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UNITED STATES GENERAL ACCOUNTING OFFICE

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STATEMENT OF

JOHN LANDICHO, SENIOR ASSOCIATE DIRECTOR

NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

BEFORE THE

SUBCOMMITTEE ON ECONOMIC RESOURCES, COMPETITIVENESS

AND SECURITY ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE

ON

ALLEGATIONS ABOUT TRIDENT SUBMARINE PROGRAM MATTERS



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Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before the Subcommittee to discuss the results of our review to date of specific allegations concerning mismanagement and questionable practices in the construction of Trident submarines.

This work is being performed at the request of this Subcommittee and, as agreed, focused on seven allegations in the five following areas: the propriety of certain payments; destruction of Navy records; task authorization and funding on a Trident submarine technical support services contract; elimination of a financial monitoring procedure; and violations of standards of conduct.

A report containing details on all of the allegations will be submitted to the Subcommittee in the near future. Our testimony today will discuss our work to date on allegations covering contract payments that involve work progress and long lead time materials, and the allegation on destruction of records.

Our review of these matters was conducted primarily at the Plans, Programs, and Financial Management Office of the Trident Submarine Ship Acquisition Program (PMS 396P); the Supervisor of Shipbuilding, Conversion and Repair, Groton, Connecticut; and the Electric Boat Division of the General Dynamics Corporation.

PROGRESS OF
SUBMARINE CONSTRUCTION

It was alleged that (1) until at least 1982, the actual percentage of completion of construction of the Trident was less than the percentage claimed for progress payments, thus allowing Electric Boat to receive early progress payments, and (2) an adjustment made by the Navy in March 1982 to the system used for reporting progress constitutes proof that the early payments were occurring.

Our review disclosed that, in March 1982, Electric Boat significantly increased the manhour budgets for all contracts, with the majority of the budgeted manhours being added to completed or in-process work orders. The Navy's Supervisor of Shipbuilding, Conversion and Repair (Supship) at Groton notified the contractor that such budget changes would result in early progress payments and were not acceptable. In April 1982, Supship disapproved Electric Boat's system for reporting progress and began computing progress payments based on a Supship calculation of the percentage of completion. Supship continued this procedure until March 1983 when Electric Boat submitted a revised system description which Supship believed would be adequate for determining construction progress.

Our analysis of Navy documentation showed that the March 1982 budget revision was the culmination of a lengthy application of budgeting and other practices unacceptable to the Navy that may have resulted in early payment of work progress prior to March 1982.

During a period beginning in mid 1980 and extending to the March 1982 budget revision, there was much correspondence indicating that Electric Boat's cost and schedule control system was not, in the Navy's judgement, fully complying with criteria in Department of Defense (DOD) Instruction 7000.2. The criteria are intended to serve as standards for measuring the adequacy of contractor management control systems and the data and reports that are derived from that system. The documentation we reviewed showed that, in a number of instances, the Navy urged Electric Boat to cease practices that, in the Navy's opinion, had the effect of producing early payment of work progress.

Among the problems cited by the Navy was Electric Boat's practice of making retroactive changes to budget and schedule, and of overvaluing the budget allocation for work performed early in the construction cycle. The computation of labor progress was made by estimating the percent of the job completed and then multiplying by the budgeted hours for the job. Thus, an overstated labor hour budget for work to be accomplished early in the contract would result in greater reported progress.

The practice continued into March 1982, when Electric Boat significantly increased the labor hour budgets for its contracts. A total of 16 million labor hours was added to its budgets, with the majority being allocated to work authorizations which had already been completed or were in-process. As a result, Electric Boat claimed 12.6 million hours during a 2-week period in which they actually expended 1.8 million hours. The budget revision would have resulted in

increased progress payments, had the Navy not suspended payments based on Electric Boat's system. Most of these hours were claimed against the SSN 688 II contract and the Trident I contract.

During our review, we also noted other instances of Electric Boat's non-compliance with DOD Instruction 7000.2 on cost and schedule control criteria. In addition to early progress payments, Navy correspondence, from late 1980 through May 1982, also stated that Electric Boat's budgeting and other practices may have resulted in suppression of cost and schedule variances on submarine construction, and inaccurate or misleading cost reports on submarine contracts.

We did not review these matters because they were beyond the scope of this review. However, we and Subcommittee staff agreed that these matters were related to the issues being reviewed by the Department of Justice Task Force currently investigating shipbuilding activities at General Dynamics' Electric Boat Division, and we discussed and provided the pertinent documents to members of the Task Force.

CLAUSE ON CONTRACT RETENTIONS
RELATED TO PROGRESS PAYMENTS

While reviewing the allegation on progress payments, we found that the Trident IV and SSN 688 VII contracts contain special retention clauses affecting payments. The prices of these contracts are \$1.7 billion for 3 Tridents and \$471 million for 2 SSN 688s.

The contracts contain the standard clauses that prescribe payment limitations, which vary depending on the percentage of

physical completion of each submarine. The same contracts also contain a clause entitled "Special Procedures Concerning Contract Retentions." Retentions are amounts withheld by the Navy from progress payments to protect the government's interest against various contingencies.

The retention clauses state that both parties to the contracts recognized that the retentions specified in the progress payment clauses might exceed the amount necessary to accomplish the objectives of such retentions. Consequently, the clauses specified an alternative method for computing payments which deleted the requirement to retain 2.5 percent of the contract price from each progress payment due and substituted a retention of \$22.5 million and \$7.5 million per Trident and SSN 688 submarine, respectively, over the lives of these contracts.

Although the stated purpose of the clauses (special retention clauses) was to change the amount of contract retention, the Navy interpreted the clauses as also deleting the payment limitations contained in the contract payment clauses which prohibit paying progress payments in excess of a specified percentage of cost incurred. Therefore, Electric Boat received the calculated payment, regardless of whether or not it exceeded actual costs incurred. We found the deletion of the payment limitations from these clauses has been costly to the government on these two contracts.

We determined that these provisions allowed Electric Boat to receive progress payments that substantially exceeded the

amounts which would have been paid under the restrictions in the standard progress payment contract clauses. The amount of additional progress payments realized on the Trident IV contract through this clause has generally been increasing over the contract period. As of August 1985, we estimated that the additional amount totaled approximately \$69.6 million on the Trident IV and \$1.2 million on the SSN 688 VII contracts. We also estimated that the interest cost to the Government for these additional payments, for the period February 1982 through August 1985, was approximately \$9.9 million. We discussed this matter with Navy officials who agreed with our observations, but they have not yet provided us with the specific reasons for this practice.

ADVANCE PROCUREMENT OF
LONG LEAD TIME MATERIAL

It was alleged that the amount of funding authorized for advance procurement of long lead time materials was excessive on the Trident submarine program.

In order to conform to a submarine master construction schedule, some materials and components with long delivery lead-time (LLTM) must be purchased before the construction contract is awarded in order to have them available when needed. These LLTM are purchased through advance procurement contracts.

We found that advance procurement contracts with Electric Boat are cost, no fee contracts whereby the contractor is reimbursed by the Navy for actual costs incurred but does not receive a profit on these costs until after the construction contract is awarded. Materials and components purchased as LLTM are included in the construction contract at a cost based on the

latest information available when the contract is negotiated.

Our review disclosed that, after remaining relatively stable on the first 7 Tridents, advance procurement funding on each of the following 4 Tridents increased from \$35.5 million on the SSBN 732 (the last submarine of the Trident I group contract) to \$148 million on the SSBN 736. This represents an increase from 12 percent of target cost to 33 percent of target cost. Advance procurement funding for the most recently awarded SSBN 737 was \$126.4 million. The following shows the LLTM advance procurement funding:

SSBN 732 (FY 78)	SSBN 733 (FY 80)	SSBN 734 (FY 81)	SSBN 735 (FY 83)	SSBN 736 (FY 84)	SSBN 737 (FY 85)
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LLTM Funded \$35,500,000	\$70,464,818	\$101,200,000	\$128,980,000	\$148,000,000	\$126,400,000

Electric Boat and Navy officials stated that the need for the significant increases occurred primarily because of changes in construction sequencing which required the use of additional material earlier in the construction process.

Although construction sequencing changes have occurred and are undoubtedly responsible for some of the increase, we question whether these changes are solely responsible for the increases, for the following reasons:

1. The \$126.4 million for the SSBN 737 included \$33 million for two major components previously provided as government furnished equipment, not as long lead time material.

Exclusive of these two items the funding for the SSBN 737 was \$93.4 million, a decrease of \$54.6 million or 37 percent from the \$148 million authorized for the previous submarine. The significant decrease raises questions about the need for the higher level of funding on the previous submarine.

2. On some Tridents, we found that Electric Boat had not spent or obligated substantial amounts of the funds authorized for advance procurement by the date the construction contract was awarded. The unobligated balances ranged from \$22 million on the SSBN 732 to \$66 million on the SSBN 734.

Electric Boat officials noted that a major reason for the unobligated balances was the late receipt of funding from the Navy in the advance procurement period. They stated that in some instances the funding came so close to the contract award date that there was little opportunity to purchase the material during the advance procurement period. In this regard, we noted funding of \$64 million was provided as late as 2 months before contract award on the SSBN 734.

3. Procurement budgets for LLTM prepared by Electric Boat for each Trident contain an escalation reserve which has varied substantially from a low of \$1.7 million on the SSBN 733 to a high of \$22.5 million on the SSBN 735. We have requested explanations of these reserves from Electric Boat and the Navy.

4. In reviewing the contracts for LLTM, we noted a number of instances where construction schedule dates indicated that the materials did not need to be purchased prior to the award of the construction contract, and, therefore, should not have been

funded as LLTM. For example, a LLTM schedule dated August 1982 stated that in order for materials valued at \$2.7 million to be available when needed, the purchase requisition should be initiated in June 1984. This was 8 months after the construction contract was awarded for the SSBN 736.

All of the above issues, Mr. Chairman, have been discussed with Electric Boat and Navy officials who have requested time to prepare a response.

DESTRUCTION OF RECORDS

It was alleged that, in November 1983, a destruction of records took place in PMS 396P of the Trident project office during a period when three investigations, one of which was a Federal Bureau of Investigation (FBI) effort, were reportedly ongoing. It was further alleged that the records destruction violated the Navy's policy; potentially obstructed justice in connection with the past and ongoing investigations; and eliminated documentation that could have been used to substantiate allegations concerning the Trident program.

Our review showed that PMS 396P conducted a general records disposal effort and that most of the disposal activities occurred between September 1983 and September 1984. During this effort, many records were destroyed including files and reports. According to officials responsible for and involved in the effort, the records disposal was conducted because of a need for additional office space, and to organize PMS 396P's filing system in accord with the Navy's standard file indexing system.

/ Secretary of the Navy Instruction P5212.5B /provides

authority for the periodic destruction of records based on prescribed record retention standards. The Navy process classifies the retention standards for the various records according to standard subject identification codes. These codes not only identify the subject of the documents but also state how long they should be retained. Although PMS 396P compiled an inventory of documents and decided upon their disposition, we could not independently determine whether retention standards were observed on records earmarked for destruction. We were unable to do this because the subject identification codes, which would have facilitated this determination, were omitted from a designated column on the inventory listing for most of the documents.

Our review also showed that there were ongoing investigations of Trident program matters during the period in which the records disposal took place. We identified nine ongoing investigations, including three by the FBI, during the time in which most of the disposal activities occurred. We reviewed the closed case files for each of the Navy's six investigations and discussed the cases with cognizant officials. We also discussed the three FBI investigations with an FBI official. We found no evidence that PMS 396P officials were contacted about these investigations during the period in which the disposal activities occurred.

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Mr. Chairman, that concludes my statement, I will be pleased to answer any questions you have.

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