Audit Report

OFFICE OF THE INSPECTOR GENERAL

CONTRACTORS' USES OF ADDITIONAL FUNDS APPROPRIATED FOR THREE NAVY SHIPBUILDING PROGRAMS

Report No. 94-009 October 28, 1993

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Department of Defense

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400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

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MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Audit Report on Contractors' Uses of Additional Funds Appropriated for Three Navy Shipbuilding Programs (Project No. 3AL-5032)

Introduction

We are providing this report for your information and use. This audit was performed at the request of the Senate Committee on Armed Services, which wanted feedback on how Tampa Shipyard Incorporated (Tampa Shipyard) and Bethlehem Steel Corporation (Bethlehem Steel) used additional funds that they received as a result of Public Law 102-396, the DoD Appropriations Act for FY 1993, October 6, 1992 (the Act). The Act provided additional funding for three shipbuilding programs. Specifics on the additional funding are shown in the table.

Funds Appropriated by Shipbuilding Program

Program	Contractor	Contract No.	Funds (millions)
Fleet Oilers	Tampa Shipyard	N00024-90-C-2300	$45.0
Crane Ships	Tampa Shipyard	DTMA-97-87-C-70001	13.3
Survey Ships	Bethlehem Steel	N00024-85-C-2188	40.0

The Act directed the Secretary of the Navy to increase the contract prices on the three shipbuilding contracts and to pay the contractors the additional funds. As of August 10, 1993, the Navy had paid Tampa Shipyard $39.5 million and Bethlehem Steel $40 million.

Audit Results

Our audit found that Tampa Shipyard used the $39.5 million that it received on the two contracts to restructure its bank and related party indebtedness, reduce its accounts payable that existed before the Act, and pay its operating expenses. The Navy planned to pay the remaining $18.8 million to Tampa Shipyard as the contractor made progress on two Fleet Oiler ships that were under construction.

Bethlehem Steel placed the $40 million that it received into its general treasury to offset a $74.4 million loss that it incurred on the contract for the two Surveying ships.

Objective

The audit objective was to evaluate how Tampa Shipyard and Bethlehem Steel used the additional funds that Congress appropriated for the three shipbuilding contracts.

Scope

To satisfy the audit objective, we reviewed Tampa Shipyard's financial records, dated from September 1992 through June 1993, and the financial records for Bethlehem Steel, dated December 1992. We also reviewed the contracts on the three shipbuilding programs and modifications to those contracts, as well as records of progress payments, reports by the Defense Contract Audit Agency (DCAA), and other related documents, dated from October 1988 through August 1993. Enclosure 2 lists the organizations that we visited or contacted.

This program audit was made from August 10 through September 13, 1993, in accordance with the auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense.

Internal Controls

We did not assess internal controls because the Act did not place limitations on the contractors' use of the funds.

Prior Audits and Other Reviews

No prior audits had been made by the General Accounting Office, the Office of the Inspector General, or the Audit Agencies of the Military Departments on the use of the additional funds appropriated for the three shipbuilding programs .

Discussion

Fleet Oilers. The Navy awarded fixed-price-incentive Contract N00024-90-C-2300, on November 16, 1989, to Tampa Shipyard for the completion of two Fleet Oiler ships that the Pennsylvania Shipbuilding Company, the original contractor, was unable to complete. Contract N00024-90-C-2300 required Tampa Shipyard to tow the partially completed ships to its facility in Tampa, transport all available termination inventory from the Pennsylvania Shipbuilding Company, receive previously ordered materials, and complete the ships.

On May 26, 1992, Tampa Shipyard submitted a Request for Extraordinary Contractual Relief under Public Law 85-804 for $24.1 million. The request was the result of Tampa Shipyard's performance on Contract N00024-90-C-2300 for the Fleet Oiler ships. Public Law 85-804 allows for the modification of contracts when such action is determined to facilitate the national defense. On August 3, 1992, Tampa Shipyard submitted a revised request that asked for $24.5 million and an immediate progress payment of $15.2 million. Tampa Shipyard believed that relief was needed because its continued performance was essential to the national defense; the Government caused a loss to Tampa Shipyard that resulted in potential unfairness; and the Government should correct mistakes in the contract for the Fleet Oiler ships. Tampa Shipyard also indicated that, if the request was denied, it would be forced to cease all business operations by August 7, 1992.

On August 7, 1992, the Navy determined that there was no basis for granting Tampa Shipyard relief under Public Law 85-804. The Navy concluded that Tampa Shipyard's continued performance was not essential to the national defense and that Tampa Shipyard could not complete the ships even if the request was approved. In effect, the Congress overrode that Navy decision when it passed the Act.

The Act provided an additional $45 million for Contract N00024-90-C-2300, increasing the contract price for line item 0001 from $59.6 million to $104.6 million, and directed the Secretary of the Navy to pay Tampa Shipyard the difference between the total cost incurred and total payments. In October and November 1992, as directed by the Act, the Navy made two payments to Tampa Shipyard totaling $12.1 million. In addition, the Navy paid Tampa Shipyard $14.1 million in progress payments from October 1992 through August 1993.

Auxiliary Crane Ships. The Maritime Administration (MARAD) awarded firm-fixed-price Contract DTMA-97-87-C-70001, on September 14, 1987, to Tampa Shipyard for the conversion of two container ships to Auxiliary Crane ships. Tampa Shipyard completed the conversions and delivered the two Auxiliary Crane ships in February 1989 and May 1989.

At the conclusion of Contract DTMA-97-87-C-70001, Tampa Shipyard submitted a proposal for an equitable adjustment and requested $13.3 million from MARAD. In considering Tampa Shipyard's claim, the contracting officer requested that DCAA review Tampa Shipyard's proposal. The DCAA questioned $10.9 million of the $13.3 million proposed by Tampa Shipyard. The contracting officer subsequently found that Tampa Shipyard was entitled to $1.2 million of the $13.3 million claim. However, Tampa Shipyard received only $207,519, because the contracting officer deducted $993,937 for unfinished work and liquidated damages due to Tampa Shipyard's late delivery of the ships.

In February 1991, Tampa Shipyard sued the Government in United States District Court for $13.3 million. The Government prepared extensively for the case and officials in the Department of Justice believed that it would result in a resolution substantially less than the $13.3 million requested by the contractor.

Tampa Shipyard had the court case dismissed, however, when the Act directed the Secretary of the Navy to increase the contract price of the Auxiliary Crane ships and to pay Tampa Shipyard $13.3 million by November 1, 1992.

Tampa Shipyard's Application of Funds. Our review of receipts and disbursements shown in Tampa Shipyard's financial statements and accounting records, along with our discussions with company officials enabled us to determine how Tampa Shipyard used the money resulting from the Act. Tampa Shipyard used the initial payments of $12.1 million for the Fleet Oiler contract and the $13.3 million for the Auxiliary Crane ships to restructure its bank and related party indebtedness and reduce the accounts payable. For example, in November 1992 Tampa Shipyard used $8.0 million to secure two letters of credit on Government contracts that the Acting Chairman of the Board had previously personally guaranteed. Tampa Shipyard also paid the Acting Chairman of the Board $2.4 million for loans that he made to the company. The detailed disbursements of the $25.4 million are shown in Enclosure 1.

On August 25, 1993, we presented the data in Enclosure 1 to the Vice Chairman of the Board and the Chief Financial Officer for Tampa Shipyard's parent company, The American Shipbuilding Company. We also presented the data to the Treasurer of Tampa Shipyard. All agreed with our conclusions on how Tampa Shipyard used the funds.

The Chief Financial Officer, however, requested that we explain that $7.0 million of the $8.0 million that Tampa Shipyard used to secure the letters of credit was later used to reduce the accounts payable directly related to Government contracts. In April 1993, the Navy allowed Tampa Shipyard to use the $7.0 million because Tampa Shipyard failed to reduce the accounts payable to an acceptable level. The accounts payable for the Navy contracts as of April 12, 1993, was $7.4 million. Tampa Shipyard was required to place the funds into an escrow bank account and pay the accounts payable directly related to Navy contracts. The administrative contracting officer approved all disbursements from the account, and the bank disbursed the funds.

In addition to the initial $25.4 million ($12.1 million plus $13.3 million), Tampa Shipyard received progress payments on the contract for the Fleet Oilers ships from October 1992 through August 1993. In total, Tampa Shipyard received $14.1 million in progress payments and used the receipts to pay its operating costs.

Surveying Ships. The contract on the Oceanographic Survey ships that were built by Bethlehem Steel's Baltimore Marine Division was the other contract addressed in the Act. The Navy awarded firm-fixed-price Contract N00024-85-C-2188 to Bethlehem Steel on June 28, 1985, for the design and construction of two Oceanographic Survey ships. The Baltimore Marine Division completed and delivered the two ships to the Navy in March 1989 and August 1990.

In June 1987, Bethlehem Steel initiated several actions to recoup a $74.4 million loss on the design and construction of the two Oceanographic Survey ships. Bethlehem Steel claimed that the losses were the result of a flawed procurement process that underestimated the complexity of designing and building the two ships. The Navy's contracting officer concluded that Bethlehem Steel's claim had no merit and denied its requests for recoupment.

On January 3, 1991, Bethlehem Steel submitted a Request for Extraordinary Contractual Relief under Public Law 85-804 to the Secretary of the Navy. Bethlehem Steel requested an award of $74.4 million to offset the portion of the losses beyond its control. Bethlehem Steel believed that extraordinary relief was appropriate based on considerations of fairness and preserving the defense mobilization base. On August 21, 1991, the Office of the Assistant Secretary of the Navy (Research, Development and Acquisition) requested that the DCAA review Bethlehem Steel's claim and verify the direct and indirect costs to the amounts recorded in the company's general and subsidiary ledgers. The DCAA issued the "Report on Audit of Request for Extraordinary Contractual Relief Under Public Law 85-804," September 5, 1991. The report stated that DCAA verified Bethlehem Steel's $74.4 million loss in the books and records without disclosing any significant differences. On October 17, 1991, the Navy Contract Adjustment Board denied Bethlehem Steel's request for $74.4 million in extraordinary contractual relief.

In September 1991, Bethlehem Steel appealed the contracting officer's decision to the United States Claims Court. The Department of Justice made extensive preparations for the trial, including a motion to dismiss the case in May 1992. The Government's motion to dismiss the case was pending when Congress appropriated additional funds for the Surveying ships. The Act required Bethlehem Steel to dismiss the case and relieve the Government of all liabilities arising under the contract in order to receive the additional $40 million. On December 17, 1992, Bethlehem Steel dismissed the case. The Act directed the Secretary of the Navy to increase the contract price from $172.1 million to $212.1 million and pay the contractor that built and delivered the Surveying ships $40 million by December 31, 1992.

Bethlehem Steel's Application of Funds. Our review of Bethlehem Steel's financial records showed that the $40 million was used to offset the $74.4 million lost on its contract for the Surveying ships. Bethlehem Steel received a single payment of $40 million on December 11, 1992. When the funds were received by the Baltimore Marine Division, the funds were deposited into Bethlehem Steel's general treasury. The general treasury account was used by Bethlehem Steel to pay operating expenses for each of the company's divisions. When an individual division, such as the Baltimore Marine Division, needed funds, a requisition for cash was sent to the Assistant Treasurer, Money Management, in Bethlehem, Pennsylvania.

Management Comments

A draft of this report was provided to officials within the Naval Sea Systems Command and the Defense Contract Audit Agency. Since this report contains no finding or recommendation, written comments on our conclusions were not required. Management elected not to respond.

The courtesies extended to the audit staff are appreciated. If you have questions on this audit, please contact Mr. Rayburn H. Stricklin, Program Director, at (703) 614-3965 (DSN 224-3965) or Mr. Michael T. Hill, Acting Project Manager, at (703) 693-0415 (DSN 223-0415). Enclosure 3 lists the distribution of this report. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosures

Receipt and Disbursement of Congressional Appropriations by Tampa Shipyard Inc.

Receipts Stemming From Congressional Appropriations	(in millions)	
Settlement for Auxiliary Crane Ships[1]	$13.3	
Initial Payments for Costs Incurred on the Fleet Oilers Ships[2]	12.1	
Progress Payments for Construction of Fleet Oilers Ships[3]	14.1	
Total Funds Received		$39.5
Disbursements		
Payment of Principal and Interest on Related Party Loans[4]	$2.4	
Payment of Letter of Credit Loan[5]	3.0	
Transfer to Citibank Escrow Account for Letters of Credit[6]	8.0	
Reduction in Aging Accounts Payable		
Fleet Oiler Ships[7]	2.1	
Ocean Surveillance (TAGOS) Ships[8]	3.5	
Commercial Contracts[9]	1.3	
Overhead[10]	2.0	
Reduction of Other Accounts Payable[11]	1.9	
Payments of Operating Expenses[12]	14.1	
Total Funds Disbursed		38.3
Balance		$ 1.2

[1]The Department of Defense Appropriations Act for FY 1993 (the Act) directed the Secretary of the Navy to increase the price of the contract for the Auxiliary Crane ships and to pay Tampa Shipyard $13.3 million by November 1, 1992.

[2]The Act directed the Secretary of the Navy to increase the price of the contract for the Fleet Oilers ships by $45 million. The Act also directed the Navy to pay Tampa Shipyard the difference between the total costs incurred and the total payments made. This resulted in a $12.1 million payment in October 1992.

[3]Tampa Shipyard received $14.1 million in progress payments on the contract for the Fleet Oiler ships from October 1992 to August 1993.

[4]Tampa Shipyard repaid a $2.2 million loan from the Acting Chairman of the Board. The company also made interest and principal payments of about $200,000 between October 1 and December 31, 1992, to the Acting Chairman of the Board.

[5]In September 1992, the Navy allowed Tampa Shipyard to borrow $3.0 million against a letter of credit associated with the contract for the Fleet Oiler ships. The $3.0 million was placed in a special bank account and used to pay accounts payable incurred while constructing the Fleet Oilers ships. In November 1992, Tampa Shipyard repaid the $3.0 million loan from Citibank.

[6]On November 12, 1992, Tampa Shipyard deposited $8.0 million into an escrow account to secure outstanding letters of credit on contracts for the TAGOS and Fleet Oiler ships. The letters of credit had been issued to guarantee the company's performance under the two contracts. Before placing the cash into escrow, the Acting Chairman of the Board provided the security for the letters of credit.

[7]The Accounts Payable Aging Summary showed a reduction of $2.1 million in the accounts payable directly related to the contract for the Fleet Oiler ships from October 3, 1992, to December 31, 1992.

[8]The Accounts Payable Aging Summary showed a reduction of $3.5 million in the accounts payable directly related to the contract for the TAGOS ships from October 3, 1992, to December 31, 1992.

[9]The Accounts Payable Aging Summary showed a reduction of $1.3 million in the accounts payable directly related to Tampa Shipyard's commercial contracts from October 3, 1992, to December 31, 1992.

[10]The Accounts Payable Aging Summary showed a reduction of $2.0 million in Tampa Shipyard's overhead accounts payable from October 3, 1992, to December 31, 1992. The overhead accounts payable includes rents, insurance, utilities, legal fees, security services, supplies, and similar expenses.

[11]The other accounts payable included the accounts payable of The American Ship Building Company, the parent company of Tampa Shipyard, as well as other liabilities not in the Accounts Payable Aging Summary. An example would be a vendor that had not billed the Company.

[12]Tampa Shipyard received $14.1 million in progress payments from October 1992 through August 1993 on the contract for the Fleet Oiler ships. The progress payments were primarily for Tampa Shipyard direct labor and applied overhead costs.

Organizations Visited or Contacted

Department of the Navy

Naval Sea System Command Headquarters, Washington, DC
Office of the Supervisor of Shipbuilding, Conversion and Repair, Tampa, FL

Defense Agencies

Defense Contract Audit Agency, Baltimore, MD
Defense Contract Audit Agency, St. Petersburg, FL

Non-Defense Agencies

Department of Justice, Washington, DC
Maritime Administration, Washington, DC

Contractors

Bethlehem Steel Corporation, Baltimore, MD
Tampa Shipyard Incorporated, Tampa, FL
The American Ship Building Company, Tampa, FL

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Office of Management and Budget
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Senate Committee on Appropriations
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Senate Committee on Armed Services
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Audit Team Members

Donald E. Reed	Director, Acquisition Management Directorate
Thomas F. Gimble	Deputy Director
Rayburn H. Stricklin	Program Director
Roger H. Florence	Project Manager
Michael T. Hill	Acting Project Manager
Lisa E. Novis	Auditor
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