INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

REPORT
NO. 90-035

February 14, 1990

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)

SUBJECT: Report on the Followup Audit of Vendor Technical Qualification Process for Aircraft Engine Spare Parts Procured by the Naval Aviation Supply Office (Project No. 9AP-5017)

Introduction

This is our final report on the "Followup Audit of Vendor Technical Qualification Process for Aircraft Engine Spare Parts Procured by the Naval Aviation Supply Office." The audit was made as a followup to our previous audit of the "Vendor Technical Qualification Process for Aircraft Engine Spare Parts Procured by the Naval Aviation Supply Office," Report No. 88-044, dated November 3, 1987. The objectives of the audit were to determine if all agreed upon recommendations had been implemented and the amount of monetary benefits that the Navy had accrued because of timely approval of vendor source approval requests in-process as of October 1986. A source approval request (request) is a document consisting of all the parts drawings and other evidence to ensure the Navy that the vendor is capable of manufacturing a specific aircraft engine spare part. During the prior audit, we determined that the Naval Aviation Supply Office (ASO) and the Naval Air Systems Command (NAVAIR) had not established procedures for promptly qualifying vendors of flight critical engine spare parts for aircraft. We estimated that timely approval of requests in-process as of October 1986, would result in competitive acquisition of aircraft engine spare parts with pending requirements, and associated cost avoidances totaling $10.1 million.

To improve the vendor technical qualification decision process, we recommended in our prior report that the Navy issue guidance to vendors that specified what documentation must be submitted with requests and how it should be organized, and establish time standards for the Navy's evaluation and approval of requests. We also recommended that the Navy monitor the processing of requests to determine how effectively and efficiently the vendor qualification process is functioning regarding timeliness and disclosure of request status to contractors. To improve management oversight of the qualification decision process, we recommended that the Navy

verify the accuracy of data on requests in the management information system, that ASO establish input controls to ensure that the data base remains accurate, and that ASO and NAVAIR reconcile their management information systems. In addition, we recommended that ASO promptly qualify the vendors who had pending requests as of October 1986 or advise them of the steps necessary to obtain qualification.

The Navy concurred with the recommendations, but it did not agree with the projected $10.1 million cost avoidances. To implement the recommendations, Navy management agreed to publish a competition opportunities guide that contained detailed information on both source approval and bidders list application processes, to upgrade the management information system for monitoring the qualification process, to develop procedures for reconciling data in the ASO and NAVAIR management information system every 30 days, and to review input controls to ensure the accuracy of the data base. In addition, the Navy would establish time standards for information feedback to vendors and provide feedback, including a detailed description of deficiencies identified in each proposal, and advise vendors of the status of their qualification requests every 90 days. Navy officials reviewed the sample items that we used to make the $10.1 million projection, and stated that approval of the items would only result in potential monetary benefits of $6,100 on one item.

Scope of Audit

To accomplish our objectives, we examined procedures at ASO and NAVAIR, interviewed competition advocate personnel and contracting officials, and reviewed corrective actions implemented by management to resolve deficiencies identified in Report No. 88-044. We reviewed the internal controls for monitoring and managing the qualification process for new vendors because the prior audit identified a material weakness in the management of vendor requests. We concluded that the current internal controls for managing the vendor qualification process were effective because no significant deficiencies were disclosed during our followup audit.

We evaluated program statistics for requests from May 1, 1988, through April 30, 1989, and compared the results with similar statistics from the prior audit to determine if the backlog of items and the processing times were decreasing. In addition, to address the unresolved issue of cost avoidances claimed in the prior audit, we reviewed all the cost savings claimed by ASO for vendor requests that were pending during our prior audit and that were later approved by NAVAIR. We did not examine the individual source approval requests. This economy and efficiency audit was made at ASO, Philadelphia, Pennsylvania; and at NAVAIR, Arlington, Virginia, from May through August 1989 in accordance with auditing standards issued by the Comptroller

General of the United States, as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary.

Prior Audit Coverage

The Office of the Inspector General, DoD, issued Report No. 88-044, "Vendor Technical Qualification Process for Aircraft Engine Spare Parts Procured by the Naval Aviation Supply Office," on November 3, 1987. This report showed that the vendor qualification decision process was taking too long and was restricting competition. The 1987 report recommended that the Navy:

- Issue guidance to vendors that specifies the documentation to submit when requesting source approval, how the documentation should be organized, and time standards for the evaluation and approval of requests.

- Monitor the processing of requests to determine how effectively and efficiently the vendor qualification process is functioning from the standpoint of timeliness and disclosure of qualification request status to contractors.

- Verify the accuracy of data on requests in the management information system, establish input controls to ensure that the data base remains accurate, and reconcile the ASO and NAVAIR management information systems.

- Promptly qualify the vendors who have pending requests or advise them of the steps necessary to obtain qualification.

Management generally concurred with the above recommendations, but it did not agree with the projected $10.1 million cost avoidance that would accrue as a result of approving vendors who have pending requests.

Results of Audit

In January 1988, ASO issued new guidance to vendors on the qualification process and established procedures for more promptly qualifying vendors of flight critical engine spare parts. Overall, ASO and NAVAIR actions implemented the recommendations agreed to by the Navy. Approval of vendor requests that were in-process when the prior audit was completed and subsequent competitive procurements resulted in cost avoidances totaling about $15.1 million on 19 spare parts.

Guidance to Vendors. The prior audit determined that the guidance issued to vendors was not adequate because it did not specify what information vendors were required to submit with

their requests. The level of supporting detail for source approval request packages was usually based on the judgment of ASO competition advocate personnel, and packages were often developed inefficiently. In response to the audit recommendation, ASO issued new guidance during January 1988 on qualifying vendors as sources for critical aircraft engine parts. We determined that the guidance specified the data that must be submitted when requesting source approval. The guidance also provided a requirement that vendors identify any value added by the prime contractor and that test procedures be included as part of the technical data furnished with the request. We concluded that the ASO guidance will improve the processing of vendor requests.

Processing Time Frames. The prior audit determined that ASO and NAVAIR had not established processing time standards to cover the review of the source approval requests for each prioritized category. For example, guidance in effect during the prior audit classified a source approval request with a pending requirement (award being held pending a response) valued at $500,000 or more as a priority 1A. We determined that the Navy had established processing time standards in ASO Instruction No. 4200.43, "Processing Requests for Source Approval to Supply Flight Critical Spare Parts," December 17, 1987, which stated that:

> Within 180 days of a source approval request identified as a priority 1 or 2 [spare] part, the business entity shall be advised of the approval or disapproval thereof, or if additional time is required to process the request, the date on which approval or disapproval will be provided.

During October 1988, the Navy also changed the threshold for performing spare parts breakout reviews from $10,000 to $55,000. In addition, ASO has revised the way requests are prioritized. For example, a priority 1 item is now a request with a pending procurement requirement valued at $500,000 or more (see Enclosure 1 for prioritization comparisons). For items identified as priority 1 or 2 spare parts, the 180-day processing goal has been allocated as follows.

- Ninety days for ASO (60 days for in-house personnel to determine if the vendor source approval request has all the required data and 30 days for the vendors to correct any deficiencies).

- Ninety days for NAVAIR or the Navy Depots (NAVDEP's) to complete an engineering technical review and make a decision on the vendor request. During our audit, NAVAIR officials told us that some decision-making authority may be delegated to the NAVDEP's for approval of vendor requests. Under current processing policies, ASO transmits a completed request to the

appropriate NAVDEP for an initial screening. When a NAVDEP is directly involved, the 90-day processing time is generally split equally between NAVAIR and the reviewing NAVDEP.

The processing time frames established for ASO and NAVAIR to evaluate, prioritize, and approve requests appear to be realistic and, if adhered to, will also improve the efficiency and effectiveness of the qualification process.

Source Approval Request Monitoring Procedures. Report No. 88-044 recommended that ASO monitor the processing of requests to determine how effectively and efficiently the vendor source approval process was functioning regarding timeliness and disclosure of request status to contractors. The prior audit determined that the management information system did not provide essential information needed to monitor and control the processing of requests. The time standards that the Navy established since the prior audit can be used to gauge whether excessive processing time is accumulating. ASO uses a management information system that has d-Base III Software, which is capable of tracking the physical location of the request as it progresses through the review cycle. The system is capable of monitoring the processing time by location and of tracking status information sent to vendors.

Navy management, in its initial reply to Report No. 88-044, agreed to advise vendors of the status of their request every 90 days. We tested ASO's compliance with the requirement to send 90-day status reports to vendors by reviewing 19 randomly selected requests from 114 requests that were received from May 1, 1988, through April 30, 1989, and were in-process as of June 1, 1989. Each of the requests reviewed had been in-process more than 90 days. We found that of the 19 vendors, 7 received 90-day status reports, 6 received reports that addressed a specific source approval request, and 6 did not receive status reports. The results of our test also indicated that ASO's policy was to send 90-day status reports to vendors with five or more pending requests. ASO had about 40 vendors with 5 or more requests pending; the 7 vendors that received the 90-day status report represented 17.5 percent of the total population subject to receive the reports. Six of the nineteen vendors received individual reports because they had less than five requests pending. An individual report was a form letter advising the vendor of the specific action being taken regarding its request. Six of the nineteen vendors did not receive status reports because the items were not priorities 1 or 2. However, ASO advised the six vendors that the parts were low dollar value items or that a pending procurement requirement did not exist for the items and that their requests would be reviewed when they satisfied the priority 1 or 2 criteria. In August 1989, ASO representatives told us that the 90-day status reports would be

sent to all vendors despite the number of pending requests. We concluded that ASO's actions would implement the recommendation in Report No. 88-044.

Control of Source Approval Requests. The prior audit report recommended that ASO verify the accuracy of data on source approval requests in the management information system, establish input controls to ensure that the data base remains accurate, and reconcile the ASO and NAVAIR management information systems. In response, the Navy stated procedures would be developed to reconcile data in the ASO and NAVAIR management information systems every 30 days and that input controls would be reviewed to ensure accuracy of the data base. We found that ASO and NAVAIR were reconciling the data bases during monthly Buy Our Spares Smart meetings. In addition, the Navy had developed an on-line computer capability to monitor and reconcile requests. As of August 1989, this capability became operational at ASO, NAVAIR, and three NAVDEP's.

Inadequate physical accountability over the request packages while in NAVAIR's custody was another problem discussed in the prior audit report. Our followup audit showed that internal controls for safeguarding the packages had improved at NAVAIR. The prior procedures were inadequate because reviewing personnel were not required to sign for a package when it was in their custody. This deficiency has been corrected by implementing controls that require personnel involved in the technical review process to sign for the package when taking custody. NAVAIR improved internal controls by adapting the management information system to monitor the physical location of the packages. To test whether internal controls were effective at NAVAIR, we reviewed 16 request packages that were reported by ASO to be at NAVAIR for review. The 16 items represented NAVAIR'S entire inventory of packages as of June 1, 1989. The results of the test indicated that all 16 items were either physically located at NAVAIR or were properly signed for by other outside reviewing activities. Therefore, we concluded that the Navy has implemented corrective actions addressed in the prior audit report.

Pending Source Approval Requests Approved and Monetary Benefits Realized. The prior audit recommended that the Navy promptly qualify vendors that had requests pending as of October 1986 or advise them of the steps necessary to obtain approval. We estimated that timely approval of requests in-process as of October 1986, which would result in competitive acquisition of aircraft engine spare parts, could result in cost avoidances totaling $10.1 million. The Navy concurred in the recommendation, but did not agree with the projection of monetary benefits because requirements for several sample items had been canceled.

We determined that the Navy implemented the recommendation by subsequently approving 200 requests that were pending as of October 1986 and by disapproving another 136 requests. As of June 27, 1989, 61 requests that had been in-process in October 1986 were still pending. Generally, these requests were for parts that did not have an active procurement requirement or the forecasted annual buy requirement was less than $500,000.

To identify cost avoidances related to the approval of the 200 requests, we reviewed the cost avoidances that were computed and reported by ASO from October 1, 1986, through June 27, 1989, for breakout of spare parts. We determined that:

- the approval of a new source did not automatically result in the Navy claiming a cost avoidance;

- ASO's cost avoidance methodology generally excluded spare parts when new vendor sources were approved for parts that were already procured competitively; and

- 32 parts that had new sources approved, also had cost avoidances totaling $16.4 million reported as a result of breakout to competitive procurement.

We examined the contract files for the procurements of the 32 parts to determine whether the new approved source for the part submitted a responsive price proposal. We determined that vendors who had requests in process as of October 1986 and who were subsequently approved by ASO submitted responsive bids that resulted in the competitive procurement of 19 of the 32 parts. The competitive award of contracts on these 19 parts resulted in the Navy saving about $15.1 million.

Conclusion. The Navy implemented all agreed upon recommendations in the prior audit. Monetary benefits accruing to the Navy as a result of approving vendor requests that were in-process as of October 1986 were about $15.1 million, which is about $5.0 million greater than the potential $10.1 million cost avoidances that we estimated in our prior report would be saved. Overall, ASO significantly improved its management of the vendor technical qualification process for flight critical spare parts.

Management Comments

We provided a draft of this report to the Assistant Secretary of the Navy (Financial Management) on October 10, 1989. We received comments from the Assistant Secretary of the Navy (Shipbuilding and Logistics) on November 28, 1989. Enclosure 2 is the complete text of the comments.

The Navy stated that the $16.4 million in cost avoidances reported by ASO for the 32 procurements could not be attributed to the audit. The Navy stated that companies that did not have pending requests as of October 1986, accounted for 19 of the 32 procurements and about $9.4 million of the $16.4 million in cost avoidances. The Navy stated that the remaining $7.0 million of reported cost avoidances were primarily attributable to the ASO policy of expediting source approval requests relating to pending procurements. The Navy acknowledged that the additional attention drawn to these items by the audit may have guaranteed timely completion of the requests.

Audit Response to Management Comments

After reviewing the Navy's comments, we performed an additional analysis of the competitive procurement of the 32 parts and the related cost avoidances reported by ASO on the breakout of these parts. The Navy comment is correct that contracts for 13 of the 32 parts were awarded to vendors that had requests pending as of October 1986 and that contracts for the other 19 parts were awarded to vendors with no requests pending. Our analysis of the procurements of the 19 parts showed that vendors with requests pending as of October 1986 submitted responsive bids that resulted in the competitive procurements of 6 spare parts and cost avoidances totaling $8.0 million being reported on these procurements. We believe that the submission of a responsive price proposal is relevant in the determination of monetary benefits resulting from the approval of vendor requests. Our projection of $10.1 cost avoidances in Report No. 88-044 assumed that approval of a vendor request would result in competitive procurement. We did not assume that the vendor with the pending request would win the contract award. Accordingly, we revised the amount of the monetary benefits realized by the ASO's approval of the vendor requests that were in process to $15.1 million on 19 parts.

The Navy policy of expediting the processing of requests for spare parts with pending buy requirements contributed to the realization of the monetary benefits. The Navy's establishment of time standards for reviewing and approving requests, which we recommended be done during our prior audit, provided assurance that priority would be given to requests with pending procurement requirements. We were concerned that breakout savings might be lost on items with an immediate buy requirement. Therefore, the reported monetary benefits that the Navy attributed to this practice are also relevant for comparison purposes.

We are not claiming the $15.1 million cost avoidances as monetary benefits resulting from this audit. The audit validates that the Navy achieved cost avoidances in excess of the $10.1 million that we statistically projected could be saved by timely approval of the requests in-process as of October 1986.

In order to comply with DoD Directive 7650.3, we are requesting that the Navy evaluate our revised estimate of the monetary benefits related to the approval of requests that were pending as of October 1986, and provide final comments within 60 days of the date of this report. In order for your comments to be considered responsive, you must state concurrence or nonconcurrence with the estimated monetary benefits of $15.1 million. If you nonconcur with the monetary benefits or any part thereof, you must state the amount you nonconcur with and the basis for your nonconcurrence. Potential monetary benefits are subject to resolution in the event of nonconcurrence or failure to comment.

The cooperation extended to the audit staff is appreciated. If you have any questions on this audit, please contact Mr. Garold E. Stephenson on (202) 694-6275 (AUTOVON 224-6275) or Mr. Gary R. Padgett on (202) 694-3459 (AUTOVON 224-3459). A list of the audit team members is provided in Enclosure 4. Copies of this report are being distributed to the activities listed in Enclosure 5.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

cc:
Secretary of the Navy

COMPARATIVE SCHEDULE OF PRIORITIZED SOURCE APPROVAL SCREENING METHODS

Prioritized Schedule for Source Approval Screenings in Effect during Prior Audit Project No. 6AP-810

Priority	Description
1A	Pending requirement: award being held pending response (value is $500,000 or more).
1B	Same as 1A, except value is less than $500,000.
2A	Pending requirement: buy about to be generated (value is more than $500,000).
2B	Same as 2A, except value is less than $500,000.
3	Routine: no immediate procurement pending.

Prioritized Schedule for Source Approval Screenings in Effect during Current Audit Project No. 9AP-5017

Priority	Description
1	Active procurement requirement (value is $500,000 or more).
2	Active procurement requirement (value is more than $55,000, but less than $500,000).
3	Projected annual requirement (value is $500,000 or more).
4	Projected annual requirement (value is more than $55,000, but less than $500,000).

DEPARTMENT OF THE NAVY
THE ASSISTANT SECRETARY OF THE NAVY
(SHIPBUILDING AND LOGISTICS)
WASHINGTON, D.C. 20360 5000

28 NOV 1989

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR GENERAL FOR AUDITING

Subj: DRAFT REPORT ON THE FOLLOWUP AUDIT OF VENDOR TECHNICAL QUALIFICATION PROCESS FOR AIRCRAFT ENGINE SPARE PARTS PROCURED BY THE NAVAL AVIATION SUPPLY OFFICE (PROJECT NO. 9AP-5017)

Encl: (1) Navy Comments

In reply to your memorandum of 10 October 1989, we concur that savings accrued due to approval of source approval requests (SAR). However, we are unable to attribute specific savings to the audit. We believe that SAR's not reviewed during the audit accounted for more than half of the reported savings and an existing ASO policy of expediting SAR's for "live buys" was primarily responsible for the balance of identified savings.

Our detailed comments are in enclosure (1).

Frank Swofford

FRANK W. SWOFFORD
By Direction of the Secretary of the Navy

Copy to:
NAVINSGEN
NAVCOMPT (NCB-53)

NAVY COMMENTS
ON
DODIG DRAFT REPORT ON THE FOLLOWUP AUDIT OF
VENDOR TECHNICAL QUALIFICATION PROCESS FOR AIRCRAFT
ENGINE SPARE PARTS PROCURED BY THE NAVY AVIATION SUPPLY OFFICE
(PROJECT NO. 9AP-5017)

DODIG conclusion: Monetary benefits accruing to the Navy as a result of approving vendor requests that were in-process as of October 1986 were about $16 4 million, which is about $6 3 million greater that the $10.1 million in potential cost avoidances that we projected would be saved. Overall, the Aviation Supply Office (ASO) significantly improved its management of the vendor technical qualification process for flight critical spare parts

Navy comment: We concur that savings accrued due to approval of source approval requests (SARs); however, we cannot confirm that benefits were the result of the audit review The draft audit report (page 7) states "The approval of 200 vendor source approval requests that were pending as of October 1986 and the subsequent competitive award of contracts on 32 different parts resulted in the Navy saving about $16.4 million." Nineteen of the 32 spare parts contracts were not awarded to companies with "pending" SARs as of October 1986 For instance, the pending SAR from TRW Incorporated for National Stock Number (NSN) 2840-00-033-7270 was received Julian Date (JD) 85233 and approved JD 86244. However, the successful source, Howmet, SAR was received JD 85004 and approved JD 85150. ASO reported cost savings of $1,087,879 The pending SAR from Howmet for NSN 2840-01-090-0104 was received JD 85119 and approved JD 86316. However, the successful SAR from Chromalloy was received JD 87140 and approved JD 88126. ASO reported cost savings of $7,499,790. Total savings on the 19 cases where contracts were awarded to vendors with no "pending" SARs as of October 1986, accounted for $9,436,994 of the $16.4 million in reported cost avoidance *

For the remaining $7.0 million, we believe that savings are primarily attributable to the ASO policy of expediting SARs related to "live buys." However, the additional attention drawn to these items by the audit might have guaranteed timely completion of the requests. In addition, intangible benefits were realized which include fewer contractor complaints due to non-receipt of status reports, decreased manual review of status for contractors and activities involved in the approval process and notable reduction in efforts and time required to request additional data.

* Revised text on page 6 and 7.

SUMMARY ON POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM THE AUDIT

Recommendation Reference	Description of Benefits	Amount or Type of Benefits
None	None	None*

* The monetary benefits ($10.1M) are identified in Office of the Assistant Inspector General for Auditing, DoD, Report No. 88-044, which was our initial audit of the Navy's vendor source approval request decision process.

AUDIT TEAM MEMBERS

Lawrence Weintrob, Director, Contract Management Directorate
Garold E. Stephenson, Program Director
Gary R. Padgett, Project Manager
Joe E. Richardson, Lead Auditor
Leron A. Mims, Auditor

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