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

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Dear Mr. Chairman:

In accordance with your letters of August 18 and December 10, 1970, we are reviewing efforts by the Navy and its contractors to control ship construction costs at major private shipyards.

We have now completed a substantial part of this work. On some of the questions you raised, however, we are finding it necessary to expend a greater amount of audit effort than we originally thought would be needed. Rather than delay reporting until we obtain all the necessary information, we plan to furnish you with separate reports on major segments of the work as they are completed. Therefore on June 4 we furnished your office with the Navy's response to specific questions in your letters. Today's letter furnishes our response to the following question included in your August 18 letter.

"Is there enough competitive pressure in the shipbuilding business or are the types of government contracts awarded for shipbuilding work adequate to give the shipyards an incentive to control costs and work efficiently on government contracts without close government surveillance?"

Our examinations of the award and administration of contracts with private shipyards, which include contracts for ship overhauls as well as for their construction, lead us to conclude that, although there is a certain amount of competition in the shipbuilding industry, the benefits are reduced by (1) the limited number of contractors competing for contract awards and (2) the large number of changes and claims negotiated after the award.

LIMITED NUMBER OF SHIPYARDS
COMPETING FOR CONTRACTS

BEST DOCUMENT AVAILABLE

Competition is often limited to the few shipyards having the capability to construct certain types of vessels. Presently, for example, only one private shipyard has the capability to construct nuclear aircraft

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carriers. Only two shipyards are capable of constructing missile-equipped nuclear submarines; only three can construct other types of nuclear submarines.

In overhauls, competition is usually solicited only from those shipyards which are located within the geographical area at or near the home port to maintain morale of the crew.

We have been told by Navy officials that heavy work loads at times prevent shipyards from seriously bidding or from being solicited and that, conversely, the Navy has at times restricted the competition for some awards to the shipyard in need of work to help the yard maintain its capability.

CHANGES NEGOTIATED AFTER AWARD

Even where there are several bidders and competition is obtained for the original award, changes are so prevalent in ship construction and overhaul contracts that they tend to negate a considerable portion of the advantages obtained through the original competition.

The changes usually represent additional amounts claimed by the contractor to have resulted from some action by the Government or to cover the value of modifications in work scope. The changes, of necessity, are negotiated on a sole-source basis. Further, many changes are negotiated after the work is completed. For additional information on this matter, see our enclosed reports to the Congress dealing with pricing of ship overhaul contracts and claims on ship construction contracts (B-133170 dated March 19, 1970, and B-171096 dated April 28, 1971).

We have been examining nine contracts awarded in fiscal years 1967-70 that amount to about \$4 billion. The contractors are Newport News Shipbuilding and Dry Dock Company, Newport News, Virginia, and two Litton Industries, Inc., facilities at Pascagoula, Mississippi. Two of the contracts were formally advertised. Five contracts, for about 80 percent of the total value of the awards, were negotiated competitively. The remaining two contracts, involving \$680 million, were awarded on a sole-source basis.

Only one of the nine contracts we are examining was essentially complete at the time of our examination. This construction contract, a firm fixed-price type, had changes of about \$11 million added to the basic contract amount of about \$39 million--an almost 30-percent increase. Similarly, we found that, in a prior review of ship overhaul contracts, initial awards of about \$65 million were increased by about \$23 million, or 35 percent, for supplemental work.

To determine the magnitude of changes, we reviewed construction contracts for ships that were completed in 1970. Here changes amounted to \$103 million, or about 22 percent of original contract prices which totaled \$477 million.

In conclusion, it seems apparent that real competition is lacking for a significant portion of the Navy's ship repair and construction program and that, in the final analysis, many contracts are priced to a large extent on the basis of incurred costs. Under these circumstances, contractors may not have the financial incentive needed to operate in the most efficient and economical manner. Therefore we believe that it is essential that the Navy exercise close surveillance over contractors' operations and costs to assure itself that the shipyards are being properly managed so that the Government will pay only for costs necessary to the efficient performance of the contract.

We are aware that last year the Navy instituted a new program designed to reduce the number of contractor claims and to improve the ship acquisition program, in general. Organizational changes and other actions affecting personnel and procurement procedures are already being implemented. We have examined the actions taken by the Navy and are currently preparing a report on this subject.

In the near future we will furnish you with reports on the other specific areas set out in your request. We plan to make no further distribution of this report unless copies are specifically requested, and

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then we shall make distribution only after you
desired or public announcement has been made
contents of the report.

(Since:


Acting Comptroller
of the

Enclosures - 2

The Honorable William Proxmire
Chairman, Subcommittee on Priorities
and Economy in Government
Joint Economic Committee
Congress of the United States

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