade when developing a proposal to get a better sense of a reasonable estimate to include in its proposal.

We also found that the process the prime contractor goes through to submit a proposal can be chaotic. According to both prime and subcontractors we interviewed, subcontractors, to remain competitive, often wait to submit their bids to the prime contractor until just minutes before the prime contractor is required to submit its proposal to the agency, which allows minimal time for the prime contractor to ensure that the bids are reasonable and cover the required scope of work. Four of the subcontractors we spoke with told us that this is one method to help

prevent their bids being shopped prior to contract award. For a large project, the subcontractors' bids can number in the hundreds. In fact, one prime contractor estimated that for one large project it may review approximately 500 bids to prepare its proposal. Further, according to prime contractors, it can be uncertain at the time their proposals are submitted to the government that subcontractors bids include the full scope of work, so they must do their best to quickly assess the accuracy and completeness of the various bids they review for one trade. In addition, a prime contractor told us that he may submit a low proposal price depending on who he is competing against, and then hope to negotiate further with the subcontractors during the buyout process.

We were told by the prime contractors that not until after the government awards the contract do they negotiate the specific tasks and prices with subcontractors during the buyout process. The prime contractor will verify that each subcontractor has a complete scope of work for the project, and then select and award a contract to a subcontractor to do the work. The subcontractors stated that it is common practice for prime contractors to negotiate with them on the scope and price of its proposed subcontract after contract award. Several of the subcontractors we interviewed also stated that a subcontractor may erroneously believe that its bid is being bid shopped, when in fact negotiation is part of the normal buyout process. Further, most of the subcontractors we interviewed told us that if they have not done business with and are unfamiliar with a specific prime contractor's negotiation procedures or if a prime contractor is known to shop bids, they may propose an inflated price under the assumption that the prime contractor will negotiate that price down during the buyout process. In contrast, if they are bidding to a prime contractor they know, they are more likely to provide the best price in the first bid. Accordingly, it is difficult to sort out whether the prime contractor's selection of subcontractors results from bid shopping or from the chaotic and challenging process of bidding and buying out a federal construction project.

Agencies Have a Variety of Tools to Monitor Project Quality and Methods to Address or Correct Unsatisfactory Contractor Performance

Subcontractors have suggested that bid shopping leads to poor quality construction, however we found that the selected agencies have existing tools to hold the prime contractor accountable for a project's work quality and progress and, when performance is unsatisfactory, have methods to address or correct deficiencies. The government can be protected from poor quality construction if it appropriately uses the various tools at its disposal to manage and address deficiencies. Examples of oversight tools include onsite agency representatives, daily construction progress reports and periodic inspection reports. These tools can help agencies catch instances of poor quality construction for immediate remedy. If problems persist, agencies have methods for addressing or correcting unsatisfactory performance including withholding of payments to the prime contractor and potential government-wide reporting of poor contractor performance. Further, one tool that is used by some states to prevent the poor quality construction allegedly caused by bid shopping is bid listing—whereby the prime contractor must name the subcontractors in its proposal to the state government. Bid listing may provide insight into subcontractor substitution after award. However, as past analyses of the use of bid listing in the federal government have found, the benefit of requiring it for the prevention of bid shopping is questionable in part because of the administrative burden.

Agencies Use Onsite Representatives and Other Tools to Assess Prime Contractor and Subcontractors' Work Quality and Progress

When contracting for construction services, the federal government's direct contractual relationship is with the prime contractor and not with the subcontractor, a doctrine of contract law known as privity of contract. In general, this means that the government cannot direct subcontractors to perform tasks under the contract, and the prime contractor retains legal and management responsibility for overall contract performance.¹¹ Agency officials also said that due to privity of contract, they hold the prime contractor fully accountable for the subcontractors' work quality. In our review of selected contracts, we found that agencies use a variety of tools to monitor and assess work quality and progress on a project. Specifically, the tools agencies use include onsite representatives,

¹¹However, the FAR contains certain contract clauses that prime contractors must "flow down" to subcontractors, that is, they must be included in the primes' subcontracts. For example, prime contractors must include the FAR construction wage rate requirements, formerly known as the Davis- Bacon Act, in its subcontracts, thereby requiring the subcontractor to pay federally determined prevailing wages to its workers. See for example FAR clause 52.222-11(b).

inspection reports, and a host of reporting requirements to monitor and assess work quality and progress. Further, the FAR generally provides that each contract shall include quality control requirements which the prime contractor must meet in the performance of the construction contract.¹² Agencies must use these quality control requirements to assess the prime contractor and their subcontractors to ensure they meet these standards for materials, workmanship and timeliness. Some of the tools agencies in our review used include the following:

- **Onsite representatives.** We found that agency construction projects had an onsite representative (e.g. resident engineer for construction or COR). The agency onsite representative is the agency's "eyes and ears" during construction and observes the work of the prime contractor and its subcontractors on a daily basis to ensure their work and materials conforms to contract requirements. It is this person's responsibility to assess the project's work quality, timeliness and performance of equipment and systems to help ensure that the federal government receives the services it contracts for.
- **Daily construction reports.** The contracts in our review generally require the prime contractor to furnish a report each day summarizing the daily activities onsite. At the VA, for example, the reports must show the number of trade workers, foremen/forewomen, and pieces of heavy equipment used by the prime contractor and its subcontractors on the prior day. The reports must also give a breakdown of employees by craft, location where employed, and the work performed for the day, and a list of materials delivered to the construction site on the date covered by the report. Examples of reports we reviewed for a NAVFAC project included the name of the firm and its trade (e.g. carpenters and electricians), and the type of work that they performed such as plumbing, and installing switches and doors.
- **Periodic onsite progress meetings.** Some of the contracts in our review identify what types of meetings should be held, who is to attend, and how often the meetings should be held. But depending on the type and complexity of the project, government contracting personnel can require more frequent meetings with prime contractors to monitor progress of the construction work. For example, USACE provided us examples of minutes from biweekly coordination meetings

¹² FAR § 46.102(a).

with the prime contractor; and biweekly meetings with the prime contractor and certain subcontractors for the purpose of testing the performance of certain systems, such as heating and ventilation systems. For one VA contract, the government's representatives required weekly meetings with the prime contractor and subcontractors to discuss project progress and to identify problems and solutions to those problems.

- **Inspection reports.** Inspections are performed at various stages of the project to ensure that the execution of the contract by the prime contractor (and its subcontractors) meets contract specifications.¹³ Our review of examples of inspection reports from a couple of the contract files showed inspections of work quality and in some cases testing of systems, such as mechanical, fire and electrical systems, throughout the project. The contracts may also require the prime contractor to notify the onsite representative when inspections and tests are to be conducted so that he or she may choose to be present to observe.
- **Deficiency reports.** If the agency identifies prime contractor or subcontractor nonconformance with contract material or workmanship requirements, we found that a report is prepared to notify the prime contractor of the deficiencies. The report notes who is responsible for taking corrective action, and tracks the status of corrective actions taken. In examples of the deficiency reports we reviewed, if the listed deficiency in material or workmanship was not corrected, then the deficiency stayed on the reports until it was corrected to contracting officer's satisfaction. In the final stages of a project, a list of tasks that need to be completed or corrected before the agency will accept the building for occupancy is developed, called a punch list. We found examples of punch lists in the contract files we reviewed identifying tasks to be resolved prior to final acceptance.
- **Monthly progress payment reports.** The FAR provides that agencies may make monthly progress payments to prime contractors as the work progresses.¹⁴ To achieve this, agency contracting personnel and the prime contractor agree to a schedule of tasks that need to be performed and their value. At the conclusion of each

¹³Inspection reports generally includes the purpose of the inspection, date of and weather condition, items reviewed, deficiencies observed including photos or actions taken to correct previously identified deficiencies.

¹⁴See generally FAR Part 32.5.

month, the prime contractor submits a payment request to the contracting officer that identifies the materials delivered and the percentage of work performed for each task. Since a single payment can be for millions of dollars, it is important that the project's contracting personnel adequately review the contractors' payment requests to ensure that work is billed accurately, reflects the materials used, and the work has been performed. If any discrepancies are noticed they must be resolved before any payment is made. The progress payment reports we reviewed from one GSA project summarized the status of cost and schedule information to inform how much of the contractor's monthly payment request should be approved.

- **Submission of weekly certified payrolls.** The prime contractors also submitted weekly certified payrolls, which includes information on subcontractors, so that the government can check for accuracy of wages including overtime and categorization for a particular trade (e.g., tile setter and electrician). Examples from contract files we reviewed at GSA and NAVFAC showed that the payrolls included information such as the name of subcontractor, name of employee and trade title, days and hours worked for the week.
- **Liquidated damages.** To protect itself from construction delays, an agency can include the liquidated damages clause in a prime contract, meaning that if the prime contractor fails to complete the work within the time specified in the contract, the contractor pays the government a daily fixed amount for each day of delay until the work is completed or accepted. Liquidated damages can result from a delay caused by the prime contractor or one of its subcontractors. They are not to serve as a penalty but to represent an assessment of probable damage costs that would be incurred by the agency if delay causes the work to extend beyond the contractual completion date. The liquidated damages daily rate for failure to timely complete the work is included in the prime contract. These costs can vary depending on the project. For example, for one VA contract the daily rate is \$2,800 per calendar day of delay and for one USACE contract the daily rate is \$16,500 per calendar day.

Agencies Use a Number of Methods to Address or Correct Deficiencies from Unsatisfactory Performance

While oversight can help agencies identify instances of poor quality construction, we found that the selected agencies use a number of methods to prompt the prime contractor to address or correct deficiencies identified during oversight activities if problems persist. In all cases, the government held the prime contractor solely responsible for correcting all

deficiencies, whether or not the deficient work was performed by a subcontractor or the prime contractor.

Withhold a Portion of Progress Payments to Prime Contractors

Retaining or withholding a certain percentage of each monthly progress payment owed by the government to prime contractors is a powerful motivator to encourage prime contractor and subcontractor performance. The FAR allows agencies to withhold up to 10 percent of each monthly progress payment to prime contractors in accordance with the contract until completion of all contract requirements.¹⁵ According to GSA officials, prime contractors can in turn withhold a similar percentage amount from each subcontractor's monthly progress payments until satisfactory completion of the work. Progress payments may be withheld on the contracts we reviewed to account for materials and workmanship deficiencies or lack of progress on the project by prime contractors or subcontractors. For one USACE contract, the agency retained \$850,000 in payment for flooring and carpet damage and metal panel problems, among other things.

Evaluations of Contractor Performance

Some agency officials we interviewed stated that prime contractors take their performance evaluations on a current contract very seriously because a negative performance report can work against them in trying to win future federal construction contracts. The FAR generally requires agencies to evaluate and document contractor performance on contracts that exceed certain dollar thresholds at least annually and at the time the work is completed, and to make that information available to other agencies through PPIRS, a shared government-wide database.¹⁶ In completing past performance evaluations, the assessing officials rate the contractor on various elements such as quality of the product or service, schedule, and cost control. In addition, for each element, a narrative is provided to support the rating assigned. When assessing a contractor's past performance for a potential contract award, contracting officials may consider the evaluations in PPIRS.

¹⁵FAR § 32.103.

¹⁶In a recent report we found that agencies were not consistently reporting contractor's past performance in PPIRS. See GAO, *Contractor Performance: Actions Taken to Improve Reporting of Past Performance Information*, [GAO-14-707](#) (Washington D.C.: Aug. 7, 2014). See FAR § 42.15 regarding contractor performance information.

Cure Notice and Show
Cause Notice

For all of the eight contracts we reviewed, the contracting officer provided or approved performance evaluations for the prime contractors on the projects. For example, one rating for a GSA contract was marked marginal because the concrete subcontractor did not place the concrete correctly, and the prime contractor was given a poor performance rating based on this subcontractor's performance.

A contracting officer can issue a cure notice informing the prime contractor of its failure to perform, which endangers meeting contractual requirements.¹⁷ A cure notice provides at least 10 days for the prime contractor to correct the issues identified in the notice or otherwise fulfill the requirements. A show cause notice goes a step further, advising the prime contractor that a termination for default is being considered and calls the contractor's attention to the contractual liabilities if the contract is terminated for default.¹⁸ At this point the prime contractor must show that its failure to perform arose from causes beyond its control and without fault or negligence on its part. In one example from our contract file review, a VA contracting officer issued a cure notice to the prime contractor citing, among other factors, failure to maintain an adequate quality control program to correct work deficiencies. According to the show cause notice, the prime contractor provided a response that did not address the deficiencies highlighted in the cure notice and subsequently the contracting officer issued a show cause notice. Even though the show cause notice was issued, the VA contracting officer did not terminate the contract in part because the prime contractor started to take corrective action.

With the host of oversight mechanisms in place, the government can be protected from poor quality construction if it appropriately uses the various tools and methods at its disposal to manage and correct deficiencies.

¹⁷See FAR § 49.402-3 (Procedures for termination for default), and FAR § 46.607 (Deficiency notices).

¹⁸A show cause notice may be issued if the time remaining in the contract's schedule is not sufficient to permit a realistic cure period. FAR § 49.607.

Agencies' Use of Bid Listing May Provide Insight into Potential Instances of Bid Shopping, However Benefit Is Questionable

Bid listing is a practice whereby the potential prime contractors are required to identify certain subcontractors in their proposals that it will use if awarded the contract, which moves their selection and initial negotiations with subcontractors to earlier in the contracting process than if bid listing was not used. Bid listing may provide contracting officers with some insight as to when a subcontractor is substituted after contract award because if a proposed listed subcontractor is not used, the prime contractor must notify and justify to the contracting officer the reason for the substitution and obtain the contracting officer's approval. Congress has on multiple occasions proposed—but never passed—mandatory bid listing requirements to prevent the poor quality construction allegedly caused by bid shopping.¹⁹

Even though the FAR does not currently include a bid listing provision, it does provide the contracting officer authority to ask for identification of prospective subcontractors for the purpose of determining responsibility.²⁰ We found instances in our review where prime contractors had to list their subcontractors within their proposals for the purpose of ensuring that a critical subcontractor is responsible and can meet specific requirements. For example, a Smithsonian solicitation we reviewed required the listing of subcontractors. Officials at the Smithsonian told us that this is a regular practice they use to ensure that the selected subcontractors can adequately perform the work. This requirement provides similar insights into subcontractor substitution as bid listing, as the prime contractor must notify the contracting officer of a substitution, and show that the new subcontractor is also responsible.

More recently, the Small Business Administration, in response to the Small Business Job Act of 2010, implemented regulations effective in August 2013 that require a prime contractor to notify the contracting officer in writing whenever it does not subcontract to a small business subcontractor during contract performance that was used in preparing its proposal. This explanation must be submitted to the contracting officer prior to the submission of the invoice for final payment and contract close-out.²¹ However, during the public comment period prior to the approval of

¹⁹See for example, H.R. 4012, 106th Cong. (2nd Sess. 2000); H.R. 3854, 110th Cong. (1st Sess. 2007); and H.R. 1942, 113th Cong. (1st Sess. 2013).

²⁰FAR § 9.104-4.

²¹Pub. L. No. 111-240 § 1322 (2010); 13 C.F.R. § 125.3(c)(3), (4), and (7).

the regulations, some commenters expressed concerns on the proposed regulations that the notification requirement would be a disincentive for prime contractors from involving small businesses in the development of their proposal, which may potentially limit small businesses' ability to gain valuable insight into how prime contractors approach proposal development in general.²²

Past federal research and efforts to mitigate bid shopping through subcontractor bid listing have shown that the benefits of doing so are questionable, in part because of the added administrative burden. In its 1972 report to improve federal procurement practices, the Commission on Government Procurement researched the issue of bid shopping and determined that it would not be materially improved by the adoption of mandatory bid listing requirements and that the cost of implementing requirements would likely outweigh the benefits. As a result, the Commission took a position against a mandatory government-wide requirement for subcontract listing in federal construction.²³ The Department of the Interior and GSA previously required subcontractor bid listing but stopped the practice in 1975 and 1983, respectively. GSA testified in 2000 that bid listing would create more harm than benefit and strongly opposed bid-listing requirements for a number of reasons, such as adverse affect on the timeliness and cost of contract performance and increase in the government's administrative expenses.²⁴

Further, we spoke with officials from 5 of the 12 states identified as having bid listing or other methods to mitigate bid shopping, however, none were able to provide information on whether bid listing resulted in better construction outcomes related to schedule, cost and performance. We found 12 states that have varied approaches to identify

²²78 Fed. Reg. 42,391 at 42,396-42,397. The SBA responded that although it understood this concern, the requirement is statutory.

²³Congress in the late 1960s created the Commission on Government Procurement to devise fundamental improvements to federal procurement practices. The Commission developed 149 recommendations to both Congress and the executive branch. Commission on Government Procurement, *Report of the Commission on Government Procurement*, (Washington D.C.: Dec. 31, 1972).

²⁴Statement of David A. Drabkin, Deputy Associate Administrator, Office of Acquisition Policy, Office of Governmentwide Policy, General Services Administration, before the Subcommittee on Government Management, Information and Technology, Committee on Government Reform, July 13, 2000.

subcontractors at the time of contract award. For example, one state reviews bids from subcontractors, and then tells the prime contractor which subcontractors to include in its proposal to the state, rather than the prime contractor selecting its own subcontractors. We found that bid shopping for some of these states was the factor for establishing procedures to identify subcontractors prior to contract award. In discussion with officials from some of these states, the requirement to list subcontractors in the prime contractor's proposal has been required for many years. Officials from one state told us that they are reconsidering the requirement for bid listing because of the administrative burden it is causing for state contracting officials, specifically an increase in bid protests. According to these officials, unsuccessful contractors are using this requirement to protest contract awards because of administrative mistakes in contractors listing their subcontractors. This is similar to the issue that GSA raised in the early 1980s when it stopped the requirement to list subcontractors. However, according to officials from the other states that we contacted that require bid listing, they have had no complaints from prime contractors in complying with this requirement.

Moreover, in the instances from the contracts we reviewed where cost growth or schedule delays occurred as the result of government-driven changes after award or unforeseen conditions, bid listing, if required, would not have prevented these types of changes. The FAR and agencies' acquisition regulations provide for changes to fixed-price construction contracts, known as change orders.²⁵ When the change is driven by the government, the government generally bears the additional cost. We found that most of the construction projects we reviewed experienced increased costs and schedule delays as a result of government-driven changes or unforeseen conditions. For example, on one NAVFAC contract the government decided to incorporate furniture, furnishings, and audiovisual equipment into the construction project, resulting in a cost increase of \$1.9 million for an \$11.6 million contract. On a GSA contract, after construction began, the government found a different site condition than expected and added soil remediation costs of approximately \$400,000 and provided an extension of 52 days.

²⁵FAR §§ 2.101 (definition of change order); 43.201; 43.205(d); and FAR clause 52.243-4) (Changes clause for fixed-price construction contracts).

Concluding Observations

Bid shopping is widely considered an unethical business practice, but the prevalence of the practice is unknown. It is difficult to determine, for a particular contract, whether the prime contractor's selection of subcontractors was truly a result of bid shopping or appears so due to the chaotic nature of bidding for and buying out a federal construction project. Specifically attributing poor performance to bid shopping is therefore also challenging. Though considered an administrative burden, bid listing is an optional practice available to contracting officers who determine it is necessary to ensure that the prime contractor's proposal identifies qualified responsible subcontractors.

Nonetheless, in evaluating a prime contractor's proposal, the federal government must determine that the price is fair and reasonable. After the prime contractor is awarded a fixed-price contract, it must manage the subcontractors to complete the job within the established contract price and schedule. The government has additional tools available to provide oversight to manage or correct identified deficiencies during a project's duration. As the prevalence of bid shopping on federal construction contracts is unknown, and bid listing requirements to prevent it have been discontinued by federal agencies in part due to administrative burden, we are making no recommendations.

Agency Comments

We provided a draft of this report to the Departments of Defense and Veterans Affairs, and the General Services Administration for their review and comment. None provided comments on this report.

We are sending copies of this report to the Secretaries of Defense and Veterans Affairs, and the Administrator for the General Services Administration as well as interested congressional committees and other interested parties. This report will also be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-4841 or makm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of our report. GAO staff who made key contributions to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Marie Mak", with a long horizontal flourish extending to the right.

Marie A. Mak
Director, Acquisition and Sourcing Management

Appendix I: GAO Contact and Staff Acknowledgments

GAO Contact:

Marie A. Mak, (202) 512-4841 or makm@gao.gov.

Staff**Acknowledgments:**

In addition to the contact named above, Tatiana Winger, Assistant Director; Marie Ahearn; Pete Anderson; Virginia Chanley, George Depaoli, Joe Hunter; Julia Kennon, Kenneth Patton, Russell Reiter and Ozzy Trevino made key contributions to this report.

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