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Report to Congressional Committees

November 2014

OVERSEAS MILITARY CONSTRUCTION

Observations on U.S. Contractor Preference

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November 2014

OVERSEAS MILITARY CONSTRUCTION

Observations on U.S. Contractor Preference

GAO Highlights

Highlights of GAO-15-45, a report to congressional committees

Why GAO Did This Study

Since the 1980s, Congress has mandated a preference for U.S. contractors for military construction contracts in certain overseas countries. In the Joint Explanatory Statement of the Consolidated Appropriations Act for Fiscal Year 2014, Congress mandated that GAO examine the potential benefits and problems of expanding this preference to the countries that make up the CENTCOM area of responsibility.

This report (1) examines the extent to which DOD has awarded military construction projects in accordance with the U.S. contractor preference and (2) describes DOD and State Department officials' views on the potential benefits and problems with expanding the U.S. contractor preference to include all countries within CENTCOM.

To examine the extent to which DOD awarded contracts in accordance with the U.S. contractor preference, GAO analyzed information concerning the contracts awarded from October 2010 to May 2014 subject to the preference to determine whether DOD applied the preference and whether the preference affected the contract award. To identify the potential benefits and problems with expanding the preference, GAO interviewed officials with knowledge of this issue.

What GAO Recommends

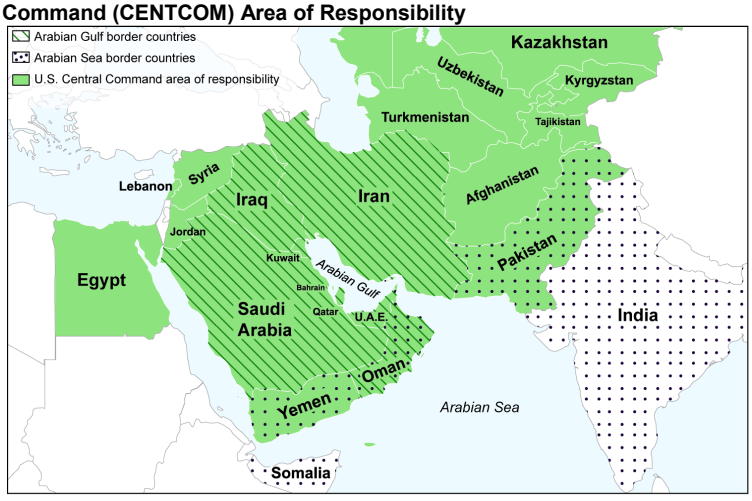
GAO is not making recommendations in this report. DOD and State Department reviewed the draft of the report but did not provide any comments.

View GAO-15-45. For more information, contact Brian Lepore at (202) 512-4523 or LeporeB@GAO.gov

What GAO Found

GAO found that the Department of Defense (DOD) did not apply the U.S. contractor preference in accordance with the current statute from October 2010 through May 2014. The fiscal year 2014 Consolidated Appropriations Act directs that military construction contracts valued over $1 million and located in countries bordering the Arabian Sea, U.S. territories in the Pacific, and the Kwajalein Atoll, be awarded to a U.S. contractor unless their price is 20 percent higher than the price from a competing non-U.S. contractor with an equally responsive and responsible bid. However, DOD incorrectly applied the preference to countries bordering the Arabian Gulf, which is geographically distinct from the Arabian Sea (see figure). DOD officials were unaware the statute changed the preference from "Arabian Gulf" to "Arabian Sea" in 2002 and therefore had not updated DOD's acquisition guidance. DOD's application, however, included the geographic area in which the majority of military construction in the Arabian Sea and Arabian Gulf locations took place from October 2010 through May 2014. GAO also found that due to other factors that are also considered, such as a contractor's experience, the preference potentially only affected 2 of the 35 award decisions for military construction contracts since fiscal year 2011. DOD updated its guidance during GAO's review, but it could become outdated, again, if a congressional bill becomes effective, as the bill would change the locations subject to the preference in fiscal year 2015.

Countries Bordering the Arabian Gulf, Bordering the Arabian Sea, and in the U.S. Central Command (CENTCOM) Area of Responsibility



Source: Department of Defense (DOD) (data); Map Resources (map). | GAO-15-45

GAO also found that DOD and State Department officials identified potential benefits and problems with expanding the statute to include all of the countries within the U.S. Central Command area of responsibility. For example, according to the officials, one potential benefit of contracting with U.S. firms would be greater familiarity with U.S. contracting and construction procedures. However, these officials also told GAO the 20 countries in the CENTCOM area vary widely in their local capacities, economies, and strategic concerns. Therefore, an expansion may run counter to specific U.S. policy goals in certain locations.

Contents

Abbreviations

CENTCOM	U.S. Central Command
DFARS	Defense Federal Acquisition Regulation Supplement
DOD	Department of Defense
FAR	Federal Acquisition Regulation
State	Department of State

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
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November 18, 2014

Congressional Committees

Since the 1980s, Congress has mandated that the Department of Defense (DOD) provide a preference for U.S. contractors when awarding contracts for U.S. military construction projects at certain overseas locations, such as U.S territories in the Pacific or countries bordering the Arabian Sea. The current U.S. contractor preference provision appears in Section 112 of the Department of Defense title within the fiscal year 2014 Consolidated Appropriations Act (hereafter referred to as Section 112).[1] Section 112 provides that

> None of the funds made available in this title for military construction in the United States territories and possessions in the Pacific and on Kwajalein Atoll, or in countries bordering the Arabian Sea, may be used to award any contract estimated by the Government to exceed $1,000,000 to a foreign contractor: *Provided*, That this section shall not be applicable to contract awards for which the lowest responsive and responsible bid of a United States contractor exceeds the lowest responsive and responsible bid of a foreign contractor by greater than 20 percent: *Provided further*, That this section shall not apply to contract awards for military construction on Kwajalein Atoll for which the lowest responsive and responsible bid is submitted by a Marshallese contractor.[2]

Congress is considering expanding this preference to apply to all countries within the U.S. Central Command (CENTCOM) area of responsibility, a region consisting of 20 countries where, according to DOD, the department is planning an estimated $699.5 million in military construction from fiscal year 2015 through fiscal year 2021.[3] The Joint

[1]This provision mirrors provisions that were in effect since 2011. All subsequent references to Section 112 refer to the U.S. contractor preference provision for the respective fiscal year military construction appropriations act.

[2]Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, div. J, Military Construction and Veterans Affairs, and Related Agencies Appropriations Act, 2014, title 1, § 112 (2014).

[3]The House of Representatives passed a fiscal year 2015 appropriations bill for Military Construction and Veterans Affairs, H.R. 4486, that would expand the preference.

Explanatory Statement accompanying the Consolidated Appropriations Act for Fiscal Year 2014 mandated that we examine the potential benefits and problems of expanding the geographical area for the U.S. contractor preference from the current 5 countries that border the Arabian Sea to the 20 countries within the CENTCOM area of responsibility.[4] This report (1) examines the extent to which DOD has awarded contracts for military construction projects in accordance with Section 112 since fiscal year 2011 and (2) describes DOD and Department of State (State) officials' observations of the potential benefits and problems with expanding the Section 112 preference to include all countries in the CENTCOM area of responsibility.

To examine the extent to which DOD has awarded military construction contracts in accordance with Section 112 since fiscal year 2011, we reviewed the statute and DOD's implementing regulations to identify and develop criteria for assessing the department's actions. Using the Federal Procurement Data System–Next Generation and in coordination with DOD officials, we then identified the DOD military construction contracts that were awarded from October 2010 through May 2014 that met the dollar value and geographic location requirements of the preference.[5] Of those contracts, we then worked with the DOD agencies responsible for awarding the contract to determine whether the project was funded with appropriations that were subject to the preference.

We then obtained and analyzed contract documentation for those awards to determine (1) whether DOD included the preference language, (2) whether the 20 percent preference was applied to the proposed offers of competing non-U.S. firms in these contracts, and (3) whether the preference affected the award. We interviewed DOD officials who have knowledge of these contracts about the extent to which the Section 112

[4]The GAO mandate appears in an explanatory statement accompanying the 2014 Consolidated Appropriations Act. Section 4 of the act provides that the statement shall have the same effect as if it were a joint explanatory statement of a committee of conference.

[5]The Federal Procurement Data System–Next Generation is a web-based collection of all unclassified U.S. federal executive-agency government contract awards. Executive agencies are required to use the system to maintain publically available information on their unclassified contract awards. We determined that data from those fiscal years were sufficient to allow us to examine whether DOD had applied the preference in accordance with statute for those years. We concluded our data collection with the most recent data as of May 2014 in order for us to conduct our review.

preference was applied to these contracts and whether the preference was a contributing factor in awarding the contracts. We assessed the reliability of the Federal Procurement Data System–Next Generation and U.S. Army Corps of Engineers data by reviewing related documentation, interviewing knowledgeable officials, and testing the data for obvious errors and completeness. We concluded the data were sufficiently reliable to determine the extent to which DOD awarded military construction contracts in accordance with Section 112 since fiscal year 2011.

To describe DOD and State officials' observations of the potential benefits and problems of expanding the Section 112 preference to include all countries in the CENTCOM area of responsibility, we identified and reviewed guiding principles of the federal acquisition system as stated in the Federal Acquisition Regulation (FAR).[6] These principles include (1) delivering the best value product or service to the customer in a timely manner using contractors with successful track records or superior ability to perform; (2) promoting competition; (3) minimizing administrative costs; (4) promoting openness, integrity, and fairness; and (5) fulfilling public policy objectives. To identify the potential benefits and problems of expanding the preference, we interviewed officials in the following offices and asked them about the effect of the preference on those guiding principles: five U.S. Army Corps of Engineers field offices located in countries bordering the Arabian Sea, bordering the Arabian Gulf, or within the CENTCOM area of responsibility that had military construction projects within the time frame of our review; U.S. Army Corps of Engineers headquarters and U.S. Army Corps of Engineers, Middle East District; two offices within the Office of the Under Secretary of Defense; U.S. State Department headquarters; and six embassies located in an Arabian Gulf border country, an Arabian Sea border country, or within CENTCOM; and a private-sector association with knowledge about this issue. This report focuses on DOD's views of the U.S. contractor preference for military construction contracts. We have included only those comments made by State officials that focus on potential diplomatic benefits and challenges since (1) officials at four embassies referred us to DOD officials for comment, and (2) State headquarters officials deferred to DOD since this report focuses on military construction. We also asked officials about their general views on the preference as it has been applied and the potential expansion of the preference to all countries

[6]Federal Acquisition Regulation § 1.102.

within the CENTCOM area of responsibility. While the information from these interviews is not generalizable, it provides varying perspectives about potential benefits and problems related to the U.S. contractor preference. In all cases, the information presented is a summary of officials' viewpoints and is not generalizable.

Further details on our scope and methodology, including a list of DOD and State offices we interviewed, can be found in appendix I.

We conducted this performance audit from March 2014 through November 2014 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.

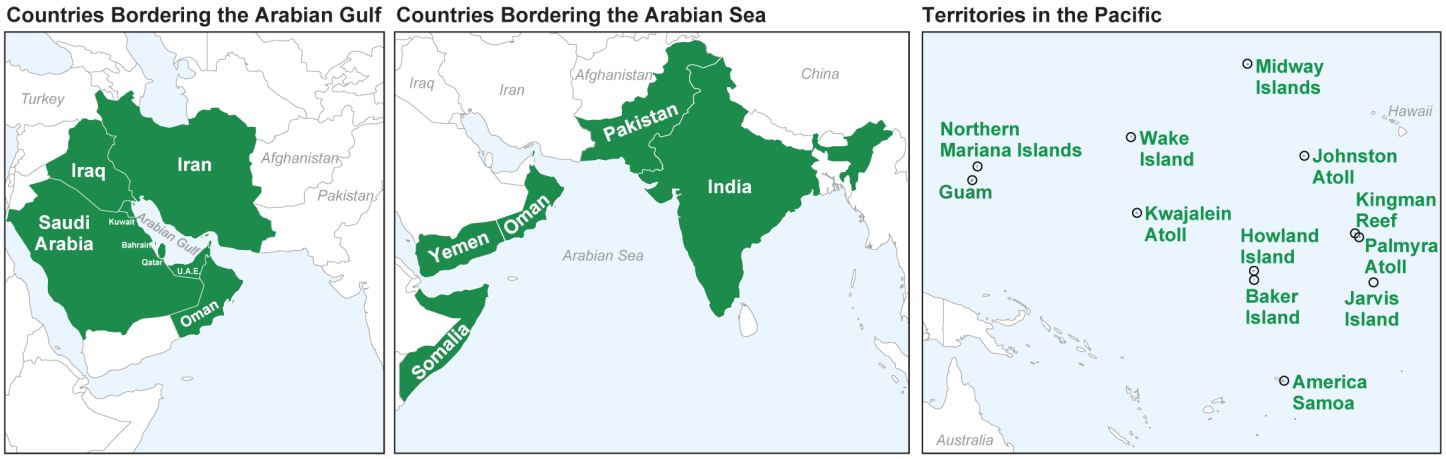
Background

Section 112 and Prior Preference Legislation

Since the 1980s, military construction appropriations have contained provisions similar to Section 112 in various forms that have provided a preference for U.S. contractors in certain overseas locations. For example, in 1984, the preference applied to "United States territories and possessions in the Pacific and on Kwajalein Island" for any military construction contract exceeding $5 million. For fiscal year 1996, Congress decreased the threshold for the preference from $5 million to $1 million, the current threshold, and included countries bordering the Arabian Gulf as countries covered by the preference.[7] In fiscal year 2002 legislation, Congress modified the preference provision to change the locations where the preference was to be applied. Instead of the *Arabian Gulf*, the preference was to be applied to construction located in countries bordering the *Arabian Sea*, which is a geographically distinct area. The Pacific locations and the dollar value at which the preference would apply to a contract remained the same. The preference provisions enacted since 2002 have continued to refer to countries bordering the Arabian Sea. Figure 1 reflects these geographical modifications.

[7]The Arabian Gulf is also known as the Persian Gulf.

Figure 1: Countries Covered by Section 112: in 1996, Bordering the Arabian Gulf; in 2002, Bordering the Arabian Sea; and U.S. Territories in the Pacific



Source: GAO analysis of legislation (data); Map Resources (map). | GAO-15-45

Note: The northernmost tip on the United Arab Emirates peninsula is part of Oman, therefore the country borders both the Arabian Gulf and the Arabian Sea.

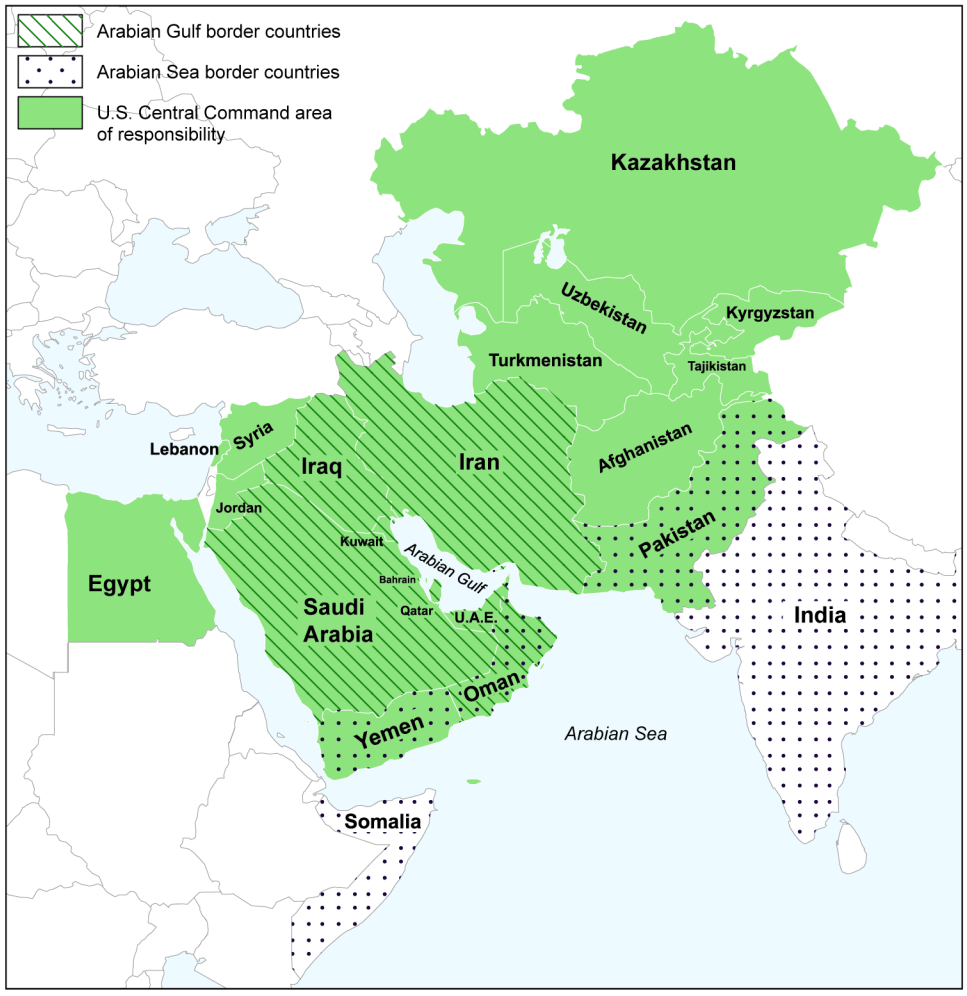
By its terms, the Section 112 U.S. contractor preference as it appears in the fiscal year 2011 through 2014 appropriations acts applies only to projects funded by the military construction title of the act. As such, the Section 112 U.S. contractor preference provision does not apply to other overseas construction or construction-related projects—such as construction services funded through Foreign Military Sales programs or facilities sustainment projects funded through Operation and Maintenance appropriations.[8]

In the Joint Explanatory Statement accompanying the fiscal year 2014 Consolidated Appropriations Act, Congress mandated that we examine the potential benefits and problems of amending Section 112 to apply the preference to all of the countries within the CENTCOM area of responsibility, which includes countries bordering the Arabian Sea and

[8]The Foreign Military Sales program is a part of security assistance authorized by the Arms Export Control Act and is conducted through formal contracts for agreements between the U.S. government and an authorized foreign purchasing government or international organization. Operation and Maintenance appropriations support the training, supply, and equipment maintenance of military units as well as the administrative and facilities infrastructure of military bases.

Arabian Gulf, as shown in figure 2. As previously stated, the version of the 2015 Military Construction Appropriations Act passed by the House of Representatives would expand the preference to all countries in the CENTCOM area of responsibility.

Figure 2: Countries Bordering the Arabian Gulf, Countries Bordering the Arabian Sea, and Countries within the U.S. Central Command (CENTCOM) Area of Responsibility



Source: Department of Defense (DOD) (data); Map Resources (map). | GAO-15-45

DOD's Defense Federal Acquisition Regulation Supplement (DFARS)

DOD implements the U.S. contractor preference, including the current Section 112 provision, through DFARS section 236.273 and DFARS clause 252.236-7010.[9] DFARS clause 252.236-7010 is to be included in solicitations that are subject to the evaluation preference and defines "United States firm" for purposes of this section. The clause allows firms submitting offers to self-identify as a U.S. or non-U.S. firm, as shown in figure 3.[10] DOD officials told us if both U.S. and non-U.S. firms compete for the contract, the contracting official increases the non-U.S. firms' bids by 20 percent for evaluation purposes. However, according to DOD, the actual amount paid to a non-U.S. firm, if it wins the contract, is not increased by the additional 20 percent.

Figure 3: Defense Federal Acquisition Regulation Supplement (DFARS) Clause 252.236-7010

"United States firm," as used in this provision, means a firm incorporated in the United States that complies with the following:

- The corporate headquarters are in the United States;
- The firm has filed corporate and employment tax returns in the United States for a minimum of 2 years (if required), has filed State and Federal income tax returns (if required) for 2 years, and has paid any taxes due as a result of these filings; and
- The firm employs United States citizens in key management positions.

Evaluation: Offers from firms that do not qualify as United States firms will be evaluated by adding 20 percent to the offer.

Status. The offeror firm _____ is, _____is not a United States firm.

Source: Defense Federal Acquisition Regulation Supplement. | GAO-15-45

[9]All federal executive agencies follow the policies outlined in the FAR for the acquisition and procurement of services and supplies with appropriated funds. DOD implementation and supplementation of the FAR are issued in the DFARS.

[10]DOD officials told us that in the interest of making the contracting process more efficient, the firm's self-certification as a U.S. or non-U.S. firm is not verified.

The DOD contracting agencies responsible for implementing the U.S. contractor preference include the U.S. Army Corps of Engineers, which manages DOD's construction in the Middle East and the Kwajalein Atoll, and the Naval Facilities Engineering Command, which manages DOD's construction on U.S. territories in the Pacific.

DOD's Application of the U.S. Contractor Preference Was Not in Accordance with Section 112 and Included Other Locations Where Military Construction Took Place

DOD Applied the U.S. Contractor Preference to Contracts in Countries Different from Those Required by Section 112 Due to an Outdated Regulation but Took Action to Correct DFARS

We found that DOD did not apply the U.S. contractor preference in accordance with the current Section 112 from October 2010 through May 2014. Since fiscal year 2002, Congress has required the preference to apply to contracts in countries bordering the Arabian Sea instead of countries bordering the Arabian Gulf.[11] However, DOD did not modify the DFARS clause to reflect this change in the statutory language. Officials from the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics told us that consequently the department's contracting offices, which follow this implementing guidance, continued to apply the U.S. contractor preference to military construction contracts performed in countries bordering the Arabian Gulf. As shown in table 1, from October 2010 to May 2014 more military construction contracts were awarded in Arabian Gulf border countries than Arabian Sea border countries. From October 2010 to May 2014, the United States did not award military construction contracts in any of the Arabian Sea border

[11]The language still required a preference for military construction in U.S. territories in the Pacific and on the Kwajalein Atoll.

countries, which include Yemen, India, Pakistan, and Somalia—except for in Oman, which is both an Arabian Sea border country and an Arabian Gulf border country. As a result, DOD's application of the preference included more contracts than it would have if it had been implemented in accordance with the current language in Section 112. In addition, DOD officials told us the department does not have any planned military construction in the CENTCOM area of responsibility for fiscal years 2015 through 2021 other than for projects located in Arabian Gulf countries.

Table 1: U.S. Military Construction Spending from October 2010 through May 2014 and Planned U.S. Military Construction for Fiscal Years 2015-2021: Arabian Sea Countries vs. Arabian Gulf Countries

Dollars in millions

Location	Military construction for October 2010 through May 2014[a]	Planned military construction for fiscal years 2015-2021[b]
Arabian Sea (i.e., Section 112–applicable) countries	57.9	253.5
Arabian Gulf (i.e., Defense Federal Acquisition Regulation Supplement [DFARS]–applicable) countries	566.5	699.5

Source: GAO analysis of contract data provided by the U.S. Army Corps of Engineers. | GAO-15-45

Notes: This table includes all military construction contracts awarded to U.S. and non-U.S. firms in these locations for the time frames identified.

[a]The country of Oman borders both the Arabian Sea and the Arabian Gulf. Therefore, the $57.9 million of military construction contracts spent in Oman was included in both rows. There was no additional U.S. military construction spending in the Arabian Sea border countries during this time frame.

[b]The country of Oman borders both the Arabian Sea and the Arabian Gulf. Therefore, the $253.5 million of military construction contracts planned to be spent in Oman was included in both rows.

Officials from the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics told us that the DFARS clause was inaccurate and identified the incorrect geographic locations because DOD officials had not noticed the change when the language in the statute was amended in 2002 from "Arabian Gulf" to "Arabian Sea." As a result of our review, on July 31, 2014, DOD issued an interim rule that aligned the DFARS locations to match the locations identified in Section 112. However, if the version of the 2015 Military Construction Appropriations Act passed by the House of Representatives is enacted DFARS will once again be out of line with statute.

The U.S. Contractor Preference Potentially Affected 2 of 35 Military Construction Contracts Awarded in the Arabian Gulf Countries and in the Pacific

Based on our analysis, there were 35 contracts awarded from October 2010 and May 2014 that were subject to the U.S. contractor preference in accordance with DFARS.[12] Of those contracts, the preference potentially affected the source-selection process in only two award decisions,[13] both of which used a best-value selection process in which the selection of competing offerors was not based solely on price.[14] In these two projects, a non-U.S. contractor submitted a lower-priced offer than any U.S. contractors. However, after applying the Section 112 evaluation preference by increasing the non-U.S. firm's price by 20 percent for evaluation purposes, the U.S. firm's offer was considered lower-priced. Since both of these projects were awarded using a best-value selection process, the contracting officer was not obligated to accept the lowest-priced offer and could potentially have still selected the non-U.S. contractor based on technical factors.[15] However, according to the contract-award decision documents, the U.S. contractors' technical proposals were considered stronger than those of the non-U.S. contractors in both instances.

[12]While DOD did not apply the preference in accordance with Section 112, it did apply it in accordance with its DFARS, so we focused our analysis of the extent to which the preference affected the award decision on those military construction contracts awarded in countries bordering the Arabian Gulf, since those were the locations where DOD applied the preference.

[13]For this report, we used the term "affected" to categorize contracts where the U.S. contractor preference had a documented effect on the award decision (i.e., a non-US offeror submitted a price that was lower than that of any U.S. offers, however the U.S. offeror's price was considered less than the non-U.S. offeror after the 20 percent preference was applied). One of the 35 contracts did not include the DFARS clause in the contract solicitation. However, we were unable to determine whether the preference affected this contract since the source-solicitation document only identified the offeror awarded the contract.

[14]In a solicitation using a best value selection process, the contracting official awards a contract to the offeror who is judged to provide the "best value" to the government based on both price and technical factors, such as past performance. See FAR § 15.101. The contracting official may award a contract to other than the lowest-priced offeror if the official determines that a higher-priced offer provides a greater benefit to DOD, and this greater benefit is worth paying an additional cost, or price differential.

[15]For additional information on DOD's use of best-value source-selection procedures, see GAO, *Defense Contracting: Factors DOD Considers When Choosing Best Value Processes Are Consistent with Guidance for Selected Acquisitions*, GAO-14-584 (Washington, D.C.: July 30, 2014).

For the remainder of the contracts we examined, there were various reasons the preference did not affect the award. For example, for more than half of the remaining contracts, only U.S. firms or only non-U.S. firms competed, so there was no requirement to apply the preference. In others, while the preference was applied to non-U.S. firms' proposed prices, other non-pricing factors, such as technical experience, determined award. In no other case did the preference provision alter the award decision.

DOD and State Officials Identified Potential Benefits and Problems with Expanding Section 112 to Include All of the Countries in the CENTCOM Area of Responsibility

Officials Identified Some Potential Benefits to Expanding the U.S. Contractor Preference

DOD officials identified the benefits they see in providing a preference to U.S. contractors based on their observations and experiences with working with U.S. and non-U.S. contractors in the officials' own country of operation. In addition, while we asked each office to provide observations on the potential benefits of expanding the preference throughout the CENTCOM area of responsibility, many of the offices did not provide responses about the specific potential benefits of expanding the preference. The information presented below is a summary of officials' viewpoints and is not generalizable.

Officials: U.S. Contractors May Have More Familiarity with U.S. Contracting Requirements and Construction Standards

Officials from three Army Corps of Engineers offices and the U.S. Air Force Civil Engineer Center told us that U.S. contractors may be more familiar with U.S. contracting processes, regulations, codes, requirements, procedures, and quality-assurance standards, as well as U.S. business practices and engineering criteria.[16] These officials said additionally that U.S. contractors may be better able to build higher-quality construction products, and have fewer problems in carrying out contracts.

Officials: U.S. Contractors May Have More Leadership and Management Experience

Officials from three Army Corps of Engineers offices told us that the U.S. contractor preference benefits military construction by providing U.S. leadership and experience in both site and project management. Officials from the U.S. Air Force Civil Engineer Center also told us that having a U.S. contractor acting as a single point of contact and integrator for multiple subcontractors and taking care of local requirements may make communication easier for the DOD contracting officials. These officials stated that U.S. management can teach local subcontractors how to manage complex contracts, U.S construction standards, and quality requirements, while also instructing local laborers in construction methods.

Officials: U.S. Contractors May Have Better Accountability

Officials from two Army Corps of Engineers offices told us that U.S. contractors can be held more accountable if there is an issue with the construction project. U.S. contractors may also be more responsive to addressing construction issues. Officials from the U.S. Air Force Civil Engineer Center told us that when working with a U.S. prime contractor, the U.S. Air Force Civil Engineer Center may have more control over payments and warranty calls. The officials stated that if a U.S. contractor refuses to honor warranty work after finishing and being paid for a fixed-price contract, the U.S. Air Force Civil Engineer Center would be able to take legal action in a U.S. court.

[16]The U.S. Air Force Civil Engineer Center mission includes facility investment planning, design and construction, operations support, real-property management, energy support, environmental compliance and restoration, and audit assertions, acquisition, and program management.

Officials: Providing a Preference for U.S. Contractors May Increase the Number of U.S. Contractors Competing for Overseas Work

Officials from five Army Corps of Engineers offices told us that the contractor preference may enhance the competitiveness of U.S. firms. One Army Corps of Engineers office told us that the 20 percent price increase added to offers by non-U.S. contractors allows U.S. companies to be more competitive by offsetting some of the overhead costs they face, such as transportation costs. Officials stated that the preference may have more of an effect in some countries than others. For example, the preference may have more of an effect in helping U.S. firms be more competitive in Arabian Gulf countries. These officials said it is their experience that the difference in price between U.S. and non-U.S. vendors is usually about 15 percent, so in their view the preference helps U.S. firms be more competitive.

Officials: Providing a Preference for U.S. Contractors May Provide Additional Financial Returns to the United States

Officials from three Army Corps of Engineers offices told us that the United States may see more financial benefits if a U.S. contractor is awarded a project. These benefits may include tax revenue going to the United States Treasury as well as the purchase of domestically sourced equipment or supplies for the construction projects. These officials said U.S. contractors would pay taxes in the United States, while non-U.S. contractors would not. Additionally, they said that U.S. contractors may be more likely to employ U.S. nationals as management staff, who would also pay taxes in the United States.

Officials: Providing a Preference for U.S. Contractors May Also Benefit Host-Nation Economies

Officials from two Army Corps of Engineers offices told us that the preference may contribute to host-nation economies even if a U.S. contractor wins the bid, because in some countries U.S. contractors routinely share work with local companies. For example, according to officials from one Army Corps of Engineers office, foreign contractors operating in Kuwait must have a Kuwaiti counterpart or sponsor. Because of this requirement, if a U.S. contractor gets the award, the local economy will still benefit through a U.S. contractor's payments for materials, labor, and sponsorship services. An official from another Army Corps of Engineers office said contractors operating in Bahrain must be licensed in that country, and foreign contractors in Bahrain generally partner with Bahraini-owned contractors or are sponsored by Bahraini-owned contractors. These measures bring revenue to Bahrain even if a non-local contractor wins a construction project. According to officials from three Army Corps of Engineers offices and one Naval Facilities Engineering Command office, both U.S. and non-U.S. contractors hire from the same local labor pool, which benefits the local economy regardless of the nationality of the prime contractor. They said that workers hired onto a project may be from a variety of countries, benefiting those nations as well.

Officials Identified Some Potential Problems with Expanding the U.S. Contractor Preference

DOD and State officials also identified problems they see in providing a preference to U.S. contractors based on their observations of and experiences with working with U.S. and non-U.S. contractors in the officials' own countries of operation. In addition, while we asked each office to provide observations on the potential problems of expanding the preference throughout the CENTCOM area of responsibility, many offices did not provide responses about the specific potential problems of expanding the preference. In all cases the information presented below is a summary of officials' viewpoints and is not generalizable.

Officials: Preference May Be Inconsistent with Other U.S. Public Policy and Security Goals

Officials from three Army Corps of Engineers offices, the U.S. Air Force Civil Engineer Center, an office within the Office of the Under Secretary of Defense for Policy, a CENTCOM office, and a U.S. embassy told us that the preference may counteract U.S. policy goals such as building local capacity.[17] For example, they said that both civilian and U.S. military agencies have promoted the Afghanistan First Initiative, which seeks to award contracts to Afghan-owned firms. One State office told us that the Afghanistan First Initiative seeks to encourage Afghan ownership on infrastructure projects as part of its program to build local capacity. Officials from one State office said while the Afghanistan First Initiative may not be favorable to U.S. firms seeking to compete for that business, the overall policy goal is to increase Afghanistan's self-sufficiency.

Officials from the Office of the Under Secretary of Defense for Policy and one Army Corps of Engineers office said the economic strength of each of the countries within the CENTCOM area of responsibility varies significantly, and the United States has policies to strengthen local economies by encouraging local procurement, such as CENTCOM's

[17]We have included State officials comments only when they were focused on potential diplomatic benefits and challenges since (1) officials at four embassies referred us for comments to DOD officials, and (2) State headquarters officials deferred to DOD since the focus was on military construction.

Central Asian States and Afghanistan Procurement Initiative.[18] CENTCOM officials stated that these initiatives aim to provide opportunities for economic expansion, entrepreneurship, and skills training for the people of the Central Asian states and Afghanistan in order to maximize positive long-term effects on local economies and workforces, support economic development, good governance, stability, and enduring trade and commerce in the region. These officials said a policy that provides a preference to U.S. contractors could be in conflict with these existing U.S. policy goals.

Officials: Preference May Limit Flexibility

The Office of the Under Secretary of Defense for Policy said the preference may limit senior diplomatic or senior defense officials' flexibility to make decisions based on the local security situation, economy, or infrastructure. CENTCOM officials told us that its component commanders require maximum flexibility to execute construction requirements and that there should be an emphasis on maximizing the use of host-nation companies to support their economic growth, stability, and capacity development.

Officials: Preference May Discourage Local Contractors from Competing

Officials from three Army Corps of Engineers offices told us that the preference may discourage local contractors from competing for contracts. An official from one of these offices told us that the local contractors might be discouraged from bidding on a construction project because they know they can work as subcontractors and do not feel they need to compete for the contract by reducing their prices.

[18]CENTCOM's Central Asian States Procurement Initiative was established on September 3, 2011. The policy was updated and renamed the Central Asian States and Afghanistan Procurement Initiative on October 18, 2013. The current version, which will expire on December 31, 2014, unless rescinded or superseded, promotes procurement of goods and services manufactured, mined, or produced in Central Asia and Afghanistan over goods and services from manufacturers or distributors outside the region. The policy states, "Commanders, procurement agencies, contracting officers, and requirements personnel operating in the CENTCOM area of responsibility will make every attempt to seek out potential Central Asian States and Afghanistan sources from manufacturers before considering sourcing from distributors and non-regional sources and, where possible, educate and develop these sources for future procurement." Central Asian States include Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.

Officials: Preference Does Not Address the Difficulty of Construction in CENTCOM Area of Responsibility for U.S. Contractors

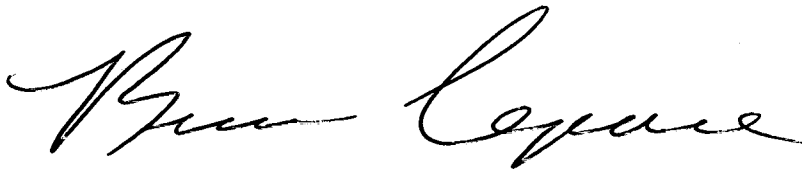
Officials from two Army Corps of Engineers offices and the U.S. Air Force Civil Engineer Center told us that construction in countries in the CENTCOM area of responsibility can be challenging as a result of the need to meet host-country requirements. For example, officials from the U.S. Air Force Civil Engineer Center told us that host nations like the United Arab Emirates may require a U.S. firm to obtain business licenses to operate in the host nation, and an official from one Army Corps of Engineers office said Bahrain also requires foreign firms to obtain business licenses to operate there. Officials in another Army Corps of Engineers office told us that Qatar requires that a non-Qatari contractor have one or more local partners that have at least 51 percent share of the capital. In addition to local registration, U.S. contractors may lack knowledge of the local market.

Agency Comments

DOD and State Department reviewed a draft of this report but did not provide any comments.

We are sending copies of this report to the appropriate congressional committees; the Under Secretary of Defense for Acquisitions, Technology and Logistics; the Under Secretary of Defense for Policy; the Commanding General and Chief of Engineers, U.S. Army Corps of Engineers; the Commander, Naval Facilities Engineering Command; the Chief of Civil Engineers, Naval Facilities Engineering Command; the Director, U.S. Air Force Civil Engineer Center; the Commander, U.S. Central Command; the Commander, U.S. Pacific Command; and the Secretary of State. In addition, the report is 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) 512-4523 or leporeb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.



Brian J. Lepore
Director
Defense Capabilities and Management

List of Committees

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Chairman
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The Honorable Sanford Bishop, Jr.
Ranking Member
Subcommittee on Military Construction, Veterans Affairs, and Related Agencies
Committee on Appropriations
House of Representatives

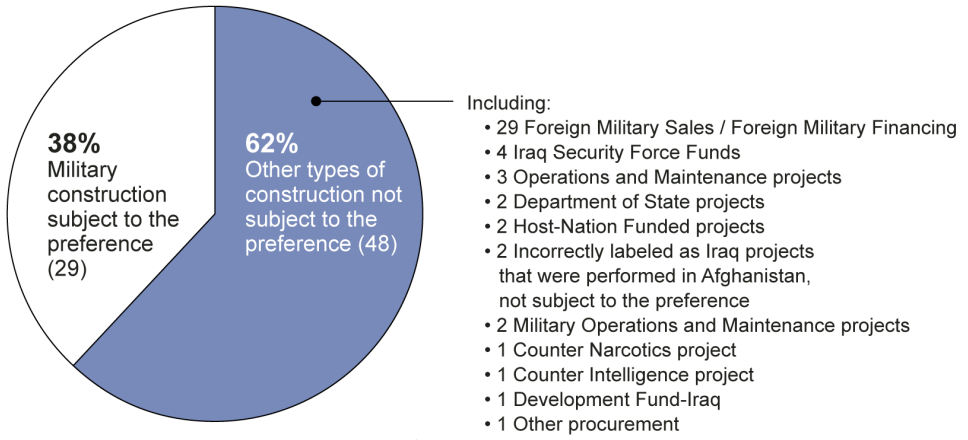
Appendix I: Scope and Methodology

To examine the extent to which the Department of Defense (DOD) has awarded military construction contracts in accordance with Section 112 since fiscal year 2011, we reviewed Section 112 and DOD's implementing guidance, the Defense Federal Acquisition Regulation Supplement (DFARS), to identify and develop criteria for assessing the department's actions. Using the Federal Procurement Data System–Next Generation and in coordination with DOD officials, we identified the DOD military construction contracts that were awarded from October 2010 through May 2014 that were valued over $1 million and either were awarded in countries bordering the Arabian Sea, as mandated by Section 112, or were awarded in countries bordering the Arabian Gulf, as implemented by DOD in DFARS. We focused our analysis on contracts awarded in the Arabian Sea border countries or Arabian Gulf border countries because those are the locations where the U.S. contractor preference is applicable to either Section 112 or DFARS. In addition, we focused on these locations because they include 10 of the 20 countries that may be included in a potential expansion of the preference throughout the U.S. Central Command (CENTCOM) area of responsibility. We provided the contract data identified by the Federal Procurement Data System–Next Generation to the U.S. Army Corps of Engineers–Middle East District, which is responsible for managing the contracts located in the Arabian Gulf and Arabian Sea. We requested that Army Corps of Engineers–Middle East District compare its record of contracts to the Federal Procurement Data System–Next Generation records of contracts to determine the accuracy and completeness of the data from the Federal Procurement Data System–Next Generation. Army Corps of Engineers–Middle East District identified one additional military construction contract in its area of responsibility that was not identified by the Federal Procurement Data System–Next Generation, resulting in 77 contracts.

Of those 77 contracts, we then worked with the DOD agencies responsible for awarding the contracts to determine whether the project was funded with appropriations that were subject to the preference. In the cases in which Army Corps of Engineers–Middle East District did not award the contract, we contacted other DOD offices—including U.S. Central Command–Joint Theater Support Contracting Command, Air Force Material Command, Air Combat Command, Air Force Central Command, Army Contracting Command, and Army Material Command—to obtain contract documentation to determine whether the contract was awarded with appropriations subject to the preference. Through this process, Army Corps of Engineers–Middle East District and the other DOD agencies responsible for managing these awards found that 29 of the 77 contracts were subject to the U.S. contractor preference. For the

remaining 48 contracts, we worked with the responsible DOD agencies to determine why those awards were not subject to the preference. As shown in figure 4, the remaining 48 contracts were not military construction contracts and therefore not eligible for the preference.

Figure 4: Construction Awards from October 2010 to May 2014 in Arabian Sea Border Countries or Arabian Gulf Border Countries



Source: GAO analysis of Department of Defense (DOD) data. | GAO-15-45

For the 29 contracts that were subject to the preference in accordance with DFARS, we then obtained and analyzed contract documentation for those awards to determine (1) whether DOD included the preference language, (2) whether the 20 percent preference was applied to the proposed offers of competing non-U.S. firms, (3) whether the preference affected the award.[1] In addition to these 29 contracts that were subject to the preference in accordance with DFARS, we found a military construction–operations and maintenance contract that the Army Corps of Engineers had incorrectly applied the preference to; however, we did not include this contract in our analysis since this type of contract was not covered by either Section 112 or the DFARS provision—and was thus outside of the scope of our engagement.

[1]All 29 contracts were located in Arabian Gulf locations. From October 2010 to May 2014, DOD did not award military construction contracts in any of the Arabian Sea border countries, which include Yemen, India, Pakistan, and Somalia—except for Oman, which is both an Arabian Sea border country and an Arabian Gulf border country.

To determine the extent to which DOD awarded military construction contracts on U.S. territories in the Pacific and on the Kwajalein Atoll in accordance with Section 112 we requested data from Naval Facilities Engineering Command and Army Corps of Engineers–Honolulu District, which are responsible for military construction in those respective locations. The Naval Facilities Engineering Command identified two construction projects awarded in Guam that were subject to the U.S. contractor preference provision. The Army Corps of Engineers–Honolulu District identified four military construction contracts associated with projects on Kwajalein Atoll that were subject to these provisions.

We assessed the reliability of the Federal Procurement Data System–Next Generation and Army Corps of Engineers data by reviewing related documentation, interviewing knowledgeable officials, and testing the data for obvious errors and completeness. We concluded the data were sufficiently reliable to determine the extent to which DOD awarded military construction contracts in accordance with Section 112 since fiscal year 2011.

We interviewed the following U.S. government offices during this engagement:

- Office of the Under Secretary of Defense for Policy;
- Office of the Under Secretary of Defense for Acquisition, Technology and Logistics;
- Army Corps of Engineers Headquarters;
- Army Corps of Engineers–Middle East District;
- Army Corps of Engineers–Kuwait Area Office;
- Army Corps of Engineers–Bahrain Area Office;
- Army Corps of Engineers–Qatar Area Office;
- Army Corps of Engineers–United Arab Emirates / Central Asian States Area Office;[2]
- Army Corps of Engineers Transatlantic Division–Afghanistan;

[2]The representative was also provided as the contact for Army Corps of Engineers–Oman Area Office. Additionally, the Central Asian States area office manages contracts in Kyrgyzstan, Uzbekistan, Kazakhstan, Tajikistan, Turkmenistan, and Pakistan.

- Army Corps of Engineers–Honolulu District;
- U.S. Air Force Civil Engineer Center;
- U.S. Pacific Command Headquarters;
- U.S. Central Command Headquarters;
- Naval Facilities Engineering Command;
- U.S. Department of State Headquarters;
- U.S. Embassy Oman;
- U.S. Embassy Bahrain;
- U.S. Embassy Afghanistan;
- U.S. Embassy United Arab Emirates;
- U.S. Embassy Kyrgyzstan;
- U.S. Embassy Turkmenistan; and
- U.S. Agency for International Development–Kabul.

To describe DOD and Department of State (State) officials' observations on potential benefits and problems to expanding Section 112 to include all countries in the CENTCOM area of responsibility, we reviewed and identified guiding principles of the federal acquisition system as stated in the Federal Acquisition Regulation.[3] These principles include (1) delivering the best-value product or service to the customer in a timely manner using contractors with successful track records or superior ability to perform; (2) promoting competition; (3) minimizing administrative costs; (4) promoting openness, integrity, and fairness; and (5) fulfilling public policy objectives. To identify the potential benefits and problems of expanding the preference, we interviewed officials from DOD, State, and a private-sector association with knowledge about this issue,[4] and asked them about the effect of the preference on those guiding principles. We

[3]Federal Acquisition Regulation § 1.102.

[4]We have included only those comments made by State officials that focus on potential diplomatic benefits and challenges since (1) officials at four embassies referred their comments to DOD officials and (2) State headquarters officials deferred to DOD since the focus was on military construction.

also asked officials about their general views on the preference as it has been applied and the potential expansion of the preference to all countries within the CENTCOM area of responsibility. In all cases, the information presented is a summary of officials' viewpoints, is not generalizable, and was not subject to further analysis by GAO.

We conducted this performance audit from March 2014 through November 2014 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: GAO Contact and Staff Acknowledgments

GAO Contact

Brian J. Lepore, (202) 512-4523 or leporeb@gao.gov

Staff Acknowledgments

In addition to the contact named above, Tommy Baril (Assistant Director); Jacob Beier; Richard Burkard; Virginia Chanley; Tara Copp; Ashley Hess; Julia Kennon; Joanne Landesman; Amie Lesser; Carol Petersen; Marc Schwartz; Kimberly Walton; and Weifei Zheng made key contributions to this report.