096626

24913

REPORT TO THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

72-0464

19

Controls Over Shipyard Costs And Procurement Practices Of Litton Industries, Inc., Pascagoula, Mississippi

B-133170

Department of the Navy

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

MARCH 23, 1972

701005

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-133170

Dear Mr. Chairman:

Your letters of August 18 and December 10, 1970, requested that we review efforts by the Department of the Navy and its contractors to control ship construction costs at major private shipyards.

On June 4 and August 23, 1971, we furnished you with data on some of your questions. The remaining questions related to the adequacy of control over shipyard costs and procurement practices as exercised by both the contractor and the Government. To obtain answers to the remaining questions, we reviewed operations of two major private shipbuilders, and on January 13, 1972, we reported to you on the operations of Newport News Shipbuilding and Dry Dock Company. In this report we deal with the operations of the Litton Industries, Inc., facilities at Pascagoula, Mississippi, and in the Los Angeles, California, area. D. 1748

It appears that much can be done by the contractor and the Navy to reduce shipyard costs and, in turn, costs to the Government. We found that Litton did not always follow effective procurement procedures to ensure that the most favorable prices were obtained for some purchases. We noted that the Defense Contract Audit Agency had questioned the contractor's cost-charging practices which had resulted in allocating to Navy contracts costs relating to Litton's commercial work. Our selective examination confirmed that certain inequitable cost allocations had been made.

We could not evaluate the effectiveness of the contractor's budgeting and cost system, because the contracts we reviewed at one of the shipyards did not require the contractor to furnish or make available budget information to the Government and because the system had not been fully developed for the contractor's other and newer shipyard.

Official comments on the matters discussed in this report have not been requested or obtained from the contractor or the Navy. We plan to make no further distribution of

BEST DOCUMENT AVAILABLE

this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

The Honorable William Proxmire
Chairman, Joint Economic Committee
Congress of the United States

Contents

CHAPTER		Page
1	INTRODUCTION	1
2	SHIPYARD CONTROLS OVER PROCUREMENT	3
	Price histories and estimates not available	4
	Opportunity to obtain lower prices by splitting awards	4
	Conduct of negotiation discussions	5
	Awards to other than low offerors	6
3	COST CONTROLS	11
	System description	11
	GAO evaluation	12
	Mat rial-charging practices	14
	GAO evaluation	14
	Labor-charging practices	14
	GAO evaluation	15
	Marine Technology costs	16
	GAO evaluation	16
4	NAVY'S SURVEILLANCE OVER THE SHIPYARDS' PROCUREMENT AND COST CONTROL PRACTICES	17
	GAO evaluation	19

ABBREVIATIONS

DCAA	Defense Contract Audit Agency
GAO	General Accounting Office
SUPSHIP	Supervisor of Shipbuilding, Conversion, and Repair

CHAPTER 1

INTRODUCTION

In accordance with letters of August 18 and December 10, 1970, from the Chairman, Joint Economic Committee, we have reviewed the adequacy of controls over shipyard costs and procurement practices as exercised by both the Government and Litton Industries, Inc., Pascagoula, Mississippi.

Litton has two shipyards located in Pascagoula--Litton Ship Systems (West Yard) and Ingalls Nuclear Shipbuilding (East Yard). The two are independent of each other, each having its own separate management and organizational structure and each following different procurement and cost control practices.

The West Yard is engaged in the modular construction of surface ships for the Navy and for private companies. At the time of our review, the value of the contracts being worked on totaled about $3 billion. About 93 percent, or $2.8 billion, was for Navy ships to be constructed under fixed-price incentive contracts, although up to that time the West Yard was devoting its construction effort primarily to commercial vessels.

Litton's Data Systems Division assists the West Yard and is responsible for assembly, test, and evaluation of electronic components which it purchases or which are furnished by the Government under the Navy contracts. Litton's Advanced Marine Technology Division purchases most of the other major components and provides engineering-design services for the West Yard. Both organizations are located in the Los Angeles, California, area.

The East Yard is engaged in the conventional construction and overhaul of submarines and the construction of Navy surface ships. This yard also constructs commercial ships for private companies. At the time of our review, the value of Navy contracts being worked on at the East Yard totaled about $266 million. This total included $113 million for a fixed-price (formally advertised) contract, $107 million for a fixed-price incentive contract, and $46 million for cost-plus-incentive-fee contracts.

Questions raised by the Chairman covered three subjects--cost controls, shipyard controls over procurement, and Navy surveillance over the shipyards' procurement and

cost control practices. The questions are restated in the chapters which follow, along with the information we obtained in our review.

CHAPTER 2

SHIPYARD CONTROLS OVER PROCUREMENT

The questions on this subject are concerned with the shipyards' efforts to obtain competition in subcontracting and, in the case of noncompetitive subcontracts, to comply with the provisions of the Truth-in-Negotiations Act.

For the two East Yard contracts we reviewed, amounting to about $120 million, the contractor awarded subcontracts totaling about $39 million. Data on subcontracting as of January 1971 and the number of items selected for our review follow.

	Prime contract amount (millions)	Subcontracts			
		Total		Selected for review	
		Number	Amount (millions)	Number	Amount (millions)
SSN-637 class submarines	$107.4	3,922	$37.4	182	$24.0
SSN-612 submarine overhaul	12.5	1,612	1.7	113	1.0
Total	$119.9	5,534	$39.1	295	$25.0

We examined 194 subcontracts, amounting to $366 million, out of the 222 subcontracts, amounting to $372 million, awarded by Litton through December 31, 1970, for work done by the West Yard on the LHA and DD-963 ships.

We examined purchasing records and held discussions with contractor and Navy officials in Pascagoula and at the assisting organizations in California that purchased most of the components for the Navy ships to be constructed by the West Yard.

The specific questions and the information we obtained follow.

"In awarding subcontracts, do the shipyards employ safeguards comparable to those used by the Government in awarding prime contracts?"

EAST YARD

The contractor's policies provide for some of the safeguards used by the Government. We noted some exceptions--Litton did not obtain cost and pricing data for certain

BEST DOCUMENT AVAILABLE

subcontract awards that were required by the Truth-in-Negotiations Act (see p. 8) and did not hold discussions with all responsible offerors before awarding negotiated subcontracts (see p. 5).

We also found that price histories of prior buys and price estimates for current purchases generally were not available to assist in determining the reasonableness of subcontract prices. Also in one instance we found that proper consideration had not been given to splitting a procurement to obtain lower subcontract prices.

Price histories and estimates not available

The purchase order files we examined, which covered larger buys, generally did not contain price estimates for the current buy or price histories of prior buys to assist in determining the reasonableness of subcontract prices. Department of Defense regulations provide that the contracting officer, before soliciting quotations, develop, where feasible, an estimate of the proper price level or the value of the product or service to be purchased based on prior purchases and other data.

We found that files for 122 of the 181 subcontracts for procurements of $2,500 or more showed no indications that price estimates had been prepared. In only a few cases did we find evidence that current quotes had been compared with prices paid in prior procurements. Although it does not necessarily follow that the subcontract prices were unreasonable, the contractor had forgone the opportunity offered by those safeguards for determining whether it was paying fair prices.

East Yard procurement officials informed us that they recently had instituted a new requirement for the preparation of price estimates and a system for recording pricing data relating to prior procurements.

Opportunity to obtain lower prices by splitting awards

Government regulations and Litton's procurement manual required that, if appropriate, individual prices be evaluated to determine whether awards to more than one offeror would be advantageous.

In our examination of 32 subcontracts in excess of $100,000, we found that one subcontract could have been split between two suppliers and that as a result lower prices could have been obtained. An award for $343,217 was made to a

BEST DOCUMENT AVAILABLE

subcontractor for various ball valves even though a lower price for some of the valves had been proposed by another responsive, qualified firm. Two firms proposed individual prices for 34 line items of ball valves. The solicitation was not on an all-or-none basis. One firm proposed prices that were lower for each of 16 items but higher for each of the remaining items. If two contracts had been awarded, for 16 items to one firm and for 18 to the other, the cost of the 34 items would have been approximately $21,000 less than the amount of the single award. An East Yard procurement official agreed that this order could have been split to obtain more favorable prices.

WEST YARD

The procurement policies of the West Yard and the assisting organizations provided for many of the safeguards used by the Government. These included making preaward surveys to determine subcontractors' capabilities, soliciting competitive bids, obtaining cost or pricing data in the circumstances prescribed by the Truth-in-Negotiations Act, and performing price-cost analyses to evaluate the reasonableness of subcontract prices offered. We noted no deviations from these policies.

"Do shipyards seek to establish maximum practicable competition in subcontract procurements?"

EAST YARD

For a few subcontracts, representing the major portion of the amounts of the subcontracts we reviewed, the East Yard made awards on competitive bases. The East Yard, however, did not make maximum efforts to obtain lower prices for a large number of subcontracts. In addition, we found no evidence that Litton had held negotiation discussions on 200 of the 224 awards we examined. We did find a questionable justification for several awards made to one subcontractor which had not been the low offeror.

Conduct of negotiation discussions

The shipyard apparently did not hold negotiation discussions for most of the subcontract awards we reviewed. As a result the lowest available subcontract prices may not have been obtained. The Truth-in-Negotiations Act provides that Government procurement officers hold such discussions in the absence of clear demonstrations that fair and reasonable prices can be obtained without holding such discussions. Discussions are not required when all offerors are notified that the awards might be made without such discussions.

Our review of 224 subcontracts showed that the files for 200 of the procurements contained neither evidence of negotiation discussions with offerors nor evidence of offerors' having been notified in the requests for proposals that the awards might be made without such discussions. Litton officials stated that their procurement files not always were documented to show evidence of negotiations. We noted that negotiation discussions in connection with 24 awards had resulted in reductions in initial proposed prices from $8.8 million to $8 million. It therefore appears that, through added emphasis on the use of this negotiation technique, the contractor might have realized further price reductions.

It is of interest to note that the Advanced Marine Technology Division, a major procuring activity for the LHA ship construction program, follows an extensive practice of conducting negotiation discussions with offerors. We reviewed subcontracts, totaling about $117 million, awarded for the LHA program and found that such negotiations had reduced initial proposed prices by about $16.9 million.

Awards to other than low offerors

In several cases where the contractor awarded subcontracts to other than the low offerors, the contractor's justifications appeared to be reasonable. These included instances where the low offerors were considered to be nonresponsive, were not qualified, or were unable to meet delivery requirements.

One subcontractor, however, who was not the low offeror, received seven awards on the basis of proposed earlier deliveries where such deliveries were not essential. These awards totaled $57,539. Had these awards been made to the low offerors, the contractor could have realized savings of $29,913--the difference between the low proposals and the successful offeror's prices.

WEST YARD

We found that competition had been sought for the West Yard's purchases. The contractor solicited two or more sources of supply for 150 of the 194 subcontracts we selected for examination. Of the 150 subcontract awards, 99 were for amounts over $100,000. In all but a few instances, Litton solicited from three to 18 sources.

For the other 44 purchases, amounting to $2.3 million, Litton appeared to have had sufficient justification for soliciting only one source. In the award of one contract

BEST DOCUMENT AVAILABLE

to Sperry Rand Corporation in the amount of $1.6 million, Litton had concluded, on the basis of its procurement records, that Sperry Rand was the only qualified source capable of providing certain navigation equipment in the required time frame. Most of the remaining $0.7 million had been awarded without attempting to obtain competition because Litton believed either that only one source could meet delivery schedule requirements or that it was impracticable to change suppliers when awarding follow-on subcontracts.

"Is there evidence of undue subcontracting by shipbuilders to other subsidiaries of their parent firms?"

EAST YARD

We found no evidence of undue subcontracting by the East Yard to its affiliated companies. In our sample of 295 subcontracts selected from 5,534 subcontracts awarded under two contracts we reviewed (see p. 3), we found that only one award had been made to an affiliate. In addition, the contractor furnished us with a listing of all subcontracts awarded to subsidiaries of Litton, which showed 25 awards, including the one we had found in our test, totaling about $123,800 under the two Navy contracts.

WEST YARD

In relation to the current value ($2.8 billion) of the two Navy contracts, we found no undue subcontracting by Litton with its subsidiaries or affiliates.

There were 12 subcontracts, amounting to about $14 million, which had been awarded to subsidiaries or affiliates. All but $26,000 worth had been awarded on the basis of price competition.

"What percentage of subcontract procurements are sole-source?"

EAST YARD

The contractor had no classification of subcontract procurements to show the extent of awards on a sole-source basis. In our review of the 295 subcontracts, amounting to $25 million, we found that only one responsive bid had been received in each of 204 procurements, or 69 percent of the subcontracts. The 204 procurements amounted to $7.3 million, as shown below.

	Quantity	Amount (millions)
SSN-637 class of submarine	105	$6.8
SSN-612 submarine overhaul	99	.5
	204	$7.3

Of the procurements amounting to $6.8 million, procurements amounting to $4.3 million had been based on a pooling arrangement with the Electric Boat Division of General Dynamics Corporation to obtain lower prices on selected items. Electric Boat is the lead yard for the SSN-637 class of submarines.

With respect to the overhaul contract, the contractor stated that the reasons for single, responsive bids had been the restricted number of qualified sources capable of meeting the requirements of the submarine overhaul program and that the replacements of many system components had been required to be procured from the original source.

WEST YARD

Under its two prime contracts for the LHAs and DD-963's, Litton awarded 222 subcontracts amounting to $372 million. We examined 194 subcontracts awarded for $366 million and found that 62 had been awarded on sole-source bases. The sole-source awards totaled $64.9 million, or about 17.5 percent of the value of all subcontracts awarded. A tabulation of the sole-source awards follows.

	Number of awards	Amount (millions)
Multiple solicitations but only one responsive bid	18	$62.6
One source solicited	44	2.3
	62	$64.9

"Are the shipyards in full compliance with the Truth-in-Negotiations Act?"

EAST YARD

For the two contracts that we reviewed, we examined all subcontracts in excess of $100,000 and found that the East

BEST DOCUMENT AVAILABLE

Yard had complied with the requirements of the Truth-in-Negotiations Act, except for 20 procurement actions which had been based on prices arranged with Electric Boat.

Litton explained that it had relied on Electric Boat to obtain the required pricing certificates and cost or pricing data from the subcontractors. Therefore we made a review of the 20 procurements at Electric Boat and found that 12 had been subject to the act. In four instances the required data and pricing certificates were obtained. In four other procurements, data and/or pricing certificates had not been obtained. In the remaining four instances, Electric Boat had requested but had been refused the cost or pricing data.

Electric Boat officials stated that the requirements of the Truth-in-Negotiations Act had not been completely understood by some of its buyers and vendors at the time the awards we examined into had been made. They said, however, that contractor procurement system reviews performed by the Navy at Electric Boat in October 1969 and December 1970 had led to a better understanding of the act. They stated also that the shipyard's current subcontract awards complied with the cost or pricing data requirements of the act. On a limited basis we examined current awards and found that in each instance the required pricing certificate and cost data had been obtained.

East Yard procurement officials stated that for future procurements they would obtain cost and pricing data and pricing certificates without relying upon the other shipyard to do so.

We also reviewed tabulations by subcontractors of 1969 and 1970 procurements, to determine whether the East Yard had attempted to avoid the cost or pricing data requirements of the act by splitting awards into amounts below $100,000. We found no evidence of such splitting.

WEST YARD

We believe that Litton awarded subcontracts in compliance with the cost or pricing data requirements of the Truth-in-Negotiations Act. Of 194 subcontracts we selected for examination, 11 subcontracts, amounting to about $63 million, were subject to the cost or pricing data requirements of the act. We reviewed each of these subcontracts and found that Litton had obtained the required certificate and cost or pricing data in each case.

BEST DOCUMENT AVAILABLE

We reviewed also selected subcontracts to determine whether the contractor had attempted to avoid the cost or pricing data requirements of the act by splitting awards into amounts below $100,000. We found no evidence of such splitting.

CHAPTER 3

COST CONTROLS

"Are shipyards' budgeting and cost control systems adequate to ensure proper control of labor and material cost on Navy ships?"

EAST YARD

We could not evaluate the effectiveness of the contractor's budgeting and cost control systems because the contracts we reviewed at the East Yard did not require the contractor to furnish, or to make available, budget information to the Government. For that reason we did not have the information necessary to evaluate the effectiveness of the system. We did note, however, that the contractor's system did not provide for segregating actual cost of change orders to permit comparison with budgets in order to evaluate change-order pricing and performance. The Navy and the contractor contended that it was not practicable to segregate costs of changes and that to do so would be very costly.

WEST YARD

Unlike the contracts at the East Yard, the contracts at the West Yard required the reporting of budgetary data to the Navy. We could not evaluate the adequacy of the contractor's budgeting and cost control system, however, because it had not been fully developed and implemented. The LHA ships were in the early stages of production, and Litton officials told us that detailed budgetary data were not yet available. Construction of the DD-963 ships had not started. We noted that the contractor's system did not provide for segregating actual costs of change orders to permit comparison with budgets in order to evaluate change-order prices and performance. The contractor and the Navy contend that it would be impracticable to segregate costs of changes and that to do so would be extremely costly.

System description

The description which follows relates to the system to be used by the West Yard to control production costs on LHA ships.

BEST DOCUMENT AVAILABLE

After the contractor submitted a price proposal for a Navy ship construction contract, the Navy and the contractor negotiated target cost, target profit, target price, and ceiling price. The target cost of the contract was the basis upon which budgets were to be prepared.

The contract provided for the quarterly reporting of development and production costs in terms of budgeted costs, actual costs, and the value of the physical progress. The development costs consisted of costs for such major groups as design and engineering, peculiar support equipment, common support equipment, training, and data. Production costs will be broken down into nine major groups (systems), such as hull structure, propulsion, and electric plant. The hull structure will be broken down into 33 smaller groups, such as superstructure, main deck, and inner bottom. There will be 175 smaller groups within the nine major groups. At the time of our review, the Navy and the contractor had not decided on the extent of reporting for the smaller groups.

Litton plans to budget material and labor costs by systems. Labor costs also will be budgeted by function for the contractor's internal purposes. There will be about 15 functions or tasks, such as design, procurement, and manufacture.

The work to be performed by the functional organizations will be stated in a management work package. This package will contain a time-phased budget and a schedule of performance and will identify the manager responsible for accomplishing the task. The package will contain also data for converting from the functional basis to the systems basis. As yet management work packages have not been put into use. In addition, hardware work packages will be developed for use at the shop level.

In negotiating change-order prices, a minimum or maximum provisional price, rather than a fixed price, was agreed to between the Navy and the contractor before change-order work was authorized. Final prices were to be adjudicated at a later date. Navy officials stated that most of the change orders issued had been design changes. The provisional price system was employed so that change-order work could be authorized promptly to prevent the accumulation of unnecessary costs.

GAO evaluation

We were unable to evaluate the East Yard's budgeting and cost control systems, because the contractor would not

make budget data available to us and because the contracts we reviewed did not require Litton to furnish such information to the Government.

At the West Yard we were unable to determine the adequacy of its budgeting and cost control system because it had not been fully developed at the time of our review.

The cost control systems for both yards do not identify separately the actual costs of change orders. Navy and contractor representatives told us that it would be impracticable and very costly to segregate change-order costs. They also stated that generally a price was agreed to before change-order work was started. We believe that, where firm prices are not established before significant changes in work are started, the segregation of change-order costs, where feasible, is needed to provide a sound basis for negotiating change-order prices.

"Are there adequate contractor and government controls over labor and material charging practices?"

EAST YARD

The contractor has established procedures for controlling material charges to specific systems and for controlling labor charges to work packages of a ship. Government control is exercised through review and analysis by the Defense Contract Audit Agency (DCAA) of the contractor's cost-charging practices.

On the basis of our test of the contractor's system for charging costs and our review of the Government's surveillance over the charging procedures, we believe that the controls over the charging of labor and material are adequate.

Up to March 31, 1971, $81,694,207 had been charged to two Navy contracts whose prices totaled about $120 million, as shown in the following schedule.

	Three SSN-637 class submarines	One SSN-612 submarine overhaul	Total
Material	$37,879,693	$ 2,196,467	$40,076,160
Labor	15,201,656	6,907,849	22,109,505
Overhead	14,691,139	4,817,403	19,508,542
	$67,772,488	$13,921,719	$81,694,207

BEST DOCUMENT AVAILABLE

Material-charging practices

The contractor's policy on material-charging practices provided that material which could be identified to a particular ship was to be charged direct. Material consumed in routine shop and plant operations or material used for repairs and maintenance of buildings and equipment was to be charged to overhead expense accounts.

Direct purchases

Purchase orders were identified by ship and by system. A purchase order number was placed on correspondence, invoices, and packages related to the purchase. The cost of the purchase was charged to the appropriate ship and system.

Stores issues

The contractor, in addition to purchasing material specifically for a ship, issued material from stores to the various departments on the basis of a stock control stores requisition signed by an authorized person. Stores issues included common-type items, such as rivets and pipe. The costs of stores issues were charged to the appropriate ship and system.

DCAA reviews

We reviewed the recent DCAA reports of the contractor's material control procedures and practices. DCAA found no mischarging of costs between contracts.

GAO evaluation

We selected for examination 41 direct purchases and 71 stores issues recorded during 1 month, to determine whether material costs had been charged properly. We traced material transactions from the source documents, through the intermediate accounting records, to the general ledger work-in-process account. Also we physically verified the existence of individual purchases costing more than $1,000. Our verification of material charges and our physical verification of material revealed no mischarges.

Labor-charging practices

Labor hours were accumulated for each ship by cost center, operation, system, and work package. The contractor's control of cost charging for labor was placed primarily with the workers' supervisors.

BEST DOCUMENT AVAILABLE

Time cards

Hourly employees received prepunched time cards at gate racks as they entered the yard. Information such as the employee's name, badge number, and rate of pay was preprinted on the card. The employees reported to their assigned work areas and punched in at nearby clock stations. The supervisors entered the hours worked on the cards by hull, cost center, operation, system, and work package.

Time cards for salaried employees were issued and prepared on a weekly basis. Salaried employees followed the same procedure in recording their time as did the hourly employees.

Payroll department timekeepers audited time cards for proper signatures and for valid hull, system, and work-package numbers.

DCAA reviews

We reviewed the audit reports and supporting workpapers covering three DCAA audits of the contractor's labor-charging practices and procedures. The reports showed only minor mischarging of labor costs between contracts.

GAO evaluation

To determine whether labor costs had been charged properly, we traced 113 direct labor transactions recorded during 1 week from the time cards, through the intermediate accounting records, to the general ledger work-in-process account. Our verification revealed no mischarges between contracts.

On the basis of our review and the work performed by DCAA, we concluded that the contractor's accounting practices were adequate to accurately record labor costs.

WEST YARD

For our review of contractor and Government controls over labor- and material-charging practices we made a random selection of 83 material transactions and 98 labor transactions at the West Yard; 19 other direct costs and 59 labor transactions at the Advanced Marine Technology Division; and 21 material transactions and 53 labor transactions at the Data Systems Division. In our review we traced each of the above transactions from the source document, through the intermediate accounting records, to the general ledger accounts. We found that these charges had been made to the proper contracts.

Marine Technology costs

DCAA found that, during the period 1969 through 1971, Navy contracts for the LHAs and DD-963's were charged about $7 million for overhead expenses applicable to Litton's commercial work.

DCAA's reports indicated that this had resulted from (1) Litton's including in material cost, for the purpose of allocating material overhead of the West Yard between its Government work and its commercial work, the costs incurred on the two contracts by Marine Technology in California, none of which were for material but rather were for direct labor, overhead, other direct costs, and general and administrative expenses and (2) Litton's charging Marine Technology (where work was almost wholly on Government contracts) with general and administrative costs incurred at that facility which were applicable, in part, to the West Yard. In addition, general and administrative expenses incurred at the West Yard (engaged primarily in commercial work) were allocated on the basis of the costs incurred at the two locations. This resulted in inequitable charges between Litton's Government work and its commercial work. According to DCAA the activities at Pascagoula and California were so integrated that the treatment of the two organizations as separate entities with separate general and administrative pools was unrealistic.

Although we did not review Litton's overhead-charging practices in detail, our selective examination indicated that they were resulting in the Navy contracts' bearing some of the overhead expenses applicable to the West Yard's commercial work.

Litton takes the position that there are no inequities in the direct- and indirect-costing practices. The treatment of labor, material, and overhead costs of an assisting division as material costs at the prime division has been in effect at the East Yard since before the construction of the West Yard. The contractor is considering changing its allocation method beginning with fiscal year 1972. The contractor believes that an adjustment should not be made for prior years' costs.

GAO evaluation

Our limited review confirmed the DCAA finding that the contractor's method of charging costs incurred by Marine Technology had resulted in Navy contracts' bearing certain overhead costs applicable to commercial work. The Navy currently has this matter under consideration.

BEST DOCUMENT AVAILABLE

CHAPTER 4

NAVY'S SURVEILLANCE OVER THE SHIPYARDS' PROCUREMENT AND COST CONTROL PRACTICES

Two questions were raised concerning Navy surveillance of shipyard operations.

"Does the Navy maintain effective surveillance over shipbuilders' procurement, cost control, and cost charging practices?"

"Is closer Navy surveillance of shipyard operations needed?"

The Navy's Supervisor of Shipbuilding, Conversion, and Repair (SUPSHIP) at Pascagoula is the organization responsible for administering the contracts at the East and West Yards. In this capacity it exercises surveillance over the contractor's operations to ensure conformance with contractual requirements. To carry out this surveillance, SUPSHIP, as of November 1971, had a staff of 275 civilians and 19 military personnel. This staff was involved in surveillance of such contractor operations as quality assurance, planning, control of material procurement, and cost control.

EAST YARD

The Navy had reviewed the East Yard's purchasing system in accordance with an Armed Services Procurement Regulation requirement. Approval of the contractor's purchasing system was withdrawn following a procurement review in August 1969 when the Navy determined that

--the purchasing manual did not fully implement the requirements of the Truth-in-Negotiations Act,

--the bidders' lists were incomplete,

--criteria for conducting negotiation discussions were needed,

--procedures and capability for making cost analyses did not exist, and

--adequate documentation to enable reconstruction of purchase transactions was not present.

In a later review, in September 1970, the Navy found that most of the deficiencies previously disclosed had not been corrected.

Litton was required by the contract for construction of the SSN-637 class of submarines to submit proposed subcontracts which exceed $100,000 to the contracting officer for consent. There were 69 such subcontracts. We reviewed the 69 subcontracts and found that 11 had not been submitted to the Navy. The contracting officer stated that these subcontracts were issued before the establishment of controls to ensure that the contractor submitted the subcontracts for Navy consent. The Navy did not consent to 31 subcontracts until 3 to 207 days after they were awarded.

SUPSHIP surveillance was augmented by DCAA at Pascagoula. In November 1971 nine of DCAA's auditors were assigned to the East Yard. During fiscal year 1971 DCAA performed audits in such areas as financial control, material, labor, and overhead. Reports on its findings, along with the contractor's comments, were sent to SUPSHIP. SUPSHIP and DCAA periodically discussed with the contractor the extent and propriety of corrective actions taken.

WEST YARD

In addition to having its staff at Pascagoula, SUPSHIP had a branch office at Culver City, California, with a staff of 10 civilians and seven military personnel. This staff had surveillance responsibility over Marine Technology's operations.

The surveillance responsibility at the Data Systems Division was delegated by SUPSHIP to the Defense Contract Administration Services Office, Woodland Hills, California.

Contractor procurement system reviews were made at the two California organziations but not at the West Yard. Marine Technology's procurement system was approved informally after a review by the Navy in August 1970. The Defense Contract Administration Services Office, after its reviews, approved the procurement system of the Data Systems Division for a period of 1 year, which started in January 1971. Notwithstanding the system approvals, the contracts require prior written consent by the contracting officers of individual procurements in excess of $100,000 for the LHAs and the DD-963's. We reviewed 146 subcontracts in excess of $100,000 and found that the contractor had failed to submit 14 procurements for consent before the awards. The contracting officers' consent to these procurements was not obtained until 10 to 168 days after they were awarded.

BEST DOCUMENT AVAILABLE

SUPSHIP surveillance at the West Yard and at the two organizations in California was augmented by DCAA. During the fiscal year ended June 30, 1971, DCAA performed audits of financial reporting, financial management, costs, overhead, general and administrative expenses, and other matters.

To improve its surveillance over shipyards, SUPSHIP was establishing a business review staff consisting of a supervisory business analyst, an industrial engineer, and a financial analyst. The staff was to be responsible for maintaining surveillance over all aspects of the contractor's business practices, including management objectives and policies, work operations and progress, resources utilization, and cost control and reporting systems.

GAO evaluation

Surveillance over the cost-charging practices at Litton has been adequate. Closer surveillance of the contractor's subcontracting practices, however, appears necessary. As discussed on pages 3 through 10, the East Yard did not always follow effective procurement procedures to ensure that the most favorable prices were obtained in some subcontract procurements and there were considerable delays at both yards in approving subcontracts as required by the Navy's contracts.