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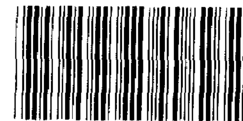
## Report To The Chairman, Subcommittee On Procurement And Military Nuclear Systems Committee On Armed Services House Of Representatives

## OF THE UNITED STATES

# Observations Concerning Profit Rates On Selected Navy Contracts

In testimony before the Subcommittee on June 16, 1981, Admiral Hyman G. Rickover alleged that four contractors were making excess profits on specific Navy contracts.

GAO was asked to verify the allegations and provide any special or extenuating circumstances surrounding the procurements that should be considered in evaluating the reasonableness of the profits. GAO found that the profit figures cited by Admiral Rickover were essentially accurate.

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B-207729

The Honorable Samuel S. Stratton
Chairman, Subcommittee on Procurement
and Military Nuclear Systems
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

This report is in response to your Subcommittee's request that we review specific allegations made by Admiral Hyman G. Rickover (Retired), former Deputy Commander for Nuclear Propulsion, Naval Sea Systems Command, Department of the Navy, to determine whether excess profits have been made. During your Subcommittee's June 16, 1981, hearing covering profit limitations on Defense contracts, Admiral Rickover provided specific examples of contracts on which he believed excess profits had been made.

In subsequent meetings in your office, we advised that we could not render an opinion whether excess profits had been made in any individual case since there are no generally accepted criteria as to what constitutes excess profits. We pointed out that this particular issue had been much debated in certain congressional committees without resolution. Accordingly, as agreed with your office, our study was basically a data-gathering effort to determine whether the situations described by Admiral Rickover actually occurred and to identify any extenuating or special circumstances which the Subcommittee should consider in assessing the reasonableness of the profits realized by the contractors.

As requested, we limited the review to the allegations concerning contracts and/or subcontracts with the Cabot Corporation, the Carborundum Company, the Newport News Shipbuilding and Dry Dock Company, and the United States Steel Corporation. We reviewed the cases and supporting data provided by Admiral Rickover's staff, and we contacted the contractors to determine if (1) the profits discussed were normal for similar work and (2) there were any special circumstances, such as heavy investment requirements, unusual risks, etc. In addition, we obtained other financial information that has been considered relevant in the past to determinations of excesssive profits. Our review was performed in accordance with generally accepted government audit standards.

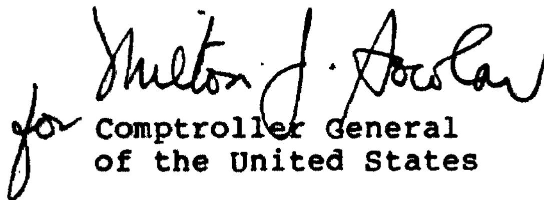
Our review showed that the profit figures cited by Admiral Rickover were essentially accurate. In each case, contractors claimed special circumstances -- unusual quality control requirements, highly trained personnel, or special facilities -- which they believe justified their profits. These circumstances,

together with other details on our work, are contained in appendix I.

We interviewed the individual contractors after completing our review work, and we briefed them in detail about our findings. The contractors' comments did not change the amounts and rates of profits identified in our draft report. The contractors generally identified additional circumstances which they believe would justify the profits negotiated or made. We have incorporated, where appropriate, the contractors' and the Department of Defense's (DOD's) comments in appendix I. Copies of letters providing written comments are in appendixes II through V.

As arranged with your office, unless you publicly announce the report's contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to the Secretaries of Defense and the Navy, the four contractors whose contracts we reviewed, and other interested parties.

Sincerely yours,



for Comptroller General
of the United States

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## ABBREVIATIONS

DCAA Defense Contract Audit Agency

DCASMA Defense Contract Administration Service Management Area

| | |
|---|---|
| GAO | General Accounting Office |
| HTMD | High Technology Materials Division |
| LSI | Lear Siegler, Inc. |
| PSAs | post shakedown availabilities |
| SUPSHIP | Navy Supervisor of Shipbuilding, Conversion and Repair |
| USS | United States Steel Corporation |

# OBSERVATIONS CONCERNING ADMIRAL RICKOVER'S EXCESS PROFITS ALLEGATIONS

This appendix contains our observations of Admiral Rickover's excess profits allegations. We have presented our findings by individual contractor.

## THE CABOT CORPORATION, HIGH TECHNOLOGY MATERIALS DIVISION, KOKOMO, INDIANA

### Allegation

Admiral Rickover made the following allegation about certain procurements involving Cabot:

> "A sole-source supplier of special material used for large valves in nuclear powered ships initially refused to submit the cost and pricing data required by law in the Truth in Negotiations Act. The order was placed contingent upon his agreement to provide this data. After the contract award, the company submitted cost data which showed a 66 percent profit in his price."

### GAO analysis

The allegation relates to purchase order number 70224 issued to Cabot's High Technology Materials Division (HTMD), in Kokomo, on February 10, 1981, by Lear Siegler, Inc. (LSI), Energy Products Division, Santa Ana, California. In turn, LSI was the first tier subcontractor to the prime contractor, General Electric Company, Machinery Apparatus Operation Division.

Cabot was not the only source for the special material. Another source existed (Crucible, Inc., Specialty Metals Division) and that company was solicited and submitted a proposal. Its offered price so far exceeded Cabot's that LSI did not consider it interested in winning the award. The original award price of $274,440 included a 66-percent profit on estimated cost according to a cost breakdown submitted by Cabot to LSI shortly after contract award. A Cabot official told us that the price to be charged upon delivery of the material was based upon the terms of the purchase order, which provided for an increase or decrease in price at delivery time depending on Cabot's assessment of the price changes in the special metals market. LSI subsequently exercised options for additional quantities of the material, which increased the award price to $439,172. This award price included the 66-percent profit on estimated costs.

When Cabot delivered the material to LSI on February 16, 1982, it unilaterally reduced the contract price from $439,172 to $360,696. The decrease was primarily due to the lower market price paid by Cabot for cobalt, the primary metal used to manufacture the special material.

During our review, Cabot prepared a special breakdown of actual costs incurred to demonstrate that profit was less than the 66 percent included in its estimates. Cabot's actual cost breakdown showed a realized profit before taxes of 6.2 percent. However, this breakdown included items of cost never mentioned in its earlier estimated breakdowns because Cabot said its accounting system did not collect such costs. Inventory carrying costs included in Cabot's actual costs are unallowable. Also, Cabot did not adjust its material, when it computed actual costs incurred, to reflect the lower raw material costs incurred that had been reflected in its adjusted price to LSI. If unallowable costs are excluded and lower actual raw material costs are used, Cabot's actual profit was 61.3 percent of estimated costs. Although costs included in Cabot's estimate were audited by the Defense Contract Audit Agency (DCAA) at the Navy's request, the additional types of costs, while allowable, have not been examined for allocability or reasonableness. The $360,696 paid to Cabot under the LSI purchase order will subsequently be passed on to the Government since the purchase order awarded to LSI by the prime contractor included the costs paid to Cabot.

For comparison purposes, we looked at a purchase order issued to Cabot by another company for the same material Cabot provided LSI. This purchase order price was also to be adjusted based on material costs in effect at the time of delivery and included an identical estimated profit figure of 66 percent.

## Comparative profit data

We requested comparative profit data for Cabot's other Department of Defense (DOD) work, for its non-DOD work, and for various product lines. Cabot officials told us that such information was not available since the accounting system did not provide this information. They stated that they considered profit as a percentage of cost to be inappropriate for a capital intensive industry and considered return on assets a more appropriate measure of profitability.

They provided us a computation showing a return on assets of 2.4 percent after taxes for the LSI purchase order. Assuming that Cabot paid the maximum corporate tax rate of 48 percent, its claimed return on assets of 2.4 percent after taxes would be 4.7 percent before taxes. We verified the asset base used in the computation to the general ledger; the profit was taken from the LSI cost schedule, and adjusted as previously discussed, as follows:

$$\text{Return on assets} = \frac{\text{Profit before taxes}}{\text{Asset base}} = \frac{\$137,068}{\$462,537} = 29.6 \text{ percent}$$

Cabot's return on assets did not adjust material cost to reflect actual cost at time of delivery to coincide with Cabot's pricing policy. Rather, the company incorrectly used the cost in effect at the time it initially estimated the material cost. Since material costs declined during this period, Cabot used an inflated material cost for computation purposes. Cabot also deducted inventory carrying costs, which are not allowable (Defense Acquisition Regulation sec. 15). Even if inventory carrying costs were allowable, Cabot would have had a 19-percent return on assets (before taxes)--well above its claimed 2.4 percent return (after taxes) or 4.7-percent return before taxes, assuming a 48-percent tax rate. We also calculated a 30.4-percent return on assets for the other purchase order we examined.

Based on Cabot's data, we determined that HTMD realized a return on average assets for all work performed in 1981 of 8.1 percent before taxes, whereas the goal was 24.2 percent before taxes. Based on our calculations, the rate of return on assets for the two subcontracts under Government prime contracts discussed above exceed company return on investment goals.

Special circumstances

Cabot officials believe that special circumstances exist in producing the material. The factors are the risk involved because of stringent specifications and inspection procedures imposed by the Navy, the excessive paperwork, and the heavy investment required due to the capital intensive nature of the business.

They said that although DOD work constituted a very small percent of HTMD's workload, additional costs were incurred that were not required for commercial business. These are costs for tracing the material in the manufacturing process, the testing required, and the administrative requirements imposed for Navy nuclear work. The division's process cost accounting system, however, is not designed to identify these costs.

Cabot officials believe that although the inventory carrying costs are not allowed by the Defense Acquisition Regulation, they are extraordinary costs incurred to carry raw material from time of purchase to finished product shipment and billing, generally 9 to 12 months. Cabot officials told us that to produce the material for the LSI purchase order, it had begun the manufacturing process with 30,000 pounds of raw material which cost about $400,000. The Cabot officials believe that the carrying costs for the raw material are proper costs which should be considered when determining profitability.

Cabot's written comments are included as appendix III.

CARBORUNDUM COMPANY,
ELECTRO MINERALS DIVISION
NIAGARA FALLS, NEW YORK

Allegation

Admiral Rickover made the following allegation about certain procurements involving Carborundum:

"A sole-source supplier of special material used in nuclear propulsion plants demands a profit of 25 percent of his estimated cost."

GAO analysis

The allegation pertained to sales of boron carbide by Carborundum's Electro Minerals Division in Niagara Falls to two prime contractors that produce nuclear reactor cores for naval vessels. We found that the allegation was correct based on our examination of records and discussions with officials of Carborundum; DCAA's Buffalo, New York, office; the Schenectady Naval Reactors Office, Schenectady, New York; and one of the prime contractors. We focused our review primarily on the 1980 production year. 1/

Carborundum provides both finished and unfinished boron carbide to two prime contractors. Prices for each type of boron carbide are negotiated on a production (i.e., calendar) year basis, are based on total production, and include a 25-percent profit (on cost) rate. Purchase orders were issued to Carborundum by both prime contractors at a unit price that included the 25-percent profit. These firm-fixed-price purchase orders amounted to $852,545 for unfinished boron carbide and $1,346,208 for the finished boron carbide and cover part of 1979's and all of 1980's production requirements. Carborundum officials were not aware of the basis for the 25-percent profit rate except that it is historical in nature. Negotiation correspondence for the 1976 production year indicates that, during that time, Carborundum had a before-tax profit goal of 25 percent for its product lines and divisions. This same correspondence indicates that product lines not meeting this goal would be seriously considered for elimination or redirection and that during that time, the commercial market for a similar product provided profit percentages as high as 50 percent.

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1/Carborundum Company was a wholly owned subsidiary of the Kennecott Corporation in 1980. The Kennecott Corporation was acquired by the Standard Oil Company (Ohio) in June 1981.

Carborundum 1980 estimate of costs/profits

Carborundum maintains a process cost accounting system designed to accumulate and control costs by product line. The system does not provide the data to determine the actual costs and profits for Navy nuclear boron carbide production because it is only part of a product line.

Carborundum prepared an estimate of its actual boron carbide production costs for 1980 for one of the prime contractors to use in negotiating the 1982 order for Navy nuclear boron carbide. The estimate was based on certain assumptions and was reconstructed from available information, including the costs for idle facilities and allocations of corporate expenses, labor, and overhead. The costs for two of the four departments involved in the manufacturing process were wholly charged to the Navy product, while the costs of the other two departments were allocated between Navy and commercial production of boron carbide. The estimate showed an overall weighted average profit on cost of 23.28 percent consisting of a 10.89-percent loss for unfinished boron carbide and a 39.23-percent profit for the finished boron carbide.

We reviewed the estimate and, where readily available, traced selective cost elements to source records. In other cases, we accepted Carborundum officials' explanation of certain costs. We examined purchase orders and production and shipping records for 1980.

Costs passed on to the Government

To determine whether the costs under the above-mentioned purchase orders are passed on to the Government, we looked at the Government's approval of one prime contractor's price proposal for 1980. The approved proposal contained the price paid to Carborundum for finished boron carbide, including a 25-percent profit rate, but did not include the cost of Carborundum's idle facilities which DCAA had questioned. When the prime contractor issued the purchase order to Carborundum, it paid the full price. Carborundum's payment included the 25-percent profit rate. The Government contracting officer informed us in February 1982 that the prime contractor was underrunning its fixed-price-incentive contract and that the price to Carborundum would be passed on to the Government.

Comparative profit data

In the opinion of Carborundum officials, profits made producing Navy nuclear boron carbide are not excessive. Considering the risks involved in production, they feel the profits may be inadequate.

We asked the Carborundum officials to provide us the return on investment for producing Navy nuclear boron carbide and the profit data for other Carborundum business. Carborundum officials told us that the accounting records could provide reliable and comparable return on investment and profit data only at the Kennecott Corporation (parent company) level. They said that the accounting records for divisions and product lines within the corporate structure did not uniformly reflect operating results since they were maintained differently depending on the corporate level and company needs.

Special circumstances

Carborundum officials consider Navy nuclear boron to be a high risk product and they cited the following factors as special circumstances which justify a 25-percent profit based on costs. The Electro Minerals Division does no other Government business, and boron carbide is a small part of the division's business. Boron carbide represents less than 1 percent of the Division's sales.

--Carborundum, which is the sole producer of boron carbide, sells only to the Navy and is thus dependent on the Navy for orders of this material. There is never an assurance of orders beyond each year's purchases.

--The boron carbide production process, which involves a large amount of fixed assets, has been dedicated exclusively to Government work since 1980. Certain usually variable costs, such as payroll, are considered a fixed cost since personnel are carried on the payroll regardless of the level of production and personnel cannot be transferred to other product lines because special skills and security clearances are involved. The boron carbide furnacing operation, for example, requires certain skills that not only assure optimum yield from the furnacing process, but also assure that the furnaced lot is not spoiled.

--Carborundum maintains full operating capacity to meet Navy requirements, and the greatest cost economies are at full operating capacity. However, the Navy is not specific with its needs and cannot guarantee purchase orders for full operating capacity since it depends on funding levels. When purchase orders for less than full operating capacity are awarded, inefficiency in production results. For example, production for 1980 was at a reduced operating capacity.

--Carborundum has only one source for the high purity boric oxide needed in boron carbide production, and it has little control over its price. Furthermore, the supplier is on the west coast, which causes additional delivery costs and sometimes shipping delays.

--Navy nuclear boron carbide production requires detailed and unique recordkeeping that are not part of Carborundum's normal business practices. Special quality control and security measures are required. Meeting the strict naval chemical and grading specifications is risky and any below-grade material is discarded.

--Carborundum officials said that the Navy was experimenting with another product which may replace boron carbide for Navy nuclear purposes. They believe that the boron carbide product line has an uncertain future.

Carborundum's written comments are included as appendix IV.

NEWPORT NEWS SHIPBUILDING
AND DRY DOCK COMPANY,
NEWPORT NEWS, VIRGINIA

## Allegations

Admiral Rickover made the following allegations about certain procurements involving Newport News:

> "One sole-source contractor typically negotiates a target profit equal to 10 percent of the estimated cost of the work. The work is done under risk-free, cost plus-incentive fee contracts. After the contract is completed and all changes have been negotiated, he ends up making, on the average a 17 1/2 percent profit on his actual incurred costs."

> Admiral Rickover estimated that Newport News received approximately a 27-percent return on investment for these risk-free cost-type Navy overhaul contracts in 1980.

> "One contractor has made profits as high as 36 percent of some firm fixed price contracts for ship repair work. The contractor has averaged a 21 percent profit on these contracts, even though his risk has been negligible."

## GAO analysis

Admiral Rickover's first two allegations pertained to six consecutive cost-plus-incentive-fee contracts completed from May 1977 through December 1979 for the examination and repair of submarines, referred to as overhauls. The third allegation refers to seven consecutive firm-fixed-price contracts completed from March 1978 through March 1980 for repairs and improvements of deficiencies found during the testing of newly constructed submarines, referred to as post shakedown availabilities (PSAs).

Newport News pointed out that, although the Navy had awarded the overhaul contracts to Newport News without competition, it was not the only firm that performed overhauls of nuclear submarines when these contracts were awarded and performed. Such work was also performed by the Electric Boat Division of General Dynamics, the Ingalls Shipbuilding Division of Litton Industries, and certain Navy shipyards. Newport News also stated its experience on the 13 specific contracts had not carried through to current submarine overhaul contracts and that it was not currently underrunning negotiated target costs for current submarine overhaul contracts.

We examined records at and talked with personnel at the offices of DCAA and the Navy Supervisor of Shipbuilding, Conversion and Repair (SUPSHIP), Newport News. We also discussed these matters with personnel of the Naval Sea Systems Command and the Naval Material Command, but we did not audit any Newport News company records.

We found that the allegations concerning profits and incentive fees earned by Newport News on the specific contracts reviewed were essentially correct.

We could not verify Admiral Rickover's allegation concerning return on investment because of the lack of data available to us, the lack of consistency between Admiral Rickover's and Tenneco's (Newport News' parent company) method in computing return, the lack of industry data for comparison, and the fact that various methods of computing return on investment are acceptable.

Incentive fees earned on overhauls

Newport News has underrun target costs negotiated for the contracts cited. These contracts are cost-plus-incentive-fee submarine overhaul contracts which, according to Government officials, are of minimum risk, since all allowable costs will be reimbursed. From 1974 through 1978, target profits for these contracts were negotiated at 9.6 to 9.8 percent of the estimated allowable cost with incentive fees for superior performance payable up to a maximum of 15 percent of allowable target costs. For the six overhaul contracts reviewed, Newport News' actual costs were less than originally agreed targets in three cases and less than the total of original targets plus negotiated changes in all cases. For three of the contracts, the actual costs expended by Newport News in doing the work were low enough for Newport News to earn a maximum incentive fee of 15 percent of target costs.

Newport News pointed out it was Government practice to disallow (not reimburse) certain business costs (such as interest and certain advertising costs) under cost-type contracts. Contractors must pay any disallowed costs with their own funds. Newport News also said not all costs included in these contracts were fee bearing. Thus, the actual realized fee will be less than alleged by Admiral Rickover when costs expended but disallowed and interest are considered.

The Navy takes other actions provided for by contract that minimize or offset the incurrence of interest costs. Costs incurred by the contractor can be billed and paid as frequently as biweekly, thus reducing the outlay and duration of private funding to support the contract. In addition, the Navy permits the contractor to charge as a cost the imputed interest on facilities capital (investment in fixed assets) devoted to the contract. This is an offset to interest costs that may have been incurred to finance such facilities.

We updated the schedule used by Admiral Rickover to show the incentive fees earned by Newport News on these submarine overhauls. (See p.15.) SUPSHIP officials agreed with the data in our schedule. Also, Newport News officials did not disagree with the amounts stated. The final contract target cost is the basis for the fee actually earned and is generally higher than the original contract target cost because of change orders and equitable adjustments for increased costs for which the Navy has accepted responsibility, which increase the target fee. Our schedule reflects data available as of December 21, 1981, and shows an actual average incentive fee of 18 percent of actual allowable costs incurred. Admiral Rickover's figures were based on earlier data that showed an actual average incentive fee of 17.6 percent.

As indicated above, the contractor's incentive fee was limited to 15 percent of target costs negotiated before or during contract performance. However, as a percentage of actual allowable costs, the fee realized was higher than this because actual allowable costs incurred were less than target costs.

Newport News pointed out that under incentive provisions of the submarine overhaul contracts, the Navy paid $32 million less than it would have had to pay if Newport News had performed its contracts at the target amounts initially negotiated by the parties (target costs). Newport News earned about $17.8 million in total increased fees under these contracts due to performance at lower than negotiated costs.

DOD noted that since the selected contracts were incentive type, Newport News was heavily motivated to cut costs to obtain the maximum incentive fee rates possible. These high fees did not adversely affect contractor performance or quality of work. Further, awarding of contracts appears to indicate that Newport News will earn less fees in future overhauls. DOD also pointed out that the Government was getting a better deal than described in the report since Litton Industries and General Dynamics were performing overhauls at much higher prices than those referred to at Newport News.

Profits on PSAs

Newport News' profits on PSAs have historically been above the Government's projections. The estimated profit (before tax and interest) included in the prices of these contracts ranged from 11.7 to 14 percent, according to the Navy. Although PSAs are not a very large product line, these firm-fixed-price contracts have recorded some of the highest profit rates for Government work at Newport News. The total price for all seven PSA contracts was $42.6 million, whereas Newport News' total revenues for corresponding years were $2,353.7 million. Total profit earned on these PSA contracts was $7.6 million.

Using data provided by the Navy, we updated the schedule used by Admiral Rickover to show the profits on the PSA work.

Profit Earned by Newport News on SSN 688 Class Submarine PSAs

| Submarine | Fixed price | Costs incurred (note a) | Profit (note b) | Actual profit as percent of cost |
|---|---|---|---|---|
| | ---------------(000 omitted)------------- | | | |
| 688 | $ 6,072 | $ 5,319 | $ 753 | 14.2 |
| 689 | 6,387 | 5,784 | 603 | 10.4 |
| 690 | 6,726 | 5,152 | 1,574 | 30.6 |
| 691 | 7,210 | 5,261 | 1,949 | 37.0 |
| 693 | 5,153 | 4,137 | 1,016 | 24.6 |
| 694 | 5,523 | 4,295 | 1,228 | 28.6 |
| 695 | 5,508 | 5,051 | 457 | 9.0 |
| Total | $42,579 | $34,999 | $7,580 | 21.7 |

a/Unaudited by GAO.
b/Profit before taxes and interest.

Our schedule shows that the lowered costs increased PSA profits from the average of 21 percent of costs reported by Admiral Rickover to an average of 21.7 percent. SUPSHIP officials agreed with the data in our schedule, but Newport News did not comment.

Comparative profit data

The 13 identified overhaul and PSA contracts discussed above were negotiated as early as 1974, and the costs and profits for them span calendar years 1975-80. During these 6 years, Newport News' overall profit before interest and taxes averaged 5.3 percent and its average return on net assets employed was 9.9 percent. As the overhaul and PSA costs were 5.2 and 0.8 percent, respectively, of total cost, their effect on overall profit was negligible. Newport News' total costs for all 6 years were $4.2 billion, and combined total costs for these contracts were $254.6 million.

Newport News classifies its work into product lines which include overhauls, PSAs and other repairs, Government new ship construction, commercial new ship construction, and commercial ship repair. Newport News did not furnish profit data by product item and stated it could not compute profit data in this fashion. Newport News officials told us that during this period, final profits on completed Navy ships were much lower than negotiated target profits, which averaged 11.6 percent. They said commercial ship repair profits were comparable to overhaul and PSA profits and that since the late 1970s, commercial new ship construction work had been profitable. Newport News did not furnish data to support these comments.

Return on investment

Admiral Rickover said Newport News' return on net assets for 1980 was 18 percent. Further, using data submitted by Newport News to receive payments for cost of facility capital employed, Admiral Rickover estimated return on investments for overhaul contracts in 1980 at about 27 percent.

Newport News computes its return on net assets employed in accordance with Tenneco practices. According to the 1980 annual report, which shows the 18-percent return, return on net assets employed is income before interest and Federal income taxes divided by average net assets employed (average net assets employed is total assets less current liabilities exclusive of short-term debt).

Since Newport News gave us access to records concerning only Government contract costs, we did not verify the accuracy of the computations for return on assets. Annual reports, however, show an increase in income from 1978 through 1980, which combined with a decrease in average net assets, has caused a rise in return on average net assets employed, as follows:

Newport News Sales, Revenues, Costs, Profits, and Returns on Average Net Assets Employed

| | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 |
|---|---|---|---|---|---|---|
| Percent of Government sales to total sales | 71 | 71 | 69 | 68 | 74 | 76 |
| Total revenues | 613.5 | 688.1 | 785.6 | 733.0 | 729.9 | $891.5 |
| Costs (millions) | 583.2 | 647.7 | 735.6 | 718.7 | 697.5 | $836.7 |
| Income before interest and Federal income taxes (millions) | 30.3 | 40.5 | 50.0 | 14.3 | 32.4 | 54.8 |
| Profit as a percentage of cost | 5.2 | 6.3 | 6.8 | 2 | 4.6 | 6.5 |
| Average net assets employed (ANAE) (millions) | 333.2 | 413.7 | 450.6 | 455.3 | 395.0 | 305.4 |
| Percent of return on ANAE | 9.1 | 9.8 | 11.1 | 3.1 | 8.4 | 18 |

Although Newport News would not supply details regarding the makeup of items included as average net assets employed, officials did state that long-term deferred taxes were excluded from investment in the calculation of net assets employed and that the actual investment to support its Navy ship construction, overhaul, and repair programs was therefore substantially understated.

Admiral Rickover's cited estimate of return on investment for submarine overhaul contracts was based on data available to the Navy. The computation included sales; reported cost data; allocations of some foundry, tug, and dry dock costs to other product lines; and estimates of the average working capital (cash outlay for the period between the time cost was incurred by Newport News and when it was reimbursed by the Navy). This method differs from the Tenneco method. Newport News said it did not subscribe to the validity of a return on investment for individual product lines or contracts because they were a complex integrated facility engaged in several product lines and such a return could only be very arbitrarily computed.

Special circumstances

In addition to the views presented above, Newport News said its profits were justified by its heavy capital investment and its excellent performance record.

Fee on Submarine Overhauls

| Ship | Completed | Original fee-bearing contract target cost | Final fee-bearing contract target cost | Cost billed as of Dec. 1981 (note a) | Fee billed as of Dec. 1981 (note b) | Original contract fee percent | Fee as a percentage of cost (note b) |
|---|---|---|---|---|---|---|---|
| | | (millions) | | | | | |
| SSBN 622 | May 1977 | $44.5 | $57.7 | $ 48.4 | $ 8.7 | 9.6 | 18.0 |
| SSN 661 | October 1977 | 33.2 | 39.1 | 30.2 | 5.9 | 9.8 | 19.5 |
| SSN 663 | April 1978 | 32.8 | 41.0 | 28.8 | 6.1 | 9.8 | 21.2 |
| SSBN 631 | January 1979 | 45.3 | 53.0 | 43.7 | 7.9 | 9.7 | c/17.8 |
| SSN 668 | July 1979 | 33.1 | 39.3 | 33.9 | 5.5 | 9.8 | c/15.9 |
| SSN 670 | December 1979 | 34.0 | 40.0 | 34.7 | 5.4 | 9.8 | c/15.2 |
| Total | | | | $219.7 | $39.5 | | d/18.0 |

a/Although additional costs may be billed subject to adjustment for final overhead determination, these additional costs should not affect computed fee as a percentage of cost.

b/Fee is before interest, taxes, and unallowable expenses.

c/Newport News received cost of facilities capital for these contracts. If these payments are considered an additional return to the contractor, the above figures would increase to 18.1 percent (SSBN 631), 16.2 percent (SSN 668), and 15.6 percent (SSN 670).

d/Average fee: $\frac{\$39.5\ (M)}{219.7\ (M)}$ = 18 percent.



APPENDIX I

UNITED STATES STEEL CORPORATION,
SPECIALTY STEEL PRODUCTS,
CHRISTY PARK WORKS,
MC KEESPORT, PENNSYLVANIA

Allegation

Admiral Rickover made the following allegation about certain procurements involving United States Steel Corporation (USS):

"A company that manufactures high pressure air flasks for TRIDENT submarines insisted on a profit between 27 and 38 percent of estimated cost."

GAO analysis

We reviewed the six purchase orders awarded to USS by the prime contractor, the General Dynamics Corporation, Electric Boat Division, Groton, Connecticut, for high-pressure air flasks for Trident submarines. We focused mostly on the initial purchase order. We reviewed the other purchase orders in less detail but concentrated on critical elements, such as the negotiated profit margin. We obtained USS' contract pricing proposals for each purchase order. We also requested contract profit data from USS and reviewed correspondence from both General Dynamics and the SUPSHIP in Groton.

We confirmed that the allegation was correct. USS requested before-tax profit percentages which ranged from 31 to 38 percent of cost on the initial purchase order and 35 to 42 percent of cost on the second purchase order and negotiated a before-tax profit of 27 percent of cost for the third through the sixth purchase orders. Profit percentages are shown as ranges for the first and second purchase orders because USS had different profit percentages in each line item in the orders. General Dynamics' procurement records showed that USS would not accept a profit margin below 27 percent of cost.

The initial General Dynamics air flask subcontract with USS: a chronology

In July 1975 General Dynamics awarded a subcontract to USS for manufacturing Trident submarine high-pressure air flasks. The purchase order (K 7253-501) detailed specifications for various flasks and other items. General Dynamics solicited bids from two firms--USS and the Taylor-Forge Division of the Gulf and Western Manufacturing Company. USS bid $3.9 million for the contract, subject to price of component raw materials in effect at the time of shipment. (See note b. on p. 21.) Gulf and Western bid $5.49 million as a firm fixed price.

According to a General Dynamics official, the SUPSHIP office disagreed with General Dynamics' contention that the purchase order had been awarded based on adequate price competition. The Department of Defense informed us that the finding of inadequate price competition was due to the difference in the nature of the proposals. The standard provision in all steel contracts is that the price paid will be the price in effect at the time of shipment. While the USS proposal was subject to the standard provision, the Taylor-Forge proposal was a firm fixed price.

SUPSHIP subsequently requested that USS submit a DD633 (contract pricing proposal). On September 3, 1976, USS submitted its proposal to SUPSHIP. The proposal detailed the costs and profits associated with manufacturing 20 separate sets of items for the first 3 Trident submarines. The requested profit margins ranged from 31 to 38 percent of cost. USS indicated that its cost data were proprietary and confidential and explicitly stated that the data was not to be disclosed outside the Government.

At the request of SUPSHIP, the Defense Contract Administration Service Management Area (DCASMA), Pittsburgh, Pennsylvania, performed a technical review of the USS proposal. In addition, DCAA, Pittsburgh, performed a pricing evaluation of the proposal. DCAA questioned about 11 percent of the cost, and DCASMA took exception to certain technical aspects of the proposal. According to USS, a meeting was held on January 27, 1977, with DCAA, DCASMA, and USS representatives to discuss the audit findings. All audit items were resolved with USS agreeing that costs in the purchase order had been overstated by less than one-half of 1 percent. USS advised SUPSHIP of this action by letter of April 28, 1977, and assumed no further action was required since USS' records indicate no subsequent communication on the issue.

Purchase order price was never negotiated

Although the DCASMA and DCAA analyses were completed in July 1977, USS did not give SUPSHIP permission to release either the proposal, the DCASMA technical review, or the DCAA pricing evaluation to General Dynamics until May 21, 1979. USS said that it had no record of any request by General Dynamics or SUPSHIP for releasing the proposal, the DCASMA technical review, or the DCAA pricing evaluation to General Dynamics before May 9, 1979. We identified DCAA and DCASMA records (dated 1/13/77 and 7/29/77, and 2/2/77, respectively), however, which indicate that USS, for the period involved, refused to allow release of cost and pricing data to General Dynamics and that USS constantly reminded DCAA and DCASMA representatives that it was adamant on this issue.

SUPSHIP stated that DCAA and DCASMA representatives had told him of USS' steadfast refusal to release the data to General Dynamics. Based on this information, SUPSHIP believed it would be fruitless to ask USS for its permission.

Three days after permission was finally granted, a SUPSHIP representative transmitted the audit data to General Dynamics and directed it to negotiate a lower contract price based on the audit results. The SUPSHIP representative stated that his office would subsequently reconsider ratifying the purchase order after negotiations. According to a USS representative, USS and General Dynamics have never negotiated the price of purchase order K 7253-501. General Dynamics explained that it had not negotiated the price of this purchase order because the cost breakdown and analysis had not been made available until 4 years after the purchase order was issued. Under the circumstances, it believed it had little leverage to negotiate the prices. Based on the proposal data, USS requested and received a 34.7-percent profit (before income tax) on standard costs.

Contract negotiations did occur after the second air flask subcontract

According to profit data provided by USS, it requested a 36.6-percent profit margin (before tax) on cost for the second purchase order (B 7037-500). The 36.6 percent profit was an average that ranged from 35 to 42 percent for the individual items. A USS representative stated that General Dynamics had not negotiated profit margins with his firm until the third (B 7082-591) through the sixth (E 7130-501) purchase orders. The following table shows the negotiated profit margins for those purchase orders.

| Subcontract purchase order number | Negotiated profit before income tax percent return on cost | Pricing proposal date |
|---|---|---|
| B 7082-591 (note a) | 27.3 | 4-12-79 |
| C 7144-500 (note a) | 27.3 | 4-12-79 |
| D 7031-500 (note a) | 27.3 | 4-12-79 |
| E 7130-501 | 27.0 | 10-02-79 |

a/At General Dynamics' request, USS combined these purchase orders into one pricing proposal. For these purchase orders, USS consistently requested a 27-percent profit on cost for individual items. USS representatives said that the Christy Park Works had established a standard DOD contract profit margin of 27 percent over standard cost (before tax) on all proposals submitted after January 1, 1978. The table above confirms this. (See p. 21 for a more complete perspective of each of the six purchase orders.)

## Comparative profit data

We asked USS representatives to provide us the actual profit and return on investment for the initial purchase order, the profit on other defense and comparable non-DOD contracts for the high-pressure air flasks, and the profit and return on investment by product lines. This data would help put in perspective the profits actually made on the purchase orders reviewed.

USS representatives informed us that the actual profit data requested for specific Trident contracts, other DOD contracts, comparable commercial contracts, and other USS product lines were not available from the normal accounting records. They explained that the Christy Park Plant used a standard process cost accounting system, a uniform system designed for and used by most USS plants. Under this system, standard costs of products are developed at least once per year. For monthly accounting, standard costs are accumulated and variances are determined in most cases by cost center, in some cases only on a total plant basis. They also explained that the system did not provide for accumulation of actual costs by individual contract or product for either Government or commercial business. However, for purposes of our review and from existing records, Christy Park developed, by the best means available, a reasonable approximation of the profit rates it experienced in 1977 on cylinders fabricated for the Navy. The estimated before-tax profit rate on Navy cylinders was 23.5 percent which, according to USS, is significantly lower than that attained on comparable commercial business and lower than the 27.3 percent profit figure used in the proposal quoted to General Dynamics. In addition, they stated that return on investment data was not available from the accounting records in 1977 nor could such data be reasonably reconstructed in the necessary format.

## Special circumstances

USS representatives said that there were factors involved in manufacturing the cylinders for the Navy which increased the risk and the cost of performing. These factors included the potential liability involving possible loss of either life or submarine, if a cylinder fails; the very high level of quality control required during manufacturing to meet Navy specifications; the training and periodic recertifying of welders; extensive performance testing to meet Navy standards; the retooling of facilities because Navy cylinders differ from commercial cylinders; and the use of special manufacturing processes because of the different configuration of the Navy cylinders.

In addition, they said that investment cost was required for testing equipment and processing facilities as well as significant investment in manpower; training; and technical skills necessary to meet the required manufacturing competency, reliability, and other critical specifications for these cylinders for submarine application.

We asked USS to identify the factors involved in determining the profit margin requested for the Navy cylinders (high-pressure air flasks). USS representatives told us that the profit margin or objectives for the cylinders produced and sold for Navy submarine applications were determined principally by the profit margin or objectives for comparable cylinders sold for various commercial applications. They said that the following factors were involved in determining profit objectives:

--Substantial expertise, labor skill, and training is required to manufacture the Navy cylinders to meet critical specification requirements. The Navy cylinders represent a specially manufactured product rather than an item of mass production for which significant yield loss and product liability risks are involved.

--Major maintenance expenses for buildings and equipment are not fully recoverable in unit prices on a current basis.

--Training of craftsmen and their periodic requalification tests are not fully recovered in unit prices.

--Incurred costs for product liability and other risks are not included in USS unit product costs and hence are not recoverable in unit prices.

--Development and design costs are high on this product due to critical specification requirements.

--There are various risk factors to be considered.

--It is very reasonable to price the Navy cylinders within the general pricing framework of the commercial cylinders sold on competitive terms in order to receive comparable returns and to provide adequate incentives for the continued production of such a product.

USS's written comments are included as appendix V.

## Highlights of the High-Pressure Air Flask Subcontracts

## Involving the First Eight Trident Submarines

| Trident number | Contract number | Purchase order number | Negotiated profit before income tax | Type of contract | Contract ratified by SUPSHIP |
|---|---|---|---|---|---|
| 1,2, 3 | N00024-75-C-2014 | K 7253-501 | 34.7-percent return on cost (note a) | Firm fixed price (note b) Competitive (note c) | No |
| 4 | N00024-75-C-2014 | B 7037-500 | 36.6-percent return on cost (note a) | Firm fixed price (note b) Sole source | Yes |
| 5 | N00024-75-C-2014 | B 7082-591 (note d) | 27.3-percent return on cost | Firm fixed price Sole source | Yes |
| 6 | N00024-75-C-2014 | C 7144-500 (note d) | 27.3-percent return on cost | Firm fixed price Sole source | Yes |
| 7 | N00024-75-C-2014 | D 7031-500 (note d) | 27.3-percent return on cost | Firm fixed price Sole source | Yes |
| 8 | N00024-78-C-2453 | E 7130-501 | 27.0-percent return on cost | Firm fixed price Sole source | Yes |

a/According to a USS representative, the parties did not negotiate the contract profit margins on these purchase orders.

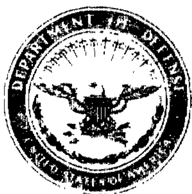
b/According to a USS representative, the purchase orders were all firm fixed price subject to price in effect at time of shipment. The price at time of shipment is subject to an increase or decrease depending upon the fluctuating prices paid by USS for the raw materials used in manufacturing the high-pressure air flasks.

c/Based on the data presented on page 17, this designation is questionable.

d/USS consolidated these purchase orders into one proposal.



APPENDIX I



THE UNDER SECRETARY OF DEFENSE

WASHINGTON D C 20301

RESEARCH AND ENGINEERING

10 NOV 1982

Mr. Donald J. Horan
Director, Procurement, Logistics and
Readiness Division
U.S. General Accounting Office
Washingtron, D. C. 20548

Dear Mr. Horan:

This is in reply to your letter to the Secretary of Defense regarding your report dated August 19, 1982, on "Retired Admiral Hyman Rickover's excess profits allegations on select Defense contracts during June 16, 1981, Congressional testimony," OSD Case No. 6050, GAO Code No. 942081.

While we do not concur with all of the conclusions in the subject profit report, we agree the findings are substantially correct. The following comments are offered in explanation.

The final negotiated prices contained in the defense contracts specified in the subject draft report, with the exception of Newport News, were in fact the best prices obtainable by the Navy. Another source was available as stated and could have supplied the item, but at a significantly higher overall price. Therefore, we believe that under the circumstances present in each case, the prices paid were appropriate.

While not disagreeing with the figures in the Newport News case, it should be noted that the selected contracts were incentive type. Therefore, Newport News was heavily motivated to cut costs to obtain the maximum incentive fee rates possible. The fact that high fees were obtained does not mitigate against the contractor's performance or quality of work. Further, awarding of contracts appears to indicate that Newport News will earn less fees for future overhauls. It should be noted that overhauls were being performed by Litton Industries and General Dynamics at much higher prices than those referred to at Newport News. This fact cannot be ignored, and it appears the government was getting a better deal than described in the draft report.

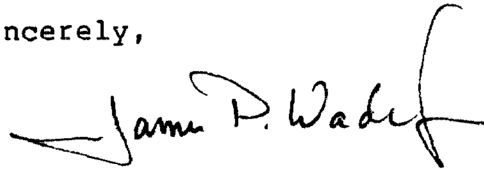
[See p. 10, para. 4.]

We do not clearly understand the GAO question concerning the "air flask" subcontract. The standard provision in all steel contracts is that the price paid will be the price in effect at the time of shipment. Counsel, SUPSHIP Groton, indicated the reason for a finding of inadequate price competition

was due to the difference in the nature of the proposals. While the U.S. Steel proposal was subject to the standard provision, or price in effect at shipment, the Taylor-Forge proposal was firm fixed price. [See p. 17, para. 1.]

Most of the conditions were discussed by GAO and NAVSEA. However, specific comments by NAVSEA personnel do not appear in the draft report. [See GAO note below.]

Sincerely,



James P. [illegible]
Pri[illegible] [illegible]tary of
De[illegible] [illegible]gineering

GAO note: The specific comments by NAVSEA personnel refer to two interviews at which several general topics were briefly mentioned. Since the information presented by NAVSEA personnel was not substantive and appeared to be conjectural, we did not address it in the report.

**CABOT CORPORATION** 125 HIGH STREET, BOSTON, MASSACHUSETTS 02110

SENIOR VICE PRESIDENT

CABLE ADDRESS "CABLAK" BOSTON
TEL 617 423-6000

August 26, 1982

Mr. Donald J. Horan, Director
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Horan:

RE: Draft of a Proposed Report

We have tried to cooperate with you in every way possible to answer the charges made by Admiral Rickover in his testimony presented to the Subcommittee on June 16, 1982.

We do not agree with the assumptions made by you, and, therefore, do not agree with your findings of fact or conclusions as stated in your draft. You have apparently concluded that we made a return on assets of about 30%, which was higher than our corporate goal. We believe we made a return on assets of 2.4%. You believe the nuclear navy business is highly profitable to us, and we believe it is, at best, marginally profitable.
[See p. 2, para. 4.]

As indicated by your report, Cabot was not a sole source supplier. You indicate that the competitor's price did not indicate a serious interest in winning the award. Perhaps that merely shows there are at least three generally-accepted systems by which you could compute cost, and therefore, profit.

Very truly yours,

William D. Manly
Senior Vice President
Engineered Products Group

GAO note: Cabot officials declined to meet with us to discuss the draft report or factual data supporting the company's written response.

CARBORUNDUM

**Carborundum**
**Electro Minerals Company**
Electro Minerals Division
P.O. Box 423
Niagara Falls, New York 14302

Telephone 716 278-2000

September 9, 1982

Mr. Donald J. Horan, Director
Procurement, Logistics, and
Readiness Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Horan:

Per your request, we have reviewed the draft reports you provided in your letter of August 18. It is our belief that the drafts are a fair representation of Carborundum's position. However, we would like to clarify the following points:

1. DCAA - Calculated Profit Rates - Graph

   In this section, you graphically present DCAA's data but do not graphically present Carborundum's response data. This data is covered in earlier narratives but does not have the same impact on the reader as your DCAA section. We would also want to re-emphasize our position that Carborundum has not made "a significant accounting change". [See GAO note, p. 26.]

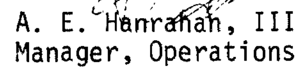
2. [Special] Circumstances

   i.e. special skill and security clearances are required.

   The majority of the personnel utilized by the Naval Nuclear Program require DOE security clearances. A typical clearance takes three to six months to process. If individuals were curtailed during slack periods, we would constantly run the risk of losing cleared individuals and thus have to process clearances for their replacements. During this period, individuals would be on payroll but would not be allowed to work until, and if, they obtained the required approvals. Once cleared, we would have to commence training these individuals.
   [See p. 6, para. 2, line 12.]

Enclosed are your three draft copies. If you have any additional questions or need additional data, please contact me at 716/278-2370.

Sincerely,



A. E. Hanrahan, III
Manager, Operations

p

Attachments

**GAO note: This section has been deleted.**

ROBERT C. SCHELL
GENERAL MANAGER

USS SPECIALTY STEEL PRODUCTS

CHRISTY PARK WORKS
2214 WALNUT STREET
McKEESPORT, PENNSYLVANIA 15132
412/664-6600

September 13, 1982

REGISTERED MAIL
RETURN RECEIPT REQUESTED

Mr. Donald J. Horan
Director
Procurement, Logistics, and Readiness Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Horan:

In reply to your letter of August 18, 1982 which requested our review of, and comments regarding your draft report pertaining to Admiral Rickover's excess profits allegations as applied to United States Steel Corporation selected defense contracts, we wish to submit the comments listed below.

For purposes of clarity in addressing our comments to the draft letter to The Honorable Samuel S. Stratton and to the specific draft Report on Christy Park Plant contracts, we have numbered the draft letter pages sequentially 1 through 4 and the draft Report sequentially 1 through 8.

A. Draft of letter to the Honorable Samuel S. Stratton

1. [Para. 3.] Regarding the list of contractors whose contracts are being reviewed, we question why United States Steel Corporation is listed first. We suggest that either: (1) for purposes of uniformity, the listing should be in the same order as shown in the list of Admiral Rickover's specific allegations (beginning on page 2); or (2) the listing should be in alphabetical order. [See GAO note 1, p. 30.]

2. Page 3 - last paragraph: Should be qualified as being applicable specifically to Christy Park Plant fabricated alloy seamless cylinders for the Navy -- it does not apply (as implied in the letter's present wording) to all U.S.S. Corporation sales to the government. It is suggested that the first sentence of this paragraph should be restated as follows:

"For fabricated alloy seamless cylinders produced by its Christy Park Plant for the Navy, Christy Park has established a standard before tax profit margin cf 27 percent

of standard costs on all proposals submitted after January 1, 1978. For calendar year 1977, profits based on costs for Christy Park Plant fabricated alloy seamless cylinders for the Navy were significantly less than for comparable commercial cylinders according to USS." [See GAO note 2, p. 30.]

3. Page 4 - top paragraph, 5th line: The word "demanded" is too strong and should be eliminated. If there is evidence to show that some contractors did "demand" certain profit levels, we believe they should be specifically identified. [See GAO note 2, p. 30.]

B. Draft Report on Christy Park Plant Contracts

1. [Page 16, para. 3, line 1.] Should be restated as follows:

"USS requested before tax profit percentages which ranged from 31 to 38 percent of cost on the initial purchase order and from 35 to 42 percent of cost on the second purchase order and negotiated a before tax profit of 27 percent of cost on the third through sixth purchase orders."

2. [Page 17, para. 3.] After the paragraph which begins, "At the request of the SUPSHIP. . . .", the following paragraph should be added:

"On January 27, 1977 a meeting was held to discuss the audit findings and to discuss pending audits of other subcontracts. Attending were representatives of DCAA, DCASMA and USS. Subsequently, all audit items were resolved with USS agreeing that costs on Purchase Order K7253-501 had been overstated by less than 1/2 of 1%. The SUPSHIP was advised of this action by letter of April 28, 1977 from USS. Since USS records indicate no subsequent communications on this subject, they assumed that no further action regarding Purchase Order K-7253-501 was required."

3. [Page 17, para. 4.] States, "USS did not give the SUPSHIP permission to release either the proposal, the DCASMA technical review, or the DCAA pricing evaluation to General Dynamics until May 21, 1979".

This comment is with reference to Shipsets 1, 2 and 3 and requires the following clarifying comments:

Review of USS records reveal no record of any request by General Dynamics or SUPSHIP for release to General Dynamics of the proposal, the DCASMA technical review, or the DCAA pricing evaluation regarding such shipsets prior to May 9, 1979. By telephone conversation May 9, 1979, the SUPSHIP made such request and by letter dated May 21, 1979 authorization was given by USS.

It is our firm opinion that USS would have given the SUPSHIP permission to release the data in question at least 20 months earlier had a request been made to USS. This opinion is based on review of USS records which indicate that for Shipset 5 (Purchase Order B 7082-591) USS authorized the SUPSHIP to release USS audit data to General Dynamics in October, 1977 as shown by the following:

| | |
|---|---|
| Original Christy Park DD 633's submitted to SUPSHIP | 6-17-77 |
| DCAA Audit submitted to SUPSHIP | 8-10-77 |
| Christy Park DD 633's submitted to General Dynamics | 9-16-77 |
| USS telegram authorized SUPSHIP to release Audit to General Dynamics | 10-04-77 |
| Final DD 633's submitted to General Dynamics reflecting negotiated prices | 4-12-79 |

Since, in 1977 when negotiating Shipset 5, USS adopted the policy of making direct submittal of DD 633's and release of audit reports to General Dynamics, if at any time after September, 1977 either the SUPSHIP or General Dynamics had similarly requested authorization for the SUPSHIP to release to General Dynamics the proposal and/or the audit reports regarding Shipsets #1, 2 and 3, it is reasonable to assume that USS would have agreed thereto.

4. [Page 19.] Several references are made to "USS officials". These should all be changed to "USS representatives".

5. [Page 19.] Comparative Profit Data - 2nd paragraph, 2nd sentence:

Should be revised to read:

"They explained that the Christy Park Plant utilizes a standard process cost accounting system, a uniform system which is designed for and used by most USS plants. Under this system, standard costs of products are developed at least once per year. For monthly accounting standard costs are accumulated and variances are determined by cost center and in some cases only on a total plant basis. They also explained that the system does not provide for the accumulation of actual costs by individual contract or product for either government or commercial business."

Then the following new paragraph should be inserted:

> "However, for purposes of the GAO review and from existing records, Christy Park developed by the best means available a reasonable approximation of the actual profit rates it experienced in 1977 on Navy fabricated alloy seamless cylinders and on similar cylinders for commercial sales. The estimated actual before tax profit rate on Navy cylinders was 23.5% which is significantly lower than that attained on comparable commercial business as well as lower than that used in the proposal quoted to General Dynamics."

6. [Last sentence in the Comparative Profit Data section] which starts "In addition, where ..." should become a separate paragraph, and the words "In addition" should be deleted.

7. Footnote a. [Page 18.] The following statement should replace the first sentence to clarify that our combined quotation for Shipsets 5, 6 and 7 was made at General Dynamic's request:

   On June 17, 1977 USS submitted to the SUPSHIP original DD 633's for Shipset #5. On April 12, 1979 USS submitted to General Dynamics final DD 633's for Shipset #5 and at the request of General Dynamics combined in this submittal its proposal for Shipsets #6 and #7.

We appreciate the opportunity to provide comments on your draft Report regarding certain of our contracts, and trust that the same will be duly considered and reflected in your final Report.

Sincerely,

Robert C. Schell
General Manager

GAO note 1: The page numbers in brackets have been changed to correspond to those in the final report.
2: This section has been deleted.

(942081)

24784

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