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STATEMENT OF  
ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES  
BEFORE THE  
SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT  
JOINT ECONOMIC COMMITTEE

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Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear here this morning to discuss  
some of the work we have been doing at your request. This work concerns  
claims by shipyard contractors seeking additional compensation from the  
Navy; the adequacy of cost controls in effect at commercial shipyards;  
and, our investigation into charges made before your Subcommittee by a  
former employee of Lockheed Aircraft Corporation regarding Lockheed's  
management of the C-5 program.

Handwritten note in a diamond shape: "What was used?"

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RECENT REVIEWS OF SHIPBUILDING

Perhaps it would be useful to start with a brief recapitulation of  
our major findings on the general subject of shipbuilding.

We have devoted a considerable amount of attention to the matter  
of shipbuilding claims. Last April we reported to the Congress on the  
Navy's settlement of claims submitted by three contractors including one  
very large claim by Todd Shipyard Corporation for \$114 million which was  
settled for \$96 million. We pointed out that in these settlements the  
records we examined established no relationship between the additional  
costs claimed and the actions by the Navy which, the contractors con-  
tended, caused them to incur these costs.

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Earlier this month we reported on the settlement of a claim by Lockheed Shipbuilding and Construction Company. Here again the reasonableness of the settlement is uncertain because of the absence of data to show the extent to which the Navy's actions contributed to the delays and disruptions experienced by the contractor.

At last year's hearing we testified that we were starting a review of various actions being implemented by the Navy which were designed to eliminate or, at least, minimize claims for price increases under future shipbuilding contracts. We submitted a report to the Congress last month on our evaluation of the Navy's efforts. We believe these changes hold considerable promise for reducing the number and size of claims. At the same time, however, it is important that contractors, submitting claims based on actions of the Government, be required to maintain and furnish records in support of the claims which will clearly show the relationship of the additional costs incurred to the Government's actions.

In the latter part of 1970, Mr. Chairman, you asked us to examine into the extent of competition in the shipbuilding industry and the effectiveness with which shipbuilding contracts were being administered. You submitted a series of questions, along with reports prepared by Admiral Rickover and copies of an exchange of correspondence over a period of time between Admiral Rickover and Navy officials, dealing with cost controls and procurement practices at certain shipyards as well as various other ship construction contract matters.

Last August we submitted a report to you pointing out that only a limited number of shipyards can compete for certain types of ship construction work. We reported that even where competition is obtained the advantages of competition are often negated because of the prevalence of

numerous and costly change orders, sometimes priced after the work is substantially completed, which are negotiated in a noncompetitive atmosphere.

In January of this year we submitted a report to this Committee on our review of cost controls at Newport News Shipbuilding and Dry Dock Company, pointing out the ineffectiveness of the contractor's budgeting system in promptly pinpointing cost overruns, in addition to some serious weaknesses in the contractor's procurement practices. And just last week we reported to the Committee on a similar review we made at the Litton Industries, Inc., shipyard in Pascagoula, Mississippi, where we found that much can be done by the contractor and the Navy to reduce shipyard costs and, in turn, costs to the Government.

I should now like to take up each of these matters - shipbuilders' claims, competition in the shipbuilding industry, and cost controls - in greater detail.

#### SHIPBUILDING CLAIMS

Contractors' claims for price increases have been a recurrent element in Navy shipbuilding programs. Claims are submitted on the premise that the Government's failure to comply fully with its responsibilities under the contracts, and additional requirements imposed by the Government after the award, caused the shipbuilders' production costs to increase and the contractor is therefore entitled to additional compensation.

Although such claims are not new, the size of the claims has grown significantly in recent years both in terms of total dollars and as a percentage of shipbuilding contract prices. Claims still to be settled exceed \$800 million, the earliest dating from January 1969.

Our most recent review of claims showed that claims settlements were averaging 37 percent of the total contract prices as they stood before the settlements.

Our reviews have shown that the four principal factors giving rise to claims were:

- ✓ 1. Inaccurate lead-yard plans.
- ✓ 2. Poorly written specifications.
- ✓ 3. Unanticipated increases in quality assurance requirements, and
4. Late delivery of Government-furnished equipment and information.

In the settlements covered in our April 1971 report which I mentioned at the outset the contractors contended that their operations were delayed and disrupted because of the Government's imposition of impossible specifications, because of its late delivery of material, as well as its furnishing of defective material. The three contractors involved did not provide specific information to show that the amounts claimed as additional costs were caused by the Government's actions. Without information linking the additional costs to the actions of the Government, we believe that the Government had insufficient assurance that the settlements made were fair and reasonable.

The largest claim was that of Todd Shipyard Corporation in the amount of \$114.3 million for additional costs the contractor claimed were incurred, or would be incurred, as a result of actions of the Navy during the construction of 14 ships of the destroyer escort 1052 class.

Todd contended that the Navy specifications for dynamic analysis, shock resistance and noise reduction were defective, were impossible to achieve within the time and monetary constraints of the contract, and delayed construction progress for more than a year. Also, Todd attributed a large part of its claim to the Government's failure to provide design information and equipment, when needed. Todd contended that this interfered with its ability to construct the ships as planned.

In its claim, the contractor estimated that Government-caused delays and disruption resulted in its incurring an additional 5.6 million labor-hours over the original amount estimated to complete construction of the ships involved. We found that Todd calculated the increased labor-hours by subtracting from its estimate of the total hours it would actually incur, the labor-hours originally bid for the ships, and then reducing this by the increased hours judged by the contractor to be due to its own inefficiencies. Initially, the contractor was willing to assume responsibility for 10 percent of an additional 4,181,179 labor-hours incurred, or 418,117 labor-hours. Subsequently, Todd increased its estimate of the additional labor-hours incurred to 5.6 million but was unwilling to assume responsibility for more than 418,117 hours. mt

The claim was settled for \$96.5 million, or about 60 percent of the total contract price.

The Lockheed claim which I mentioned earlier, was for \$46.3 million. It covered five fixed-price contracts for destroyers, destroyer escorts, a hydrofoil, oilers, and ammunition ships whose original prices totaled \$83 million.

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Lockheed's claim was based on a number of underlying causes such as late and defective Government-furnished material, defective or impossible Government specifications, late and defective lead-yard plans, increased inspection requirements, work in excess of specification requirements, delays and disruptions caused by change orders, and various constructive changes.

For example, Lockheed claimed in excess of 243,000 additional production man-hours attributable to late delivery of Government-furnished boilers for the construction of two destroyer escorts. Lockheed contended that delivery of the boilers for one of the ships had been delayed 14 months and for the other ship 7 1/2 months.

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In another instance, Lockheed claimed that almost 8,800 additional production man-hours were attributable to work, not required by contract specifications, to correct an overweight condition of a hydrofoil. Lockheed contended that a defect in the Government specifications caused the ship to be overweight, and that it had to conduct a comprehensive, far-reaching research and engineering development effort to reduce the weight of the ship.

Lockheed's cost accounting system and other records did not relate its additional costs to Government actions; therefore, the effect of these actions on the contractor's costs was difficult to establish. In the absence of such accounting records, Lockheed based its claims largely on engineering estimates.

The Navy spent approximately one year in evaluating Lockheed's claim with the help of the Defense Contract Audit Agency. The audits of each contract showed that a significant portion of the claims was

inaccurate and lacked adequate supporting documentation. The advisory audit reports questioned about \$8.9 million of the amounts claimed by Lockheed including \$2.2 million of additional labor costs questioned on the basis that they exceeded recorded labor costs. A Lockheed official told us that the company believed its claim was proper because when added to the basic contract price, the total price did not exceed recorded costs plus a 10 percent profit.

The Navy found that the installation of boilers in one escort had been delayed 48 working days and the installation of boilers in the second escort had not been delayed at all. In evaluating the additional hours claimed by Lockheed, the Navy determined that 24,960 man-hours of delay were caused by the late delivery of Government-furnished boilers compared with 243,334 man-hours included in Lockheed's claim for the late delivery.

In May 1970 the Navy negotiated a settlement in the amount of \$17.9 million. Because of the significant number of engineering and technical judgments that entered into the settlement and because of the lack of available documentation against which to verify the extent of the Government's responsibility, we are not in a position to express an opinion on the reasonableness of the settlement.

We believe that the Navy should require contractors to maintain records in support of claims. We have discussed the issue of adequate record-keeping with the Navy. Navy officials advised us that they were exploring with an industry group problems that might be anticipated in requiring contractors to segregate direct costs for contract changes. In addition, the Navy stated that offices had been established at three supervisor-of-shipbuilding locations to study estimating and pricing techniques of major private shipbuilders constructing Navy ships.

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To improve the ship procurement process, the Navy has undertaken an extensive program which includes a number of tasks intended to eliminate or minimize claims for price increases under future shipbuilding contracts.

In our February 1972 report to the Congress we reviewed a number of these actions. They include programs to improve ship specifications, to minimize delays and defects in Government-furnished equipment and information, and to promote a common understanding of quality assurance requirements. We suggested in our report that, in considering requests for shipbuilding authorizations and funds, the Congress may wish to inquire about the specific claims prevention measures that the Navy plans to apply in carrying out proposed ship construction programs.

#### COMPETITIVE PRESSURES IN THE SHIPBUILDING BUSINESS

Although there is a certain amount of competition in the award of contracts for ship overhauls and construction, the benefits of competition are reduced by the limited number of contractors capable of constructing certain types of vessels and by the large number of changes and claims negotiated after the award.

Newport News and the Electric Boat Division of General Dynamics, for example, are the only private shipyards which can construct missile-equipped nuclear submarines, and these two shipyards along with the Ingalls Shipbuilding Division of Litton, are the only private shipyards which can construct other nuclear submarines. In addition, Navy officials told us that heavy workloads at times prevent shipyards from competing for contracts while at other times shipyards in need of work are given a contract to help them maintain their capability.

Changes are numerous in ship construction and overhaul contracts. For construction contracts on ships that were completed in 1970, we found that changes added \$103 million to the cost, or, about 22 percent

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of original contract prices. In a prior review of ship overhaul contracts, we found supplemental work of \$23 million increased contract costs by about 35 percent. The changes, of necessity, are negotiated on a sole-source basis with many changes negotiated after the work has been completed.

In the final analysis, then, many contracts are priced to a large extent on the basis of incurred costs. This, and the lack of competition, reduces the incentive for shipbuilders to produce economically. We believe it essential, therefore, that the Navy exercise close surveillance over contractors' operations and costs.

#### COST CONTROLS

The profit motive and other incentives may motivate a contractor and its employees to hold the line on costs. But the Government cannot afford to rely entirely on the contractor to exercise restraints and should take the initiative to insure that the contractor is using every means at its disposal to keep contract costs at a reasonable level.

In theory the type of contract can serve to some extent as a deterrent to inefficiency and waste. Firm-fixed-price contracts, for example, or other types of contracts with price ceilings, might encourage contractors to strive for better cost control. But all too often, as pointed out earlier, negotiated change orders and claims add significantly to the cost so that the final contract price exceeds the original ceiling and it is not always clear that the Government is justified in paying the higher price.

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The Government must therefore assure itself that contractors are making a conscientious effort to keep costs down by such measures as buying competitively, maintaining appropriate accounting procedures to ensure that costs are properly charged to the contracts, and maintaining a budgeting system which will disclose in a timely fashion the possibility that the budgeted costs may be exceeded and that prompt management action is therefore needed.

The Supervisors of Shipbuilding, Conversion and Repair commonly referred to as the SUPSHIPS, are responsible for administering the Navy's contracts at commercial shipyards. The SUPSHIPS are located in proximity to the larger commercial shipyards in the United States and exercise surveillance over the contractors' operations. Surveillance consists of a continuing analysis and evaluation of the shipyards' contracting policies, practices, records, and reports. It should include the verification and enforcement of corrective action by the contractor to ensure conformance to contractual requirements.

Both at Newport News and at Litton, we found a need for more aggressive following up of action being taken by the shipyards to correct deficiencies disclosed during surveillance. Litton's East Yard, for example, has been unable to get its purchasing systems approved since 1969, and the system at Newport News has been in an approved status for only a brief period within the past three years.

The SUPSHIPS at Newport News and at Litton were assisted, in their reviews of the contractors' operations, by a staff of DCAA auditors. The auditors made periodic management and financial-type audits during which they examined the contractors' cost charging practices.

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Contractors' subcontracting practices

For proper control of contract costs it is essential that shipyards attempt to obtain maximum competition for their subcontract work or, where competition is lacking, that they employ effective procedures for negotiating reasonable prices.

It is the SUPSHIP's responsibility to assure that the contractor's procurement practices are consistent with these objectives. This it does by reviewing the contractor's purchasing system. Where the SUPSHIP has satisfied itself that the system contains the necessary elements for effective control, by such means as competitive buying practices and appropriate negotiating procedures, the system is approved. From then on the Government relies on the adequacy of the system to ensure proper control over subcontracting with only periodic surveillance. If, however, the contractor's purchasing system is found wanting, and until such time as the deficiencies in the system are corrected, the Government generally reserves the right to review and consent to the awarding of individual subcontracts (generally, those in excess of \$100,000).

At Newport News approval of the contractor's purchasing system was withdrawn by the Navy after a review made in May 1969, and was again withheld after a review made in June 1970.

The Navy, in its reports, cited source selection deficiencies, the lack of documentation in the files to explain the large volume of single source procurements, the lack of a capability for performing effective cost or pricing analysis, the fact that attempts were not made to get cost or pricing data on certain steel procurements, and the need for updating the purchasing manual.

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Approval of the purchasing system at Litton's East Yard was withdrawn in August 1969. The Navy cited as reasons the nonexistence of procedures for making cost analyses; incomplete bidders' lists; the need for criteria for conducting negotiation discussions, and the fact that the contractor's purchasing manual did not include procedures for fully implementing the requirements of the Truth-in-Negotiations Act. The Navy, in again reviewing the purchasing system in September 1970, found that most of these deficiencies had not been corrected.

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In view of the Navy's withdrawal of its approval of the systems at both Newport News and Litton the Navy's consent to the award of subcontracts took on additional significance. We found that this requirement for subcontract approval had not been made part of one of the three prime contracts we examined at Newport News. The result was that none of the purchase orders awarded under this contract were reviewed by the Navy.

At Litton's East Yard, Navy consent to 31 subcontracts was not issued until 3 to 207 days after they were awarded. At the West Yard we reviewed 146 subcontracts in excess of \$100,000 and found that the contractor failed to submit 14 for approval before award. The contracting officer's consent to these procurements was not obtained until 10 to 168 days after award.

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Opportunities for increasing competitive procurement  
at Newport News

In reviewing Newport News' subcontracting practices we found that the contractor was not making a sufficient effort to obtain maximum practicable competition. It is therefore not surprising that only one supplier bid, or that only one supplier was considered responsive, in about 42 percent of the \$125 million of subcontracts let in 1970 at that yard. This is equivalent to \$52 million of procurements. The contractor's records identify about \$13 million of this as being for proprietary items. We believe that better source selection procedures would have brought to light the existence of additional suppliers for many items other than those which were proprietary.

Newport News, for example, did not publicize proposed purchases to obtain additional sources. Only some of its buyers update their lists of suppliers by contacts with vendors or by identifying additional sources through publications. In most cases buyers rely on lists of suppliers compiled from the history of prior procurements, catalogs, requests from vendors to be placed on the lists, and their personal awareness of potential sources.

In a number of cases the contractor solicited fairly large numbers of sources but only one qualified bid was received. Many solicited sources could not make the desired item. This would indicate that the contractor's lists of suppliers needed screening, expansion and updating so that unqualified suppliers can be removed and additional qualified suppliers added.

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As an example, for a \$116,000 June 1970 procurement of air-operated hoists Newport News solicited bids from four of eight suppliers solicited for an earlier procurement of this item, and from six additional suppliers - a total of 10. Nine declined to bid, seven because they did not manufacture the item, and two because the required equipment was the standard product of another vendor. We examined one of several national publications which list suppliers for various commodities. This publication identified many other firms who manufactured air hoists. The buyer for this item said that, although it was possible that some of the suppliers listed in the publication could supply the air hoists, it was difficult to find a supplier who could manufacture this item in accordance with military specifications.

We compared the suppliers solicited for specific commodities purchased under several purchase orders, where Newport News had received responses from but a single qualified supplier, with the suppliers listed in one publication. We found that there were between 15 and 290 listed suppliers not solicited by Newport News. Buyers we questioned expressed reservations about the ability of many of these suppliers to manufacture to Government specifications. The procurement files at Newport News, however, contain little data as to the qualifications of suppliers and their interest in competing for orders.

Subcontracts awarded by Litton

Litton's East Yard solicited two or more sources for the majority of its subcontracted work and two or more responsive bids were received for the larger subcontracts. However, for many small subcontracts which we examined only one of the bids received was considered by Litton to be

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responsive. The following is our analysis of 295 subcontracts awarded under two submarine prime contracts - one a construction contract, the second for overhaul. The 295 which we examined represented about 64 percent of the dollar value of all subcontracts awarded under the two contracts.

	<u>Number of subcontracts</u>	<u>Amount (millions)</u>
Purchased under pooling arrangement whereby lead-yard on submarine construction contract selects supplier and arranges price	43	\$4.3
Only one responsive bid received	161	3.0
Two or more responsive bids received	<u>91</u>	<u>17.7</u>
Total	<u>295</u>	<u>\$25.0</u>

At the West Yard we examined 194 subcontracts having a value of \$366 million awarded under two construction contracts - one for General Purpose Amphibious Assault Vessels, commonly referred to as LHAs, and one for destroyers (DD963).

For 150 of the 194 subcontracts Litton solicited two or more sources. In all but a few instances the number solicited ranged from 3 to 18. However, in 18 of the 150 procurements, having a value of \$62.6 million, only one bidder was considered responsive by the contractor.

For the remaining 44 subcontracts, valued at \$2.3 million, Litton solicited only one source and appeared to have reasonable justification for doing so - that is, Litton determined that only one supplier could meet the delivery requirements, or that it was impractical to change suppliers on follow-on awards.

Lower prices possible through holding negotiation discussions with offerors

Of 224 negotiated subcontracts we looked at, awarded by Litton's East Yard, we found that competitive proposals had been obtained in 79 cases. In 62 of these, involving procurements totaling \$11 million, we found no evidence that oral or written discussions were held with offerors. Holding such discussions is required of Government procurement officers by the Truth-in-Negotiations Act in the absence of a clear demonstration that they are not needed to obtain fair and reasonable prices. Discussions need not be held if all offerors are advised that the award might be made without them. Litton officials told us that references to negotiation discussions are not always documented in their files.

In 24 instances, including 17 competitive and 7 noncompetitive procurements we found evidence that discussions were held and that East Yard negotiators reduced the prices initially proposed from \$8.8 million to \$8.0 million. Litton's Marine Technology Division, making purchases for the West Yard, was able to reduce prices initially proposed on subcontracts awarded for the LHA program from \$134 million to \$117 million following discussions with offerors.

Compliance with the Truth-in-Negotiations Act

As part of our reviews at Newport News and Litton we looked into the degree of their compliance with the provisions of the Truth-in-Negotiations Act requiring prime contractors to obtain cost or pricing data from vendors on subcontracts over \$100,000 awarded without adequate competition.

During 1970 Newport News issued purchase orders costing \$125 million. About half this amount was subcontracted under three fixed-price incentive prime contracts. On a statistical sampling basis we selected for review 177 purchase orders issued under the three contracts. The 177 orders were awarded in amounts totaling \$17.8 million. There were 65 purchase orders subject to the Act.



In all 65 instances Newport News attempted to obtain cost or pricing data and was successful except for procurements involving high-yield steel. The contractor referred these to the Navy which made additional unsuccessful efforts to obtain the data and finally consented to Newport News awarding the contracts. H. J.

At Litton we found that both yards were obtaining cost or pricing data when required except for the procurements based on prices arranged by the lead yard on the submarine construction contract. Litton officials explained that they had relied on the lead yard to obtain data and pricing certificates. They propose to obtain these in future procurements irrespective of actions taken by the lead yard.

#### Budgeting and cost control systems

One of the matters you asked us to look into was the effectiveness of the shipyards' budgeting and cost control systems in providing proper controls over labor and material costs on Navy ships.

We were unable to make this type of evaluation at Litton. The systems at the West Yard, a relatively new yard, had not been fully developed and implemented at the time of our review. Construction on the DD963 contract had not begun. The LHAs were in the early stages of construction and detailed budgetary data were not yet available.

Neither could we make this evaluation at Litton's East Yard because Litton's officials said it was their policy not to release budget information to our Office. In effect the company took the position that we were not entitled to this information under our access to records clause. The contracts we reviewed at the East Yard also did not require Litton to furnish budget information to the Navy.

We believe that the system at Newport News was not adequate for insuring proper cost control. This is because it did not provide for a breakdown of costs at a sufficiently low level to permit pinpointing areas of the ship where overruns are likely to develop. Labor is budgeted for at the department and system level. Material cost is budgeted for the entire ship, not for individual structural sections. Therefore, a comparison of actual and budgeted costs below the level of the entire ship cannot be made. Costs of a particular item or group of items of material may run higher or lower than the material cost estimate included in the budget but the system only reveals the material variance for the entire ship. We feel that tracking costs at a lower level is needed so that management can identify areas of the ship where costs are running higher than anticipated and take the necessary action to bring them under control.

Newport News is currently designing a revised cost control system. At this time, of course, we are unable to conjecture on how effective the new system will prove to be.

Both at Newport News and at Litton we examined the contractors' procedures for charging material and labor costs to the Navy contracts. Our tests did not turn up any serious problems in this area. The controls in force seem to be adequate to accurately show labor and material contract costs.

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Although your request did not touch on the propriety of overhead charges we did some limited work in this area at Litton after we noted that the Defense Contract Audit Agency had recently questioned the charging of certain overhead expenses by the West Yard.

Up to now most of the West Yard's construction activity has been confined to its commercial ship contracts. Work on the LHA and DD963 contracts has involved material purchases and engineering design, accomplished primarily by Litton's Advanced Marine Technology Division, and assembly and testing of electronic components performed primarily by Litton's Data Systems Division. Both divisions are located in the Los Angeles, California area.

The Defense Contract Audit Agency found that during the period 1969-1971 the Navy contracts were charged about \$7 million for overhead expenses applicable to Litton's commercial work carried on at the West Yard. The Defense Contract Audit Agency attributed the greater portion of the overcharges to (1) Litton's including in material cost, for the purpose of allocating material burden of the West Yard between Government and commercial, Marine Technology costs such as direct labor and overhead type costs 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 recorded as a direct cost of the West Yard. The Defense Contract Audit Agency

reported that this resulted in inequitable charges to the Navy contracts inasmuch as West Yard activities included commercial as well as Navy ship construction.

Our selected review confirmed that these practices were resulting in Navy contracts bearing some of the West Yard's commercial overhead.

The Navy currently has this matter under consideration.

Navy surveillance over shipyard procurement  
and cost control practices

At Newport News, Navy surveillance was being carried out by a staff of about 400 people, 38 of whom were military personnel. Of the total, 278 were involved primarily in quality assurance, planning, and control of material. There were 36 people involved in surveillance over procurement, cost control, and cost charging. The remaining personnel were primarily administrative.

A recent reorganization of the SUPSHIP staff contemplates an increase in the number of procurement analysts and pricing analysts. Also, a so-called business review staff consisting of a supervisory business analyst, an industrial engineer, and a financial analyst was established which is responsible for maintaining surveillance over the contractor's cost and labor control.

The SUPSHIP at Pascagoula maintains supervision over both Litton's East and West Yards with a staff of about 300. A branch office in Culver City, California, with a complement of 17 people, has surveillance responsibility over the Advance Marine Technology Division operations. We were informed that a business review staff is also being established at Pascagoula with responsibility for surveillance over various aspects

of Litton's business practices including management objectives and policies, work operations and progress, resources utilization, and cost control and reporting systems.

I have stated earlier that the Government's surveillance, exercised by the SUPSHIPS with the assistance of the Defense Contract Audit Agency, has identified some significant weaknesses in the purchasing systems at both contractor operations. The Navy also has been critical of the budgeting system at Newport News. In a March 1971 report a Navy audit team pointed out that budgets at the working level were not related to contract price and that labor and material costs were not related to budgets in a way that would identify potential overruns or underruns in time for corrective action to be taken.

The Navy has made specific recommendations for correcting the deficiencies found. We believe that aggressive follow-up action by the SUPSHIPS is needed to ensure that the contractor take timely action to implement the recommendations. In addition, the SUPSHIPS should exercise closer surveillance over subcontracting practices, particularly in the light of the limited competition obtained for numerous awards.

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CHARGES CONCERNING CERTAIN ASPECTS OF  
LOCKHEED'S MANAGEMENT OF THE C-5 PROGRAM

I should now like to turn to our investigation into the charges of Mr. Henry M. Durham before this Subcommittee last September. Following that hearing, you wrote me on October 12, 1971, requesting that we investigate the charges and verify the evidence presented to the Subcommittee by Mr. Durham. You also requested that our report of the investigation not be circulated in draft form to either the Defense Department, the contractor, or any other persons outside of the General Accounting Office.

The assignment was made to our Atlanta Regional Office, and audit work began immediately. Due to the scope and complexity of the matters presented, and the requirement to perform work at two locations, the staff study was not available from the Regional Office until March 8.

Because of other pressing work, neither Mr. Keller nor I have had an opportunity to review the draft, nor has it had the normal review in the Division, in the Office of General Counsel, or the Office of Policy and Program Planning.

We have thus not had sufficient time to complete a full review of the facts or conclusions in the staff study. Furthermore, I find that while the staff study has been made available to Mr. Durham for review, a similar opportunity has not been afforded to the contractor or the Department of Defense. I have concluded that if we are to perform an adequate evaluation of the matters covered, the comments of these parties would be essential.

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In the meantime, your staff requested that we furnish you such information as we have obtained in advance of today's hearings. Accordingly, on Friday, March 24, I authorized the Director of our Procurement and Systems Acquisition Division, Mr. Richard Gutmann, to furnish you the unevaluated staff study as prepared by the Atlanta Regional Office. We will be pleased to have the Audit Manager who supervised this work discuss the study with the staff of the Committee if that should serve any purpose.

We believe the staff study by our Atlanta Office provides an adequate basis for obtaining the views of the contractor and the Department of Defense and for any further hearings the Committee may wish to have. We believe this would be a satisfactory way to proceed.

I suggest that attention also be given to the following:

- Evaluate the awareness of the contractor of the problems cited by Mr. Durham; and the timeliness and effectiveness of the actions taken, including the communication of such actions to Mr. Durham and others in the contractor's organization. It appears from an initial review of the staff study that management attention was being given to the missing parts problem at the highest company levels while Mr. Durham's observations were being made during the summer and fall of 1969 in his capacity as General Department Manager in charge of Production Control Activities in the flight line, flight test and avionic areas. It is not clear

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what management actions had taken place before, during, and after Mr. Durham's observations; and why they were not apparent or effective at Mr. Durham's level.

- Ascertain how Lockheed's experience on the C-5 compares with its past experience, and with that of other major aircraft companies, at similar points in the production of new aircraft systems. In the absence of such data, conclusions cannot be drawn as to whether the problems cited (about which there can be no doubt) were similar to, less than, or more than those experienced in other programs in the past.
- Evaluate the awareness of, and the actions taken by, the Air Force in respect to these matters, and the extent to which contractual arrangements then in effect proved an obstacle to more adequate supervision by the Air Force.
- Examine the progress payment practices in effect prior to the restructuring of the contract, to ascertain the extent to which they resulted in payments in advance of contract requirements and over what period of time.

We believe that the Staff Study, along with an exploration of the above matters by your Committee with the contractor and the Department of Defense would provide the Committee a comprehensive basis for evaluating the matters on which Mr. Durham testified last September.

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