

GENERAL SERVICES ADMINISTRATION OFFICE OF INSPECTOR GENERAL

**Recovery Act Report –
Thurgood Marshall U.S. Courthouse Project
Audit of PBS’s Major Construction and Modernization
Projects Funded by the American Recovery and
Reinvestment Act of 2009
Audit Number A090172/P/R/R11012**

August 19, 2011





Date: August 19, 2011

Reply to: R. Nicholas Goco
Attn of: Deputy Assistant Inspector General
For Real Property Audits (JA-R)

Subject: Recovery Act Report – Thurgood Marshall U.S. Courthouse Project
Audit of PBS’s Major Construction and Modernization Projects Funded by the
American Recovery and Reinvestment Act of 2009
Audit Number A090172

To: Robert A. Peck
PBS Commissioner, Public Buildings Service (P)

As part of our oversight of the General Services Administration’s American Recovery and Reinvestment Act (Recovery Act) projects, we noted contracting violations related to Option 2 of the Construction Manager as Constructor (CMc) contract for the Thurgood Marshall U.S. Courthouse (Thurgood Marshall) project that we believe warrant your attention. Specifically,

- The Public Buildings Service’s (PBS) exercise of Option 2 for construction phase services violated Federal Acquisition Regulation (FAR) and Competition in Contracting Act of 1984 (CICA) requirements and represents a cardinal change to the contract; and
- PBS did not adequately establish fair and reasonable pricing before exercising Option 2.

Exercise of Construction Option 2 Does Not Meet FAR and CICA Competition Requirements

PBS exercised Option 2 of the CMc contract for the Thurgood Marshall project for a firm-fixed price of \$201.9 million; \$75.0¹ million more than the \$126.8 million guaranteed maximum price (GMP) established for the option at contract award. This effectively made the option a sole source procurement in violation of both FAR and CICA requirements. In addition, a price increase of this magnitude represents a cardinal change to the contract.

PBS awarded the Thurgood Marshall CMc contract in January 2007. This type of contract is initially awarded for design phase services at a firm-fixed price with an option for construction phase services at a GMP that is established at contract award. The GMP acts as a ceiling price for the actual construction phase services. The proposed GMP should be evaluated in

¹ Difference due to rounding.

conjunction with the pricing for the design services for the award to be made in accordance with FAR 52.217-5. The Thurgood Marshall contract included preconstruction phase services at a firm-fixed price of \$120,000, and two options for construction phase services: Option 1 for bulk demolition and exterior closure repairs; and Option 2 for mechanical, electrical, plumbing, and interior construction work. Option 1 was offered at a firm-fixed price of \$42.2 million; Option 2 at a GMP of \$126.8 million. The winning CMc firm was not the highest technically qualified bidder on the project, but its total price proposal was nearly \$14.5 million (10 percent) lower than that of the highest technically qualified firm. Since the technical scores were close (within 5 percent), PBS awarded to the lower-priced firm on a best value basis.

Six months after contract award, at 90 percent design completion, the CMc contractor submitted a revised construction cost estimate for \$188.6 million.² This estimate was \$61.8 million more than the established GMP and \$47.2 million more than the GMP proposed by the highest technically qualified firm. PBS later requested a firm-fixed price proposal for Option 2, in response to which the contractor submitted a proposal with a base bid of \$255.4 million and a total evaluated price of \$295.1 million. PBS attributed a vast majority of the cost increase to drastically changing market conditions, and considered re-competing Option 2.

PBS eventually determined that re-competing the option was not feasible due to schedule and cost implications. The contracting officer estimated that a new procurement would have taken approximately eight months, plus an additional four months for a new contractor to duplicate the existing contractor's efforts to date. This additional year would have resulted in substantially increased costs, including rent for the Courts' swing space and lost rent revenue at Thurgood Marshall. Further, the existing CMc contractor was already working in the building and was "intimately familiar" with the project. PBS ultimately exercised Option 2 in April 2009, when Recovery Act funds became available, for a firm-fixed price of \$ 201.9 million.³

In exercising the option in this manner, PBS effectively converted it into a sole source procurement since PBS negotiated only with the CMc contractor. As a result, PBS violated the competition requirements of both FAR and CICA which mandate full and open competition in government procurements unless otherwise expressly authorized by statute.⁴ Agencies may use noncompetitive procedures only when certain conditions are met, and must document a justification⁵ for the use of these procedures. PBS prepared a Findings and Determination that documented the project schedule and cost considerations that led to its decision to exercise the option; however, the rationale provided is not one of the allowable circumstances described by FAR 6.302.⁶

In addition, the \$75.0 million price increase over the \$126.8 GMP raised the costs for Option 2 construction phase work by 59 percent. While there were no significant changes to the scope,

² This estimate was reconciled in August 2007 to \$169.0 million.

³ Option 2 was exercised via Modifications PO72, PO73, and PO74 on April 15, 2009, with a base bid of \$201.9 million and total evaluated price of \$233.0 million.

⁴ FAR Subpart 6.1 – Full and Open Competition.

⁵ The General Services Acquisition Manual 536.270 specifies that before an unpriced option can be exercised, the agency must cite the statutory authority permitting the use of other than full and open competition.

⁶ FAR 6.302 - Circumstances permitting other than full and open competition.

magnitude, or type of work contemplated under the original contract, a price increase of this degree amounts to a cardinal change to the CMC contract. As such, PBS should have re-competed the option or provided a valid justification for using non-competitive procedures.

PBS's Determination That Option 2 Pricing is Fair and Reasonable is Inadequate

PBS did not sufficiently establish fair and reasonable pricing before exercising Option 2 for construction phase services. PBS based its pricing determination on two factors: a comparison of proposed pricing to a March 2009 Government estimate and competition in the CMC contractor's subcontracting process. However, the estimate used in this case did not qualify as an independent government estimate, and competition at the subcontractor level does not meet FAR requirements for establishing price reasonableness.

To establish price reasonableness, PBS appears to have relied principally on a comparison of the proposed Option 2 price to a March 2009 Government estimate. PBS found that the proposed price of \$201,903,657 was reasonable since it was only 7 percent higher than the Government estimate of \$188,477,747.⁷ However, the estimate used was based on a construction estimate developed by a professional estimator hired by the project's design firm. GSA guidelines require that Government estimates not be influenced by input from either the design firm or the CMC contractor. Accordingly, the requirements for an independent government estimate were not met.

PBS also relied on the CMC contractor's subcontractor competition as a basis for establishing price reasonableness. FAR 15.404-1 indicates that adequate price competition normally establishes a fair and reasonable price. However, due to the manner in which PBS exercised this construction option, there was no price competition at the CMC level. Instead, price competition was limited to the subcontractor level, which does not meet the FAR competition requirements.

Further, PBS did not verify the proposed subcontractor costs upon which the CMC contractor's proposal was based before exercising the option. Instead, the contract modifications exercising Option 2 incorporate a clause stating that, "final negotiation of this Option is subject to adjustments based on an audit by the Office of Inspector General for Auditing."⁸ PBS contracting officials stated that this "subject to audit" clause was inserted so that PBS could exercise the option and subsequently adjust the option price based on actual subcontractor costs. However, PBS exercised the option on a firm-fixed price basis instead of at a GMP, and the FAR does not permit changing pricing for firm-fixed price contracts. FAR 16.202-2– *Fixed-Price Contracts* states that a firm-fixed price contract is suitable when the contracting officer can establish fair and reasonable prices *at the outset*. Further, a firm-fixed price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. As such, the FAR does not permit the contracting officer to renegotiate the price for a firm-fixed price contract retroactively.

⁷ \$182,477,747 plus \$6.0 million for allowances.

⁸ On May 14, 2009, PBS asked the GSA OIG to audit the contractor's subcontractor procurement procedures to ensure there was adequate and fair competition for Option 2.

Conclusion

PBS contracting staff inappropriately exercised Option 2 of the CMc contract for the Thurgood Marshall U.S. Courthouse Project. As exercised, this option for construction services exceeded the agreed-upon GMP by \$75.0 million. In effect, the option is a sole source procurement that does not satisfy FAR and CICA competition requirements and represents a cardinal change to the contract. Further, the contracting officer did not provide adequate assurance that agreed-upon prices were fair and reasonable. Consequently, the Government is unnecessarily exposed to considerable financial risk.

Recommendations

We recommend that the Commissioner of the Public Buildings Service:

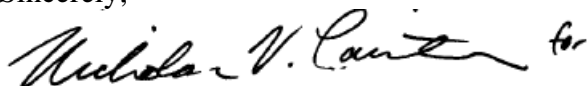
- 1) Ensure that controls are in place to prevent PBS from exercising CMc construction options at firm-fixed prices that exceed the agreed-upon Guaranteed Maximum Price; and
- 2) Ensure that firm-fixed price contracts are negotiated in final prior to award, rather than subject to retrospective pricing adjustments based on post-award audits by the GSA Office of Inspector General.

Management Comments

In its response to the draft report, PBS concurred with the OIG findings and accepted the report recommendations. PBS's response is included in its entirety as Attachment A to this report.

We appreciate the support that has been provided to us throughout this audit. If you have any questions about this memorandum, please contact me at (202) 219-0088.

Sincerely,

Handwritten signature of R. Nicholas Goco in black ink, followed by the word "for" in a smaller font.

R. Nicholas Goco

Deputy Assistant Inspector General for Real Property Audits (JA-R)

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Management Comments



GSA Public Buildings Service

AUG 08 2011

MEMORANDUM FOR R. NICHOLAS GOOD
DEPUTY ASSISTANT INSPECTOR GENERAL FOR REAL
PROPERTY (JA-R)

FROM: ROBERT A. PECK
COMMISSIONER (P)
PUBLIC BUILDINGS SERVICE

SUBJECT: Recovery Act Report - Thurgood Marshall U.S. Courthouse Project
Review of PBS's Major Construction and Modernization Projects
Funded by the American Recovery and Reinvestment Act of 2009
Audit Number A090172

The Public Buildings Service (PBS) appreciates the opportunity to comment on the subject draft audit report. A portion of the infrastructure upgrade of the Thurgood Marshall U.S. Courthouse project was awarded under the American Recovery and Reinvestment Act (Recovery Act) and is meeting the intent of the Recovery Act by putting people back to work, strengthening the economy, and meeting energy conservation goals.

The draft report contains two recommendations:

- 1) Ensure that controls are in place to prevent PBS from exercising CMc construction options at firm-fixed prices that exceed the agreed-upon Guaranteed Maximum Price; and
- 2) Ensure that firm-fixed price contracts are negotiated in final prior to award, rather than subject to retrospective pricing adjustments based on post-award audits by the GSA Office of Inspector General.

In response to Recommendation 1, the award of the construction option took place before PBS developed and implemented our corrective action plan to improve management controls. This corrective action plan, as designed by PBS management and approved by your office, is intended to strengthen the system of internal controls surrounding the CMc delivery method so that actions noted in this and previous audit reports are not repeated. Accordingly, we believe the actions achieved through this plan will satisfy Recommendation 1.

In response to Recommendation 2, the responsible contracting office hired a firm on September 29, 2010 to provide an on-site Certified Public Accountant in an effort to

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minimize the delays in reviews of cost and pricing data. The requirements of that contract include the independent review of cost and pricing data and other information to assist contracting officers in the determination of fair and reasonable pricing on future firm-fixed price contracts. We will ensure that firm-fixed price contracts are negotiated in final prior to award, rather than subject to retrospective pricing adjustments based on post-award audits by the GSA Office of Inspector General. Accordingly, we believe the actions achieved through this plan will satisfy Recommendation 2.

Please note that a more comprehensive response may follow upon issuance of the final audit report or as further information comes to our attention. Should you or your staff have any questions, please contact Jennifer Smith on (202) 501-4994.

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Background, Objective, Scope and Methodology

Background

The American Recovery and Reinvestment Act of 2009 (Recovery Act) provides the General Services Administration (GSA) with \$5.55 billion for the Federal Buildings Fund to convert federal buildings into High-Performance Green Buildings as well as to construct federal buildings, courthouses, and land ports of entry. The Recovery Act mandated that \$5.0 billion of the funds must be obligated by September 30, 2010, and that the remaining funds be obligated by September 30, 2011. The GSA Office of Inspector General (OIG) is conducting oversight of the projects funded by the Recovery Act.

On January 17, 2007, PBS awarded Contract No. GS-02P-05-DTC-0021(N) for the infrastructure upgrade of the Thurgood Marshall U.S. Courthouse (Thurgood Marshall) in New York City. This Construction Manager as Constructor (CMc) contract was awarded prior to the passage of the Recovery Act, and consists of a base contract for preconstruction services and two options for construction phase services: Option 1 for bulk demolition and exterior closure repairs and Option 2 for mechanical, electrical, plumbing, and interior construction work. Option 1 was exercised on March 28, 2007, for a firm-fixed price of \$35.6 million and substantially completed on January 14, 2009. Option 2 was exercised on April 15, 2009, at a firm-fixed price of \$201.9 million. Of this amount, \$64 million is funded by the Recovery Act. The project has a scheduled completion date of May 31, 2012.

Objective

The objective of the OIG’s Recovery Act oversight is to determine if PBS is planning, awarding, and administering contracts for major construction and modernization projects in accordance with prescribed criteria and Recovery Act mandates. The work for this report was performed while evaluating Option 2 of the construction contract for the Thurgood Marshall U.S. Courthouse project.

Scope and Methodology

To accomplish the objective we conducted fieldwork in the Northeast Caribbean Region, reviewed the contract file and other pertinent project documents, met with project staff, and reviewed applicable guidance and regulations.

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

The planning for this audit is based on the audit plan for oversight of the Recovery Act projects as well as audit guidance being applied to all Recovery Act projects. A separate guide was not prepared for this project.

As this work was performed under the continuing oversight of all GSA Recovery Act projects, management controls are currently under assessment. Only those management controls discussed in the report have been assessed.

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Report Distribution

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