

GAO Highlights

Highlights of [GAO-17-211](#), a report to congressional committees

Why GAO Did This Study

DOD encourages the use of FPI contracts because they allow for equitable sharing of costs savings and risk with the shipbuilder. Under FPI contracts, the shipbuilder's ability to earn a profit or a fee is tied to performance. After costs reach the agreed upon target cost, the shipbuilder's profit decreases in relation to the increasing costs. A ceiling price fixes the government's maximum liability.

A House Report on the Fiscal Year 2014 National Defense Authorization Act included a provision for GAO to examine the Navy's use of FPI contracts for shipbuilding. This report examines (1) the extent to which the Navy has entered into FPI contracts over the past 10 years, (2) how FPI contracts apportion risk between the Navy and the shipbuilder, and (3) the extent to which FPI contracts led to desired cost outcomes. GAO selected a non-generalizable sample of six contracts (for 40 ships) awarded during the past 10 years, analyzed Navy contract documents, and interviewed program, contract, and shipbuilding officials. This is the public version of a sensitive but unclassified report issued in November 2016.

What GAO Recommends

For shipbuilding contract awards, the Navy should (1) document in the contract file its rationale for selecting an FPI contract and the basis for contract elements and (2) conduct a portfolio-wide assessment of its use of additional incentives on FPI contracts across its shipbuilding programs. DOD agreed with GAO's recommendations and stated that actions will be taken in 2017 to address them.

View [GAO-17-211](#). For more information, contact Michele Mackin at (202) 512-4841 or mackinm@gao.gov.

March 2017

NAVY SHIPBUILDING

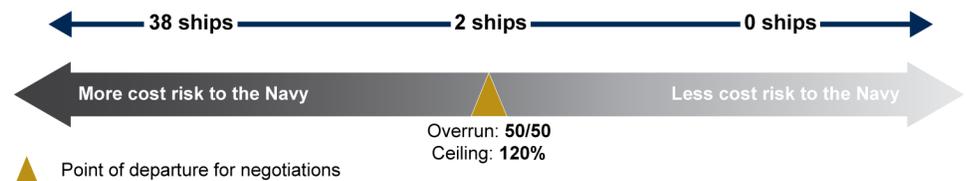
Need to Document Rationale for the Use of Fixed-Price Incentive Contracts and Study Effectiveness of Added Incentives

What GAO Found

Over 80 percent of the Navy's shipbuilding contracts awarded over the past 10 years were fixed-price incentive (FPI). However, GAO found that half of the six selected contracts it reviewed did not document the Navy's justification for selecting this contract type. Moreover, key documents that should describe the rationale for selecting contract elements varied across these contracts. Given the Navy's plans to invest billions of dollars in shipbuilding programs in the future, without adequate documentation on the rationale for use of an FPI contract and key decisions made about FPI contract elements, contracting officers will not have the information they need to make sound decisions at the negotiation table.

Department of Defense (DOD) regulation suggests, as a point of departure for contract negotiations, that the government and shipbuilders share the cost risk equally and set a ceiling price 20 percent higher than the negotiated target cost. GAO found that, for most of the 40 ships on the contracts reviewed, these contract terms resulted in the Navy absorbing more cost risk, as shown below.

GAO Assessment of Share of Cost Risk between the Navy and Shipbuilder for 40 Selected Ships at Time of Contract Award Compared to Guidance and Regulation (Not to scale)



Source: GAO analysis of Department of Defense data. | GAO-17-211

Note: Ships assessed include Arleigh Burke Class Guided Missile Destroyers (DDG 115-116), Expeditionary Mobile Bases (ESB 3-4), Expeditionary Transfer Docks (ESD 1-2), Littoral Combat Ships (LCS 5-24), San Antonio Class Amphibious Transport Dock Ships (LPD 22-27), Virginia Class Submarines (SSN 784-791).

Many factors inform the Navy's and shipbuilder's negotiation positions, including the stability of the supplier base and extent of competition. That said, guidance states that the FPI contract elements should be the primary incentive for motivating the shipbuilder to control costs. But GAO found that in five of the six contracts, the Navy added over \$700 million in incentives.

Of the 11 ships delivered as of December 2015 under the six contracts, 8 experienced cost growth. In one case, costs grew nearly 45 percent higher than the negotiated target cost. Further, it is unclear whether the additional incentives achieved intended cost and schedule outcomes, as GAO found a mixed picture among the contracts reviewed. Regulation, while not prescriptive, highlights the benefits of measuring the effectiveness of incentives. According to a senior Navy contracting official, the Navy has not measured incentive outcomes for its shipbuilding portfolio. Without assessing whether adding incentives is effective in improving shipbuilder performance, the Navy is missing an opportunity to better inform decisions about whether to include additional incentives in future awards.