



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

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JUN 29 1971

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Dear Senator Proxmire:

In response to your request of June 10, 1971, we inquired into contentions by an anonymous source that the Government was adversely affected by the change from cost contracts to fixed-price contracts for 155 mm casings production at the Louisiana Army Ammunition Plant, Shreveport, La. This plant is operated by Sperry Rand Corporation under the jurisdiction of the U.S. Army Ammunition Procurement and Supply Agency (APSA), Joliet, Ill.

The specific contentions and our findings follow:

CONTENTION

The \$150 million Army-owned Louisiana Army Ammunition Plant has been operated for the past 20 years by the Sperry Rand Corporation. Sperry has no money invested in the plant because operating capital is provided free by the Army.

The plant has been operated by Sperry on cost-plus contracts for award fees and a bonus every 6 months. This has put some \$20 million, cost-free, into Sperry's hands.

FINDING

As of March 1971 the Government's investment in the ammunition plant was about \$71 million. Sperry's investment was \$50,000.

Sperry operated the plant from February 1951 through February 1965 under a cost-plus-a-fixed-fee contract. During that period the Army reimbursed Sperry for costs incurred and paid it varying fixed fees. In March 1965 the payment of a semi-annual award fee, in addition to the fixed fees, was authorized.

From February 1951 through March 1971, Sperry was reimbursed for costs of about \$654 million and was paid fees of about \$17 million. The fees represented less than 3 percent of costs.

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CONTENTION

The Army is now switching to fixed-price contracts. This sounds good but it is even worse for the taxpayer. Prior to the changeover, the 155 mm shell produced by Sperry cost 1-1/2 times to twice the market price. Within 24 hours the fixed price dropped to the market price, and the only changes made were in the accounting procedures and a huge writeoff of in-process inventory and tooling, resulting from mismanagement by Sperry. General and administrative expenses are reimbursed by the Army.

FINDING

Switch to fixed-price contracts  
and reimbursement of  
general and administrative expenses

On April 1, 1971, the Army switched from cost contracts to fixed-price contracts for the production of 155 mm casings by Sperry. The loading, assembling, and packing operations were continued on a cost basis. The Army and Sperry also negotiated a facilities contract, effective April 1, 1971, authorizing Sperry rent-free use of Government facilities and equipment to produce casings under the fixed-price production contracts. Officials of APSA advised us that the change to fixed-price production contracts had been made to enable the Army to buy the casings competitively. When the contract with Sperry was changed from cost to fixed price, Sperry was placed in an equal competitive position with other companies that were producing 155 mm casings under fixed-price contracts.

The change to fixed-price contracts shifted certain risks of cost overruns to Sperry. Sperry assumed the risk for increases in the costs of production line overhead, including tooling, utilities, and normal maintenance of facilities and equipment. It did not assume the risk of abnormal maintenance and repair of Government-furnished facilities and equipment, plantwide overhead, and general and administrative expenses.

Sperry also assumed the risk for increases in the costs for direct labor and materials, but it did not assume the risk for increases covered by the escalation provisions of the contract. Escalation on direct labor was limited to an increase

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Sperry also assumed the risk for increases in the costs for direct labor and materials, but it did not assume the risk for increases covered by the escalation provisions of the contract. Escalation on direct labor was limited to an increase

of 0.6 percent of the end-item unit price of \$22.8869. Although this limitation was not applicable to any decrease in rates of pay for labor, the escalation provisions for material provided for changes in material prices in the event of either increases or decreases in cost.

The unit prices under the cost contract included the cost of Government-furnished material, abnormal maintenance and repair of Government-owned production equipment and facilities, and plant overhead and general and administrative expenses. Sperry's unit prices under the cost contract for M107 and M485 casings for the 155 mm shell were \$29.36 and \$32.14, respectively. To assess the change in prices for casings under the fixed-price contracts, we adjusted the unit prices to cover those costs included in the cost contract. For fiscal year 1971 purchases under the fixed-price contract, the adjusted unit prices were \$27.47 for M107 casings and \$33.89 for M485 casings. A comparison of these prices follows.

	Unit prices		Increase or decrease (-)
	<u>Fixed price</u>	<u>Cost reimbursement</u>	
M107	\$27.47	\$29.36	-\$1.89
M485	33.89	32.14	1.75

While the unit prices of M485s increased, those of the M107s decreased. The Army purchased about four times as many M107s as M485s.

APSA and Sperry officials advised us that Sperry's higher prices for M107s under the cost contract had been caused, in part, by the high production levels at which APSA had required Sperry to operate. They stated that these levels were near maximum production. This, in turn, precluded adequate maintenance of equipment, which resulted in equipment downtime and also precluded implementation of approved programs for modernization of plant equipment.

Competition was obtained in the purchase of 155 mm casings for fiscal year 1972 requirements. Norris Industries, Los Angeles, Calif., received the contract award for M485 casings at a unit price of \$26.41. Sperry received an award for M107 casings at a unit price of \$21.60. The latter unit price does not include Government-furnished material and abnormal maintenance and repair of equipment, which averaged about \$1.27 a unit under the prior fixed-price contract.

Writeoffs

We found no writeoff of tooling and the writeoff of in-process inventory was about \$55,000. The inventory writeoff spread over fiscal year 1971 production of about 537,000 casings represented a unit cost of only about \$0.10.

Sperry purchased the March 1971 in-process inventory from the Government at a price of \$534,396, or about \$55,000 below the book value of the inventory. APSA and Sperry arrived at the \$534,396 price for the inventory on the basis of what it would have cost Sperry to produce the parts using the cost factors included in the negotiated fixed-price contract rather than the recorded value of the in-process inventory. APSA negotiators advised us that the fixed-price contracts were negotiated in February 1971 on the basis that Sperry would have an in-process inventory to start production on April 1, 1971, and that the pricing of the inventory on that basis had been intended to preclude any pricing advantage to either Sperry or the Government.

Sperry's prices compared with market prices

The informant's comparison of Sperry's prior prices with market prices relates solely to the M107, because Sperry was the only producer of M485 casings prior to December 1971. The unit price of M107 casings varied among other suppliers and generally appeared to be lower than Sperry's prior prices, as shown below.

Sperry's historical unit price for M107 casings, July 1970 through February 1971	\$29.36
Price range for M107 casings under fixed-price contracts of other suppliers awarded in fiscal year 1970	\$21.33 to \$22.63

Sperry's historical price of \$29.36 under the cost contract was substantially above the fixed prices of other suppliers operating Government-owned plants, but Sperry's price included items not included in the prices of other suppliers. It included the cost of Government-furnished material and of abnormal maintenance and repair of equipment, which is estimated to be approximately \$2.36 a unit.

CONTENTION

Government money is misused. For example, support-services work done on fixed-price job orders payable by Sperry are charged to work orders reimbursed to Sperry.

FINDING

We found that the manner in which the Army implemented the conversion to fixed-price contracting resulted in Sperry's having the use of Government funds for varying periods of time. We also found several errors in accounting for, and distributing cost among, the contracts that had resulted in overcharges to the Government of about \$52,000. These errors were made because support services were being charged to the cost contract rather than to the applicable fixed-price contract. When we called this to the attention of Sperry's controller, Sperry reimbursed the Government for these overcharges and took steps to avoid these types of errors in the future. We estimate that the corrective action taken avoided additional overcharges to the Government of about \$38,000.

Sperry had the cost-free use of work-in-process materials valued at \$534,396 for almost a year because the Army did not secure prompt reimbursement for the casings-in-process inventory which was sold to Sperry for use under the fixed-price supply contracts that began in April 1971. Negotiations of the inventory value were delayed until September 1971 because of Sperry's delay in submitting a proposal and because of the time required by APSA and the Defense Contract Audit Agency to evaluate Sperry's inventory valuation. During the period September 1 to 3, 1971, APSA and Sperry agreed to an inventory value of \$534,396. In March 1972 the Army issued a contract modification and secured reimbursement from Sperry. The APSA negotiator attributed the delay in preparing the contract modification to a heavy workload and to his desire to prepare one modification to offset the sale revenue of the inventory against the additional funds needed for cost overruns on production orders for casings manufactured under the cost contract.

Also Sperry had had the use of Government-owned indirect material having a book value of \$621,000. This amount was comprised of about \$422,000 for tooling for production-line equipment and about \$199,000 for other indirect materials not included in the facilities contract. These materials, which

had been issued to the casings-manufacturing line for use under the cost-type contract but which had not been used, were available for use by Sperry under its fixed-price contract. The Army was aware of this matter, and settlement was still under negotiation in April 1972 because Sperry and the Army could not agree on the transfer value of the material.

In addition, about \$192,000 worth of other indirect material acquired under the cost-type contract was available for use by Sperry under the fixed-price contract. Under the billing arrangements between the Government and Sperry, payment for Government-owned materials issued for the fixed-price contract is made by Sperry about 2 weeks after the end of the month in which the materials are issued. Through October 31, 1971, about \$144,000 worth of these materials had been issued for the fixed-price contract and paid for by Sperry. Army representatives at the plant advised us that they would take action to insure that Sperry reimbursed the Government for the cost of the remaining materials.

#### CONTENTION

The Army is handing over the Indiana Army Ammunition Plant to Sperry's management.

#### FINDING

In May 1971 the Army solicited proposals for the operation of the Indiana plant from about 20 firms, including Sperry. On March 24, 1972, a contract to operate the Indiana plant, effective May 1, 1972, was awarded to I.C.I. America, Incorporated, Wilmington, Del.

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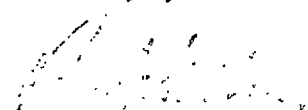
We made our review at the Louisiana plant and at APSA. We reviewed the circumstances surrounding the change to fixed-price contracts at the plant and the procedures and practices followed by the Army and Sperry in implementing and administering the change.

We discussed the matters contained in the report with agency and Sperry officials, but we did not submit the report for their formal examination and comments. We plan to make no further distribution of this report unless copies are specifically requested, and then we shall make distribution only after your agreement has been obtained or public announcement has been made by you concerning the contents of the report.

B-167724

As you requested we are returning the enclosure to your letter. If we can be of further assistance in this matter, please let us know.

Sincerely yours,



Deputy Comptroller General  
of the United States

Enclosure

The Honorable William Proxmire  
United States Senate