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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

July 26, 1985

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Admiral K. R. McKee, Deputy Commander
for Nuclear Propulsion
Naval Sea Systems Command
Nuclear Propulsion Directorate

Dear Admiral McKee:

Subject: Observations on Two Naval Nuclear Propulsion
Program Procurement Practices (GAO/NSIAD-85-111)

This report discusses two Naval Nuclear Propulsion Program procurement practices. They are procurement of "long lead material" and "split and source maintenance awards." Our observations on these areas are being provided for your consideration.

The Directorate relies extensively on two prime contractors--General Electric Company's Machinery Apparatus Operation and Westinghouse Electric Corporation's Plant Apparatus Division--to support the day-to-day procurement activities of the program. These contractors' activities include nuclear reactor component procurement and extensive engineering support. The Directorate has onsite representatives who monitor both contractors' activities and review and approve operating budgets and all purchases valued at \$25,000 or more. Funding for procurement of nuclear reactor components for new construction and fleet support totaled almost \$990 million in fiscal year 1983.

PROCUREMENT OF LONG LEAD MATERIAL

Over the years, General Electric and Westinghouse--with the Directorate's approval--have followed a policy of purchasing long lead material needed to manufacture reactor components through their component manufacturers, rather than directly from subtier suppliers. When purchasing long lead material, component manufacturers provide services similar to those provided by the two contractors, including engineering effort, contract administration, and technical review of drawings/graphics. General Electric and Westinghouse believe that

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through this practice they can support shipyard construction schedules better and prevent liability concerns. Their justifications for this practice were as follows.

- Directly purchasing such material requires extra engineering or administrative effort, which is frequently greater than presumed savings.
- Furnishing late or defective items provides a basis for component manufacturer claims or requests for delivery extensions.
- Providing items with any discrepancy could be interpreted as a change to the contract and might require extensive negotiations to settle.

We found no analyses by General Electric or Westinghouse to support these positions.

Our observations

Our analysis of all 10 fiscal year 1983 long lead material procurements indicated that General Electric and Westinghouse could have avoided costs of about \$4 to \$8 million by procuring the material directly from subtier suppliers and providing it to their component manufacturers. Our \$8 million estimate was derived by eliminating component manufacturers' profits, engineering costs, and general and administrative expenses. It also included the additional costs to General Electric and Westinghouse of buying long lead material. However, since most of the component manufacturers' production capability is dedicated to the nuclear Navy, general and administrative expenses might not be eliminated by direct procurement because they might be charged to other nuclear Navy procurements. Considering this possibility, our maximum estimated cost avoidance of \$8 million would be reduced to about \$4 million.

We agree that liability/late delivery/defective material and item discrepancy problems are valid concerns and, should they occur, could add to General Electric's and Westinghouse's costs to buy long lead material. However, a Directorate official advised us that about 50 percent of the material procured in the past had been transferred among component manufacturers for use in fabrication of components with no significant problems relating to timeliness of delivery or defects in material. In our opinion, it is unlikely that these problems would occur to any greater extent if the current practice were modified. Therefore, we believe that the contractors should analyze the advantages and disadvantages of directly procuring

long lead material from subtier suppliers on a case-by-case basis to determine the alternative most advantageous to the government.

SPLIT AND SOURCE MAINTENANCE AWARDS

General Electric and Westinghouse sometimes split procurement quantities between two or more suppliers or award the entire amount to a single supplier to maintain or increase the number of suppliers and/or meet delivery dates. Split and source maintenance awards represented about \$385 million of \$2.9 billion worth of procurements made by these contractors during fiscal years 1979 through 1983. These awards normally involve substantial premiums to suppliers whose prices are higher than others. The premiums for all 23 such awards made from fiscal years 1979 through 1983 totaled over \$19 million.

Both contractors--because of the Directorate's concern about capacity overloads at major suppliers--annually prepare and periodically update supplier capacity evaluations to measure suppliers' capabilities to design and manufacture naval reactor components. Factors considered include backlogs and available capacity, future potential nuclear business, historical pricing, and technical knowledge of reactor components. However, these contractors did not have split and source maintenance procurement procedures that described how to determine minimum quantity awards.

Our observations

Our analysis of the awards made since fiscal year 1979 showed that \$11.5 million in premiums on four awards could have been reduced by about \$6.1 million had both contractors limited awards to quantities needed to maintain higher price suppliers as viable supply sources and/or meet delivery requirements. Both contractors, in some instances, paid higher premiums than we believe was necessary because neither contractor considered the minimum levels needed to keep these suppliers in the program. Further, one contractor established split award quantities without obtaining supplier pricing and delivery estimates on the total quantity required.

The contractors could use the supplier capacity evaluations data to determine minimum award quantities needed to keep higher price suppliers in the program, thereby avoiding some costs. For example, the contractors could identify increases needed in a supplier's operating levels by analyzing 5-year production charts for critical manufacturing resources. Furthermore, the

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Directorate could use this data to evaluate contractor recommended awards to higher price suppliers. Directorate officials agreed that capacity evaluations could be used for these purposes.

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We conducted our audit work, which was performed in accordance with generally accepted government auditing standards, at the program headquarters in Crystal City, Virginia; General Electric in Schenectady, New York; and Westinghouse in Monroeville, Pennsylvania. We also met with Defense Contract Audit Agency officials in Monroeville, Pittsburgh, and Schenectady.

In reviewing the two procurement policies, we held discussions with Directorate and contractor officials and reviewed procurement procedures and program documents. In our evaluation of the feasibility of the contractors directly procuring long lead material, we reviewed all 10 fiscal year 1983 long lead material procurements. In our determinations of the cost effectiveness of split and source maintenance awards, we reviewed all 23 awards made from fiscal years 1979 through 1983.

We would appreciate being advised of any actions you decide to take as a result of our work.

Sincerely yours,



Frank C. Conahan
Director