DEPARTMENT OF DEFENSE

AUDIT REPORT

SPARE PARTS PRICING AGREEMENTS

90-062

MAY 3, 1990

Office of the Inspector General

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

May 3, 1990

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS)
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on the Audit of Spare Parts Pricing Agreements (Report No. 90-062)

This is our report on the Audit of Spare Parts Pricing Agreements. The audit was made from February through October 1988. The overall objectives were to determine whether spare parts pricing agreements between DoD buying centers and Defense contractors were being inappropriately used to circumvent the Federal Acquisition Regulation (FAR) requirement for the submission of certified cost or pricing data and whether these agreements resulted in the overpricing of spare parts contracts. The audit was requested by the Defense Contract Audit Agency (DCAA) because of problems it found during a defective pricing review. The results of 16 defective pricing reviews performed by DCAA on orders issued under spare parts pricing agreements are included in this report.

The audit verified that spare parts pricing agreements were misused and often resulted in overpricing. Spare parts pricing agreements were used to place nonrecurring, high dollar value orders without satisfying the FAR requirement for the submission of certified cost or pricing data. Also, four buying commands could have saved $15.3 million by consolidating orders, and pricing orders with certified cost or pricing data. In addition, spare parts were not broken out for direct buy from the actual manufacturer or for competitive purchase. The results of the audit are summarized in the following paragraphs, and the details and audit recommendations are in Part II of this report.

DoD buying activities misused call contract arrangements and Basic Ordering Agreements (BOA) by negotiating prices for spare parts at the time that arrangements or agreements were established rather than when individual contracts (BOA orders) were issued. These orders, while exceeding the threshold for certified cost or pricing data, were priced with data that were not current at the time of the issuance of the orders. Similar conditions were found in requirements contracts that incorporated the same clauses found in call contract arrangements. We found defective pricing of

$835,202 on four orders we audited. Separate defective pricing reports will be issued for the orders and contracts we reviewed. We also found eight orders (requirements contracts) to be overpriced by $1,036,611. Additionally, DCAA found defective pricing totaling $6.1 million for all of the 24 orders audited. In total, 36 of the 47 orders reviewed were overpriced by $8 million. We recommended that the Assistant Secretary of Defense (Production and Logistics) issue a policy memorandum discouraging use of prepriced Basic Ordering Agreements. We recommended that the Assistant Secretary of the Air Force (Acquisition) direct buying activities to discontinue using call contract arrangements to purchase spare parts. We also recommended that the Commander, U.S. Army Aviation Systems Command, require submission of certified cost or pricing data on contracts (BOA orders) over $100,000, in compliance with FAR provisions. Recommendations were also made to the Commander, San Antonio Air Logistics Center, to discontinue use of call contract arrangement clauses in requirements contracts, to obtain current cost data to reprice orders under requirements contracts, and to obtain audit analyses of updated contractor proposals. We projected that the DoD could avoid costs of at least $4.8 million and as much as $39 million over 2 years by requiring the submission of certified cost or pricing data at the time of agreement on contract (BOA order) price (page 5).

Major buying commands repeatedly split requisitions into single line item orders or failed to consolidate purchases and avoided the requirements for the submission of certified cost or pricing data under U.S.C., title 10, section 2306a. As a result, contracts and orders have been overpriced. We estimated that $15.3 million of overpricing could have been avoided through consolidated purchases. We recommended that the Commanders, Oklahoma City Air Logistics Center, U.S. Army Aviation Systems Command, and U.S. Navy Aviation Supply Office, consolidate purchases in compliance with their individual service instructions and establish adequate internal controls to ensure compliance with their instructions (page 15).

Major buying commands included spare parts in pricing agreements for use on contracts when those parts should have been broken out for direct buy from the actual manufacturer or purchased competitively. We found 65 parts on 6 contracts that were not broken out, thereby costing the DoD an additional $42.5 million for prime contractor burden expenses and profit. We recommended that the Commanders, San Antonio Air Logistics Center, and U.S. Army Aviation Systems Command, break out spare parts for direct buy or competitive purchase, in compliance with the Defense Federal Acquisition Regulation Supplement, Parts 217.7203-04 and Supplement No. 6, and establish internal controls to ensure compliance with this policy. We estimated that the DoD could avoid prime contractor costs of $18.4 million over the next 2 years if parts are bought directly from the manufacturer (page 23).

Internal controls were evaluated as applicable to the stated audit objectives. The audit identified an internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Adequate procedures were not established to ensure that purchase requirements were combined when feasible and that spare parts were subjected to breakout analysis. Recommendations B.1. through B.3. and C.1., when implemented, will correct this weakness. We could not determine the monetary benefits to be realized by implementing Recommendations B.1. through B.3. because the amount of future consolidated purchases and spare parts eventually broken out for direct or competitive purchase could not be quantified. A copy of this report will be provided to the senior officials responsible for internal controls within DoD and the Military Departments. Internal controls were adequate except for those previously discussed.

A draft of this report was provided to the Assistant Secretary of Defense (Production and Logistics); Assistant Secretary of the Army (Financial Management); Assistant Secretary of the Navy (Financial Management); Assistant Secretary of the Air Force (Financial Management and Comptroller); Director, Defense Logistics Agency; and Director, Defense Contract Audit Agency on September 27, 1989. Management comments and audit responses thereto are summarized after each finding. The complete texts of management comments are provided in Appendix P through Appendix S.

Draft report Recommendation A.1. was made to the Deputy Assistant Secretary of Defense for Procurement to revise the Defense Federal Acquisition Regulation Supplement to state that orders placed against BOA's be priced at the time the order was issued. The Office of the Assistant Secretary of Defense (Production and Logistics) nonconcurred with Recommendation A.1. and submitted a revised response which proposed, as an alternative, to issue a policy memorandum to the Services and Defense agencies. We agreed with this alternative corrective action and revised Recommendation A.1. to recommend that the policy memorandum discourage the use of prepriced BOA's in circumstances where quantities could not be accurately forecasted, where repetitive high quantity/high dollar volume orders were anticipated, and where orders would be used to fill nonrecurring requirements. We further recommended that the policy letter address the need to place a 1-year limitation on prices included in the prepriced BOA's and emphasize the need to obtain current cost or pricing data on subsequent renewals of annual price lists or when contractor actions, such as accounting system changes, could modify unit prices.

The Air Force provided unsolicited comments to Recommendation A.1. The Air Force partially concurred in Recommendation A.2. by stating that the San Antonio Air Logistics Center no longer issues call contract arrangements now that the Air Force coverage on call contracts was deleted from the Air Force Federal Acquisition Regulation Supplement. However, we

believe this response does not satisfy the intent of Recommendation A.2. because indications still exist that other Air Force commands were attempting to issue call contracts.

The Air Force partially concurred in Recommendation A.4.a., and stated that call contract arrangements clauses were not being incorporated into requirements contracts. However, our audit found that such clauses were included in Air Force requirements contracts. In response to Recommendation A.4.b., the Air Force stated that requirements contracts generally do not allow for resetting of prices during the life of the contract. However, our audit found that requirements contract F41608-85-D-A011 allowed for repricing of orders and that requirements contract F41608-85-D-A007 was not properly repriced to incorporate the contractor's accounting system changes. Similarly, the Air Force stated, in response to Recommendation A.4.c., that it was unaware of any instances where SAALC was not complying with regulatory requirements to obtain updated audit assistance. This comment was unresponsive, conflicted with our audit results, and was contrary to the fact that the SAALC was informed on several occasions, through defective pricing reports issued by the Defense Contract Audit Agency, that they were not complying with FAR sections 15.805 and 15.808.

The Air Force nonconcurred with Finding B but concurred in Recommendation B.1.a. through B.1.c. However, we believe the Air Force comments are unresponsive to Recommendations B.1.a. and B.1.b. because it did not provide specific corrective actions.

The Air Force partially concurred with Finding C but stated that the finding and recommendations should be deleted from the report. While SAALC has achieved commendable strides in the spares breakout program, we believe that Finding C and Recommendations C.1. and C.2. are valid for the contracts we examined during the audit.

We request that the Air Force reconsider its response to Recommendations A.2., A.4.a., A.4.b., A.4.c., B.1.a., B.1.b., C.1. and C.2. in reply to the final report.

The Army commented that it was preparing an overall position on the draft report findings and recommendations. However, we did not receive a response to the draft report recommendations prior to issuance of this final report. We request that the Army respond to Recommendations A.3., B.2., C.1. and C.2.

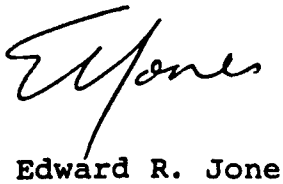
The Navy provided unsolicited comments on Recommendation A.1. The Navy concurred in Recommendation B.3.a., but nonconcurred in Recommendation B.3.b. to hold purchase requisitions for the same or similar items in suspense for a reasonable period of time to consolidate into economic order quantities. The Navy stated that because forecasting techniques were used to estimate the volume of orders, a hold period was

unnecessary. We maintain that a reasonable hold period would complement forecasting techniques for consolidating requirements into economic order quantities, and we request that the Navy reconsider its position regarding Recommendation B.3.b. in response to the final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved within 6 months of the date of the final report. In order to comply with this Directive, we request that all addressees provide us a final position on the recommendations addressed to them within 60 days of the date of this report. These comments should indicate concurrence or nonconcurrence with the results of review, potential monetary benefits, and each of the recommendations as applicable. We also ask that your comments indicate concurrence or nonconcurrence with the internal control weaknesses described above. For those recommendations with a position of concurrence, describe the actions taken or planned, completion dates of actions already taken, and the estimated dates of planned actions. If appropriate, please describe alternative actions proposed to achieve the desired improvements. For those positions of nonconcurrence, please state the specific reasons for the position taken.

The Army and the Navy did not comment on the potential monetary benefits of Recommendations A.1. through A.4. and C.1. The Air Force disagreed with the potential monetary benefits. We believe that these benefits are valid for reasons discussed in Part II of the report; therefore, we ask that the Military Departments provide final comments on the estimated monetary benefits, identified in Appendix O, of $5,514,957 for Army programs, $136,655 for Navy programs, and $17,526,827 for Air Force programs. Potential monetary benefits are subject to mediation in the event of nonconcurrence or failure to comment.

We appreciate the courtesies and cooperation extended to the staff during the audit. A list of team members who participated in this audit is shown in Appendix T. Please contact either Mr. Bruce A. Burton, Project Manager, at (202) 694-8173 or Mr. Salvatore D. Guli, Program Director, at (202) 694-6285 if you have any questions. Appendix U lists the distribution of this report.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force
Director, Defense Acquisition Regulatory Council
Director, Defense Logistics Agency
Director, Defense Contract Audit Agency

REPORT ON THE AUDIT OF SPARE PARTS PRICING AGREEMENTS

TABLE OF CONTENTS

	Page
TRANSMITTAL MEMORANDUM/EXECUTIVE SUMMARY	i
PART I - INTRODUCTION	1
Background	1
Objectives and Scope	1
Prior Audit Coverage	2
PART II - FINDINGS AND RECOMMENDATIONS	5
A. Use of Spare Parts Pricing Agreements	5
B. Consolidating Spare Parts Purchase Requirements	15
C. Breakout of Spare Parts	23
APPENDIXES	See next page

Prepared by:
Contract Management Directorate
Project No. 8CE-5001

LIST OF APPENDIXES

APPENDIX A -	Activities Visited or Contacted	31
APPENDIX B -	Summary Listing of Contract Actions Containing Price Lists	33
APPENDIX C -	Defective Pricing Reported on Spare Parts Pricing Agreements with United Technologies Corporation (Pratt and Whitney)	35
APPENDIX D -	Defective Pricing Reported on Spare Parts Pricing Agreements with Bell Helicopter Textron, Inc.	37
APPENDIX E -	Defective Pricing/Overpricing of General Electric Company Aircraft Engine Business Group Contracts	39
APPENDIX F -	Overpricing of General Motors Corporation-Allison Gas Turbine Division Contract	43
APPENDIX G -	Sample of Unconsolidated Spare Parts Purchase Requests Issued by the Oklahoma City Air Logistics Center	45
APPENDIX H -	Sample of Unconsolidated Orders Issued by the U.S. Navy Aviation Supply Office	47
APPENDIX I -	Computations of Estimated Lost Savings	49
APPENDIX J -	Computations of Excessive Costs on Breakout Parts at Pratt and Whitney	51
APPENDIX K -	Summary of Excessive Costs on Breakout of General Motors Corporation Parts	53
APPENDIX L -	Computations of Excessive Costs on Breakout Parts at General Motors Corporation	55
APPENDIX M -	Computations of Excessive Costs on Breakout Parts at General Electric Company	61
APPENDIX N -	Computations of Excessive Costs on Breakout Parts at Bell Helicopter Textron, Inc.	65
APPENDIX O -	Schedule of Potential Monetary and Other Benefits Resulting from Audit	67
APPENDIX P -	Assistant Secretary of Defense (Production and Logistics) Comments	69

LIST OF APPENDIXES (Continued)

APPENDIX Q - Department of the Army Comments 73

APPENDIX R - Department of the Navy Comments 75

APPENDIX S - Department of the Air Force Comments 79

APPENDIX T - Audit Team Members 89

APPENDIX U - Final Report Distribution 91

REPORT ON THE AUDIT OF SPARE PARTS PRICING AGREEMENTS

PART I - INTRODUCTION

Background

Government buying offices and contractors often enter into spare parts pricing agreements to expedite the processing of multiple orders of spare parts and to reduce the workload associated with processing the orders. The buyer and seller agree on how to price individual spare parts before the orders are actually placed. The buyer and seller agree on a systematic approach for pricing parts in the future, which can extend to several years. Some agreements are based on the use of cost formulas or factors, and others are based on the use of price lists for specific parts. In either case, a primary objective of the agreement is to achieve fair and reasonable prices for covered spare parts. The agreement usually states that either party can cancel the agreement whenever a determination is made that the agreed-to prices may be outdated or inaccurate.

In 1986, the Assistant Secretary of Defense (Acquisition and Logistics) conducted a survey to determine the magnitude of using spare parts pricing agreements. The response to the survey revealed that the Navy did not use any agreements, the Army and the Defense Logistics Agency used only a few agreements, and the Air Force used many agreements. A General Accounting Office audit revealed that in FY 1985, the Air Force may have purchased $400 million in spare parts using advance pricing agreements.

During a defective pricing review at Pratt and Whitney, a division of United Technologies Corporation, the Defense Contract Audit Agency (DCAA) found procurement practices that it believed resulted in the overpricing of numerous spare parts procurements. The DCAA believed that the overpricing was the result of the pricing methodology developed in accordance with a Memorandum of Agreement between Pratt and Whitney and the Oklahoma City Air Logistics Center. The DCAA also raised concerns about a similar pricing methodology employed by the San Antonio Air Logistics Center. Our audit was made because DCAA referred these concerns to our office.

Objectives and Scope

Our objectives were to determine whether:

- spare parts pricing agreements between DoD buying centers and Defense contractors were being inappropriately used to circumvent the Federal Acquisition Regulation requirement for the submission of certified cost or pricing data, thereby waiving the Government's right to subsequent review and audit.

- spare parts pricing agreements had resulted in the overpricing of spare parts contracts.

This economy and efficiency audit was made from February through October 1988. The audit was made 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 the internal controls as were considered necessary. The audit identified an internal control weakness as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Of the four contractors included in the audit, two were audited by us and two were audited by DCAA. We reviewed records from 1984 through 1988. The audited contractors were the four largest users of agreements for pricing spare parts, according to information provided by the Military Departments. The audit included reviews of the 47 largest dollar value orders selected to determine whether the failure to obtain certified cost or pricing data resulted in overpricing of spare parts orders. The DCAA performed routine postaward audits of 24 orders and we reviewed 23 orders. We have included the results of the DCAA reviews in this report. We reviewed contractors' proposals to the Government, preaward and postaward audit reports issued by the DCAA, pricing reports issued by the cognizant contract administration office, Government price negotiation memorandums, and contractors' accounting records. In addition, we reviewed requisitions, solicitations, and contract documents from the buying offices. Activities visited during the audit are listed in Appendix A.

Prior Audit Coverage

The Summary Report on the Followup Defense-wide Audit on Procurement of Spare Parts, February 17, 1987, showed that implementation of procurement initiatives has resulted in improvements in the acquisition of spare parts. Only 28 percent of parts in the followup review was determined to be unreasonably priced compared to 38 percent in the May 1984 audit. A recommendation was made that the Under Secretary of Defense (Acquisition) establish a policy to require procuring activities to record the basis for price/reasonableness determinations in their spare parts procurement history.

DoD Inspector General Report No. 85-081, "Audit of Aircraft Engine Spare Parts Pricing, Costing, Negotiation and DoD Review Functions," March 21, 1985, found that Navy and Air Force buying centers did not effectively use the services of DoD field support organizations and that support organizations did not provide timely or adequate services. We recommended that the Navy and Air Force seek price adjustments, use annual spare parts pricing factors, change contract language on accelerated delivery orders, and use fixed-price contracts with economic price adjustment clauses. We also made recommendations to require that field pricing reviews be performed when necessary and that DCAA

establish mandatory reviews of spare parts requirements contracts and forward pricing rate agreements. Actions were taken to correct the conditions cited in the report.

The DoD Inspector General also issued the DoD-wide "Audit of Procurement of Spare Parts," May 25, 1984, which found that from a random sample of 2,300 spare parts, 823 items were purchased by DoD at unreasonable prices. Corrective actions were already in process and no recommendations were made.

General Accounting Office Report, OSD Report No. NSIAD 86-18, "SPARE PARTS PRICING - Inappropriate Use of Rate Agreements," January 1986, found that procurements were overpriced because buyers relied on outdated rate agreements to determine whether prices were fair and reasonable. The conditions were presented to the San Antonio Air Logistics Center, immediate corrective actions were taken, and no recommendations were made.

The Air Force Audit Agency issued Report No. 410-9-1, "Purchase Request Processing," on October 3, 1988. The report found that the San Antonio Air Logistics Center could improve the consolidation of spare parts orders by combining procedural guidelines into a single operating instruction, using the guidelines for training item managers and supervisors, and using more effectively the automated system for consolidating spare parts. These conditions were presented to the buying center and corrective actions were in process at the time of our audit.

The cognizant DCAA offices for the four contractors included in our audit have a continuous program of audits at each of those contractors. We incorporated the results of DCAA's postaward audits performed at Bell Helicopter Textron, Inc., and Pratt and Whitney, a division of United Technologies Corporation.

PART II - FINDINGS AND RECOMMENDATIONS

A. Use of Spare Parts Pricing Agreements

FINDING

DoD buying activities have misused call contract arrangements and Basic Ordering Agreements (BOA's) by negotiating prices for spare parts when the arrangements or agreements were originally established rather than at the time individual contracts (BOA orders) were issued. Similar conditions existed in requirements contracts that incorporated the same clauses found in call contract arrangements. In addition, other requirements contracts were repriced without obtaining current cost or pricing data. These conditions were caused by the activities' noncompliance with Federal Acquisition Regulation (FAR), subpart 16.7. As a result, spare parts orders we reviewed were priced with noncurrent data and overpriced by $8 million. We projected that at least $4.8 million and as much as $39 million could be saved over the next 2 years if our recommendations are implemented.

DISCUSSION OF DETAILS

Background. FAR provides procedures for obtaining certified cost or pricing data when individual contract actions and advance agreements are involved. FAR 15.804-2 requires the submission of certified cost or pricing data for pricing actions expected to exceed $100,000, unless those actions are exempted or requirements are waived. Exemptions or waivers may be granted when adequate price competition exists, prices are based on catalog or market prices of items sold in substantial quantities to the general public, or prices are set by regulation or law. In addition, FAR 15.804-4(g) states that a certificate of current cost or pricing data shall not be required upon completing negotiations of forward pricing rate agreements or other advance agreements. When a forward pricing rate agreement or other advance agreement is used in partial support of a later contractual action that requires a certificate, the price proposal certificate shall include the data originally supplied to support the forward pricing rate agreement and all data required to update the price proposal to the time of agreement on contract price.

FAR also discusses two commonly used contracting mechanisms for procuring spare parts: indefinite delivery requirements contracts (requirements contracts) and BOA's. FAR subpart 16.5 states that requirements contracts may be used when the Government anticipates recurring requirements, but cannot determine the precise quantities of supplies or services that will be needed. Under requirements contracts, the Government agrees to obtain all requirements from that contractor. FAR 16.703 provides that a BOA is a written understanding negotiated between an agency, a contracting activity, or a contracting office and a contractor that contains terms and clauses applicable to future contracts

(BOA orders). A description of the supplies to be provided and the methods for pricing, issuing, and delivering future orders is also normally included in these agreements. The BOA, however, is not a contract. Only the individual orders issued under BOA's are contracts. BOA's and requirements contracts are subject to the provisions of FAR 15.804-2, which requires the submission of certified cost or pricing data for individual pricing actions expected to exceed $100,000.

Air Force buying commands use another contracting mechanism for procuring spare parts; namely, a call contract arrangement. This arrangement is not included in the FAR, but is explained in the Air Force FAR supplement as an agreement containing a specific description of the supplies or services to be furnished. The agreement does not contain specific quantities or delivery dates and operates similar to a basic ordering agreement. The Air Force deleted the call contract arrangement from the Air Force FAR supplement in April 1988 because it believed that the arrangement was nothing more than a requirements contract and that separate Air Force coverage was not necessary. However, the Air Force continued to use call contracts.

Details of the Audit. Buying activities negotiated unit prices and incorporated price lists into call contract arrangements, BOA's and requirements contracts to price spare parts. Certified cost or pricing data were not obtained to price each order at the time the orders were issued. These "price-list" arrangements included contract clauses stating that orders issued under these arrangements would become binding contracts when the contracting officer issued orders.

Pricing Arrangements, Agreements, and Contracts. We reviewed the procurement files for 12 contracting mechanisms identified at 3 buying commands to examine contract provisions and methods for pricing selected orders. These actions consisted of two call contract arrangements, seven basic ordering agreements, and three requirements contracts, at the U.S. Army Aviation Systems Command (AVSCOM), the U.S. Navy Aviation Supply Office (ASO), and the San Antonio Air Logistics Center (SAALC). We found that although contracting mechanisms were used to purchase spare parts, all 12 contracting mechanisms included orders that were priced without the submission of current certified cost or pricing data. In each case, order prices were based on price lists established at the time the call contracts, BOA's, and requirements contracts were awarded.

The SAALC issued the two call contract arrangements. The arrangements included contract clauses indicating that orders issued would become binding contracts when the contracting officer issued a unilateral order. The orders were then priced in accordance with the price lists included in the call contract arrangement. Similar provisions were included in one SAALC

requirements contract. Two other SAALC requirements contracts included orders that were priced without updated price lists and were not based on current cost or pricing data.

AVSCOM issued five BOA's that were priced with methods similar to the call contract arrangement and based on AVSCOM's legal interpretation of FAR requirements for obtaining cost or pricing data on BOA's. The orders we evaluated under the five BOA's were not priced with current cost or pricing data. Despite AVSCOM's legal interpretation, some AVSCOM procurement officers did require contractors to submit current cost or pricing data for orders exceeding $100,000. However, a clear and consistent application of this principle is needed. Similarly, the ASO issued orders under two BOA's that were priced on the basis of a price list and not on current cost or pricing data at the time the orders were issued. ASO has discontinued this practice. Appendix B provides a summary listing and explanatory footnotes on the 12 contract actions reviewed.

Legal Interpretations. When price-list arrangements were first introduced, varying legal interpretations were issued concerning the question: "When should certified cost or pricing data be obtained from the contractor?" AVSCOM's legal office proposed one interpretation in February 1987, on orders issued under a BOA with Bell Helicopter Textron, Inc. The February 1987 interpretation stated that a certificate of current cost or pricing data was required at the time orders exceeding $100,000 were issued. This opinion was reversed in August 1987 when AVSCOM's attorneys stated that there was no statutory or regulatory requirement that certificates be obtained when orders exceeded $100,000, if the price list was certified. The prevailing interpretation by the DoD commands visited during our audit was that certificates should be obtained at the time of agreement on unit prices rather than when orders were placed.

FAR 15.804 specifically requires the submission of a certificate of current cost or pricing data for each contract expected to exceed $100,000. A price list does not constitute agreement on contract price. BOA's and hybrid forms of BOA's, such as call contracts, are agreements or arrangements that provide the terms and conditions for future contracts represented by the placement of individual orders.

Prepriced BOA's and call contract arrangements preempted the submission and use of certified cost or pricing data on numerous spare parts orders. This was exemplified when the SAALC issued an order, valued at $81.1 million, for 127,808 blade assemblies under BOA F41608-84-G-0016. In this case, even the contractor, in a memorandum to the contracting officer, doubted the advisability of issuing the order without a submission of current cost or pricing data. The following quote is taken from an internal memorandum issued by a contract manager at Pratt and Whitney.

> I conveyed yesterday to . . . (SAALC) my concern regarding the need to certify the procurement of the $85M ACF Blade order that they are about to place with us under the Fact System. I told him that I really doubt that a DD633 and certifications were not required to prepare the order . . . .

Cost Analyses. We selected 47 of the largest dollar value orders issued against 9 contracting mechanisms awarded to 4 contractors by SAALC, AVSCOM, and ASO. These contractors, the four largest users of spare parts pricing agreements, were United Technologies Corporation (Pratt and Whitney); Bell Helicopter Textron, Inc.; General Electric Company - Aircraft Engine Business Group; and General Motors Corporation - Allison Gas Turbine Division. The Defense Contract Audit Agency (DCAA) made defective pricing reviews on 24 of the orders issued to Pratt and Whitney and Bell Helicopter Textron, Inc., under two call contract arrangements and two BOA's, valued at $177 million, and found defective pricing of $6.1 million. DCAA reported that all 24 orders were defectively priced. DCAA's rationale was that in the absence of a certificate of current cost or pricing data, the date of the order was the date of final agreement on price and the effective date of the contractor's responsibility for submission of cost or pricing data. The results of DCAA's defective pricing audits are summarized in this report. We used similar rationale to perform cost analyses on the other 23 orders, issued under two BOA's and three requirements contracts to the General Electric Corporation and General Motors Corporation, to determine if the orders were overpriced. Our analyses revealed defective pricing of $835,202 on four orders issued under the BOA's and one requirements contract and overpricing of $1,036,611 on eight orders issued under two requirements contracts. We plan to issue separate reports of defective pricing on the four defectively priced orders. Combined defective pricing (DCAA and DoD Inspector General) totaled $6.9 million and total overpricing was $8 million. Detailed computations and explanatory footnotes are shown in Appendixes C through F.

Statistical Projection. Using statistical projection techniques, we estimated that at least $4.8 million and as much as $39 million will be lost in the next 2 years if corrective action is not taken. The projection of $4.8 million for the next 2 years is based on an extrapolation of the $8 million in overpricing found on the 36 orders that were found to be defectively priced. Estimated overpricing of $39 million results from extending the overpricing on the orders reviewed to the total value of estimated future orders and projecting that overpricing over the next 2 years.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Assistant Secretary of Defense (Production and Logistics) issue a policy memorandum to the Services and Defense agencies that discourages the use of prepriced Basic Ordering Agreements in circumstances where:

a. accurate quantities cannot be forecast;

b. large volume, high dollar value orders will be issued over an extended period of time without the benefit of current cost or pricing data,

c. orders for high volume, nonrecurring requirements will be issued,

d. time limits of 1 year are placed on prices included in each prepriced BOA, and

e. there is a need to obtain current cost or pricing data for pricing each subsequent annual renewal of the price list or when the contractor institutes actions, such as accounting system changes, that could change unit prices.

2. We recommend that the Assistant Secretary of the Air Force (Acquisition) direct buying commands to discontinue using existing call contract arrangements, and to discontinue placing future call contract arrangements to purchase spare parts.

3. We recommend that the Commander, U.S. Army Aviation Systems Command, require certified cost or pricing data on contracts (Basic Ordering Agreement orders) exceeding $100,000, issued against basic ordering agreements, in compliance with Federal Acquisition Regulation 15.804-2.

4. We recommend that the Commander, San Antonio Air Logistics Center:

a. Discontinue incorporating call contract arrangement clauses in indefinite delivery requirements contracts.

b. Obtain certified cost or pricing data to reprice orders under indefinite delivery requirements contracts when the contracts allow resetting of fixed-unit prices or when prices are redetermined based on contractor accounting changes.

c. Obtain audit analysis of updated contractor proposals.

MANAGEMENT COMMENTS

Assistant Secretary of Defense (Production and Logistics). On December 4, 1989, the Assistant Secretary of Defense (Production and Logistics) (ASD[P&L]) issued comments on the draft

report in which he nonconcurred with Finding A and Recommendation A.1. The Assistant Secretary did not agree with our interpretation of Federal Acquisition Regulation 15.804. The response interpreted this section to allow certified price lists to be incorporated into Basic Ordering Agreements for later use on contract pricing actions. The response stated, in part, that ". . . certified cost or pricing data are required before . . . the award of any negotiated contract . . . expected to exceed $100,000." The response further stated that "the certified price list clearly constitutes a definitive final agreement on price as constituted by FAR 15.804-2(b)(2)." On December 14, 1989, representatives of our office met with representatives of ASD(P&L) to discuss the response. At that meeting, we clarified that these agreements were improper when used for extensive time periods, for very large single pricing actions, and for nonrecurring purchases. The ASD(P&L) representatives agreed that there was a problem that needed to be addressed and agreed to issue a revised response to our report. We also noted that the Services had different interpretations of the pertinent FAR clauses. The ASD(P&L) issued a revised response on January 25, 1990. In the revised response, ASD(P&L) offered to issue a policy letter to the Services and the Defense Logistics Agency urging caution in the use of prepriced BOA's particularly with regard to time periods and quantities. The complete texts of ASD(P&L) responses are included in Appendix P.

Air Force. The Assistant Secretary of the Air Force (Acquisition) did not agree with Finding A or Recommendation A.1. and partially concurred with Recommendations A.2. and A.4. The Air Force felt that the findings related to requirements contracts were incorrect; it also did not believe that the auditors understood the rationale for using call contract arrangements. The Air Force viewed a call contract as a combination of a requirements contract and a Basic Ordering Agreement. The Air Force disagreed with Recommendation A.1., which was directed to the Assistant Secretary of Defense (Production and Logistics), because it interpreted certification before the award of a contract action to include unit prices rather than total prices. It partially concurred with Recommendation A.2. to discontinue the use of call contract arrangements since the San Antonio Air Logistics Center was no longer using these arrangements and since call contract arrangements were deleted from the Air Force Federal Acquisition Regulation Supplement. The Air Force also partially concurred with Recommendation A.4. because it was not currently incorporating call contract clauses into requirements contracts. It stated that requirements contracts generally were not repriced and that, although it was a judgment call, it was unaware of any instances where it was not complying with the FAR concerning updated audit assistance. The complete text of the Air Force comments is shown in Appendix S.

Army. The Assistant Secretary of the Army (Research, Development and Acquisition) replied that the Army Aviation Systems Command's response to the recommendation was being staffed

to present the Army's overall position. We did not receive the consolidated Army position on Recommendation A.3. as of the final report date. The complete text of the Army's comments is shown in Appendix Q.

Navy. Although Recommendation A.1. was not addressed to the Navy, the Assistant Secretary of the Navy (Shipbuilding and Logistics) did not agree with the recommendation because the Navy viewed article price lists as a valuable tool for pricing recurring requirements and reducing administrative procurement lead time. The complete text of the Navy's comments is shown in Appendix R.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

Assistant Secretary of Defense (Production and Logistics). We believe that the revised response to Recommendation A.1. basically met the intent of the draft report recommendation. Accordingly, we revised Recommendation A.1., recommending that a policy memorandum be issued to address the concerns expressed in Finding A. However, the ASD policy letter should make it clear that price lists should not be used when accurate quantities cannot be forecast or when large or nonrecurring orders are anticipated. We believe that the intent for establishing price lists was to eliminate unnecessary administrative burden for recurring small quantity purchases within a reasonably established timeframe for readily forecast quantities. Therefore, it is important that quantities used in these agreements be reasonably accurate to allow for proper consideration of discounts associated with higher quantity purchases. Contractors should not be allowed to propose a unit price for a quantity of one if the forecast procurement is for a quantity thousands of times higher. The price list should be limited to a reasonably forecast timeframe and the price list should be terminated or repriced when conditions change, such as accounting system changes or price resetting. We believe if the policy letter provides the above guidance, then our concerns will be satisfied.

Air Force. We do not agree with the Air Force response and find that it is not entirely responsive to our recommendations. The Air Force's opinion that we did not understand requirements contracts or their reasons for using call contracts are not based on the facts of this finding. The problems that we documented for requirements contracts involved inappropriate uses of requirements contracts that allowed for resetting of prices without recertification, and negotiated costs in a manner inconsistent with an impending accounting change. In addition, these requirements contracts incorporated call contract provisions that allowed contractors to reject orders issued by the Government within 15 days. We do not find any fault with the normal method of contracting under a requirements contract, and we do not believe that our finding is inconsistent in that regard. The Air Force rationale for using the call contract did not agree with the AFFARS provisions (applicable at time of contract award) for using

call contracting. The AFFARS stated that call contracts should only be used when no other contracting mechanism is possible. It also gave examples of the types of items that would be appropriate for purchase under these agreements, such as emergency oxygen products. Clearly the intent of such agreements was for emergency situations where items were needed very quickly. This is also consistent with the rationale for using price lists. Price lists were designed to handle small, repetitive purchases without significant amounts of administration. However, the San Antonio Air Logistics Center used price lists to purchase large inventory quantities that were best suited to certified cost or pricing data. Buys were made for quantities up to 100,000 units at a time for prices in the tens of millions of dollars. These purchases were also inconsistent with SAALC reasons for using call contract arrangements, i.e., to allow breakout opportunities, since the Center often placed one order for large quantities that represented its full requirement for the part. The call contract mechanism also compounded the problem because there was no obligation to buy any quantity from the contractor. Contractors did not develop pricing beyond a minimum quantity when there was no assurance of any orders. In this case, the quantity used in pricing was one unit and as a result all economy of scale benefit was lost. Even if the contractor were to develop pricing on reasonable quantities, contract clauses allowed the contractor to reject any order if the pricing was disadvantageous to the company.

The Air Force partially concurred with Recommendation A.2., but its concurrence is not totally responsive to the recommendation. The Air Force stated that call contracts cited in the report have expired and that SAALC discontinued use of these arrangements. It also stated that AFFARS coverage has been deleted. We believe that other commands were also attempting to use call contracts. For example, at the time of our audit, the Air Force Logistics Center at Wright-Patterson Air Force Base was actively considering the use of multiyear call contract arrangements. We maintain that the Air Force should instruct the buying commands not to use these instruments. The expiration of the existing contracts and the deletion from the AFFARS does not ensure that our recommendation will be followed.

The Air Force partially concurred in Recommendation A.4., but it stated that call contract clauses were not incorporated into requirements contracts. It also stated that requirements contracts do not generally allow for repricing of orders. It further stated that it was not aware of instances where it had failed to comply with the FAR. In fact, our review found one requirements contract that did incorporate the call contract provision that allowed the contractor to reject orders. We also found one requirements contract that allowed for repricing of orders without recertification of the updated cost or pricing data. Further, the SAALC was informed on several occasions, through defective pricing reports issued by the Defense Contract

Audit Agency, that it was not complying with provisions of FAR 15.805 and 15.808, to request field pricing support, and to execute price negotiation memorandums, respectively.

We request that the Air Force reconsider its responses to Recommendation A.2. and A.4. in its reply to the final report.

Army. The Army did not provide comments to Recommendation A.3. Accordingly, we request that the Army provide a response to this recommendation in its reply to the final report.

Navy. We did not cite price lists as an inappropriate tool, but in fact cited buying activities for inappropriately using the tool. We agree that price lists can be a valuable tool for reducing administrative lead time. However, these price lists were used for large quantity purchases and nonrecurring purchases as well. In some cases, these lists were based on pricing for quantity of one or limited quantities when the actual purchases were much higher. In other cases, prices were not limited to reasonable timeframes and failed to consider anticipated accounting changes in the price negotiations. Price lists were clearly not designed to be used in this manner and timeframes and quantities should be clearly defined before using prepriced Basic Ordering Agreements incorporating price lists.

B. Consolidating Spare Parts Purchase Requirements

FINDING

Major buying commands repeatedly split purchase requisitions into single line item orders or failed to consolidate purchases and avoided the requirements for the submission of certified cost or pricing data under U.S.C., title 10, section 2306a. These conditions occurred because of inadequate internal control procedures. As a result, we estimated that $15.3 million was lost because orders were not consolidated.

DISCUSSION OF DETAILS

Background. Consolidation of procurement requirements can result in significant savings to the Government. Real cost savings can result from consolidating purchase requirements and by obtaining quantity discounts from vendors. Existing guidance on the consolidation of purchases is discussed in the following paragraphs.

FAR, paragraph 8.404-1(C), states that ordering offices should consolidate their requirements whenever possible to take advantage of lower prices normally obtained through definite quantity contracts for quantities exceeding the maximum order limitation.

FAR, paragraph 13.103(b), states, "requirements aggregating more than the small purchase dollar limitation shall not be broken down into several purchases that are less than the limit merely to permit negotiation under small purchase procedures."

The Defense Federal Acquisition Regulation Supplement, subsection 208.7003-6, states:

> The primary objective of coordinated acquisition is to obtain for the Government maximum economy through the consolidation of requirements and the elimination thereby of competitive purchases among the Departments. Further, the Contracting Department shall consolidate in one contract the requirement for the same or similar items.

Details of the Audit. We reviewed purchasing procedures and practices at four buying commands: the U.S. Army Aviation Systems Command (AVSCOM), the U.S. Navy Aviation Supply Office (ASO), the Oklahoma City Air Logistics Center (OCALC), and the San Antonio Air Logistics Center (SAALC). All of these commands except OCALC issued recent contracts with price lists to the four contractors included in our review. We also selected OCALC to review because DCAA identified this command as having previously issued spare parts pricing agreements. Policies at each buying command require that purchases be consolidated, where practicable. We found that the four buying commands did not fully comply with these policies and that three commands had inadequate internal controls over the

process for consolidating purchases. In some cases, it appeared that contracting officers split purchases to avoid requirements for submission and review of certified cost or pricing data. In other cases, contracting officers did not take advantage of opportunities to consolidate purchases. As a result, we projected that DoD lost $15.3 million that could have been saved through economies of scale and field price analyses of certified cost or pricing data.

Split Purchases. Three of the four commands that we reviewed split requirements and avoided the FAR dollar threshold requiring contractors to submit certified cost or pricing data.

The AVSCOM contracting office split Bell Helicopter's proposal numbers 85, 86, 87, and 88 on contract DAAJ09-88-G-A003, dated January 20, 1988, to ensure that individual orders would not exceed the FAR dollar threshold. This splitting was accomplished in accordance with Bell Helicopter's written instructions to AVSCOM. The contractor's January 20, 1988, proposal stated:

> Orders issued as a result of these proposals will include the statement "Certified cost or pricing data was not requested nor required. FAR 52.215-22 is not applicable to this delivery order." No more than one contract line item per order will be accepted against these priced items.

A detailed review of the January 20, 1988, price negotiation memorandum revealed that the proposed price was accepted on the same date the proposals were submitted. Further, single item orders were issued to ensure that orders did not exceed the FAR dollar threshold. The price for these single item orders was justified as follows.

> All of the FFP prices for the listed RFQ'S are low dollar values (under $100,000). Any orders placed for these parts at the prices shown should contain the following statement: "Certified cost or pricing data was not requested or required. FAR 52.215-22 is not applicable to this delivery order."

ASO's practices were basically the same as AVSCOM'S for Bell Helicopter. ASO split purchase requisitions in the same manner and included the same clauses in its orders. Specifically, we found that ASO split Bell's proposal, dated March 28, 1988. As a result, individual orders were not subject to the requirement for submission of certified cost or pricing data. On numerous occasions, ASO issued orders in which the aggregate value exceeded the FAR threshold. However, the contractor was not required to submit certified cost or pricing data because these orders contained the same contract clauses stating that certification was not required.

OCALC split the requirement for national stock number (NSN) 2840-00-406-2827PQ to keep the purchase amount for one order under the FAR dollar threshold. The estimated order quantity for this NSN was established at 720 units on February 7, 1986. If a single purchase was made, based on the purchase requirement, the amount of the purchase would have exceeded the FAR dollar threshold and required the contractor to submit cost or pricing data. In our review of OCALC records, we found that on May 7, 1986, a determination was made to split the requirement. The record stated:

> ADM Dec for Urgent walk-thru for 184 ea as buyer advised immed award could be made for PR less than $100,000 PR 86-29014 ($99,560.56) walk thru 6-10-86.

Accordingly, purchase requisition number 86-29014 was issued for 184 units and a purchase was made from the vendor at $436.58 per unit. The remaining 536 were purchased under two purchase requests in August and September 1986. Since these purchases exceeded $100,000, certified cost or pricing data were obtained and unit prices of $370 and $375 were negotiated. The uncertified order, based on purchase requisition 86-29014, was $66.58 and $61.58 higher than the two certified orders. The need for an urgent purchase and split of the estimated order quantity would have been avoided had the purchase requirement for 720 units been processed for procurement when the requirement was first identified.

Missed Opportunities to Consolidate Purchases. Buying commands failed to take advantage of opportunities to consolidate purchase requests and orders for the purchase of the same or similar spare parts. We reviewed 2,359 orders, valued at $287.8 million, at OCALC, AVSCOM, ASO, and SAALC. We found that these buying centers did not consolidate orders for which we projected lost savings of $15.3 million. We also discovered that OCALC could have consolidated purchase requests, received within 10-day intervals, into single purchase requests. These conditions were caused by inadequate internal controls over procedures for processing spare parts orders. The conditions and causes found at each buying center are discussed in the following paragraphs.

Contracting officer memorandums showed that it was OCALC's practice to consolidate spare parts orders up to but not exceeding the FAR dollar threshold requirement for contractors to certify cost or pricing data. An example of one memorandum is shown below.

> It is hereby determined to be in the best interest of the Government to consolidate priced orders against the OC-ALC and UTC, Pratt and Whitney Spare Parts Pricing Agreement up to but not exceeding $500,000. The result of this determination is that more orders will be issued but the administrative efficiency will be greatly enchanced by allowing orders to be issued

> in a timely manner. Only those items proposed in accordance with the Spare Parts Pricing Agreement and identified as Type "A" will be considered appropriate for this determination.

The practice was used because contracting officers misinterpreted the OCALC policy letter, dated January 13, 1987, to limit consolidation of purchase requests. In addition, OCALC was not combining spare parts items into a single purchase request, when feasible. We reviewed 24 purchase requests, issued within 10-day periods in FY 1988, against basic ordering agreement F34601-86-G-0254, and we found 10 instances where individual items could have been consolidated into single purchase requests. The details of the review are shown in Appendix G. This practice violated Headquarters, Air Force Logistics Command regulation 57-7, chapter 4, which required the grouping of items on the same purchase request as much as possible. OCALC did not comply with this regulation and issued numerous small orders that could have been consolidated.

We reviewed 155 orders (representing 222 purchase requests) and found that 142 orders (representing 209 purchase requests), valued at $7.4 million, could have been consolidated into 26 orders. For example, 15 orders (representing 15 purchase requests) under BOA F34601-86-G-0254 could have been consolidated into one order and may have resulted in lower prices based on contractor certified cost or pricing data.

Adequate internal controls were not in place to maximize consolidation of spare parts orders. Improvements in internal controls could include:

- a checklist to ensure that purchase requests are reviewed to determine if other purchase requirements are open,

- a checklist to determine if the spare parts order is based on the computer-generated economic order quantity computation and a statement justifying lower quantities, and

- installation of a computer system similar to the one used by SAALC to accumulate requirements for a set period of time.

At the time of our audit, AVSCOM was using single line item orders to avoid the requirement for the submission of certified cost or pricing data. Clauses in BOA's required either that single line item orders be made unless otherwise agreed to in writing, or that separate delivery orders be issued for items awarded as a result of a price list. Placing single line item orders was inconsistent with AVSCOM's March 29, 1985, policy for consolidating purchase requirements. AVSCOM'S Policy and Compliance Branch issued detailed guidance for consolidating requirements by stating:

> Long standing procurement policy places an unequivocal requirement on procurement personnel to consolidate identical/similar requirements into a single procurement action whenever practicable to ensure procurement of the most economic production quantities.

In addition, the policy letter clearly stated how the consolidation was to be performed, who was responsible and accountable for specific actions, and what records were to be reviewed to consolidate requirements. The contracting officer was responsible for consolidating actions and documenting files accordingly. We did not find any evidence indicating that the policy was implemented or widely practiced or that internal controls were established to ensure compliance with the policy.

ASO's practices were basically the same as AVSCOM'S. ASO issued single item orders in the same manner and included the same clauses in its orders.

We found four Bell Helicopter contracts that contained wording that limited orders to less than $100,000 and single line items. Our review of two of the four contracts showed that numerous orders were issued on the same day for one line item and for less than $100,000. Appendix H provides details of the review of some orders issued against two basic ordering agreements and shows that many orders could have been consolidated.

ASO practices were inconsistent with its guidelines and ASO failed to establish internal control procedures to ensure that purchase actions were combined. ASO purchasing director issued a policy letter, dated March 31, 1982, that provided specific guidelines for combining the same or similar items into one procurement so that substantial savings would be realized by the Government. However, these guidelines were not being followed. Internal control procedures could be improved by:

- establishing a checklist requiring the buyer to review the procurement history file to determine the current status of existing requisitions for the same or similar part, and

- implementing a system where purchase requisitions for the same or similar items are held in suspense for a reasonable period of time to maximize effort to consolidate into economic order quantities.

We found conditions at SAALC similar to those conditions found at the other three commands. Since the contracts reviewed and conditions found were similar to those reported by the Air Force Audit Agency (AFAA) in a recent report, the findings were not included in the details of this audit report. A discussion of the AFAA audit report is included in the Prior Audit Coverage section of this report.

Statistical Projection. We projected that $15.3 million of savings were lost in 1 year because the four buying commands' purchase requirements were not consolidated into economic quantity orders that would be priced based on the use of certified cost or pricing data. The projection covered the four buying offices included in our review. Details concerning lost savings attributable to each buying command are contained in Appendix I.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Commander, Oklahoma City Air Logistics Center, consolidate spare parts items into single purchase requirements in compliance with the Headquarters, Air Force Logistics Command's procedures and ensure compliance with that policy by:

a. Establishing internal control procedures to ensure purchase requests are checked against other purchase requirements.

b. Establishing internal control procedures to ensure spare parts orders are placed in economic order quantities.

c. Considering the use of a computer-based system for accumulating requirements.

2. We recommend that the Commander, U.S. Army Aviation Systems Command, implement established command policy to consolidate the same or similar purchase requirements into a single procurement action and establish adequate internal controls to ensure implementation and compliance with that policy.

3. We recommend that the Commander, U.S. Navy Aviation Supply Office, consolidate the same or similar purchase requirements into a single procurement action in compliance with established command policy and ensure compliance with that policy by:

a. Establishing adequate internal control procedures requiring the buyer to review the procurement history file to determine the current status of existing requisitions for the same or similar spare parts.

b. Implementing a system where purchase requisitions for the same or similar items are held in suspense for a reasonable period of time to consolidate into economic order quantities.

MANAGEMENT COMMENTS AND AUDIT RESPONSE

Air Force. The Assistant Secretary of the Air Force (Acquisition) nonconcurred with Finding B but concurred with Recommendation B.1.a. through B.1.c. In response to Finding B, the Assistant Secretary did not agree with our analysis on the issue of split buys, citing extenuating circumstances for

purchasing only a portion of the requirement. He also maintained that the requirement was split to maintain proper levels and that our reports implication that lower prices were obtainable through use of cost or pricing data was inaccurate.

We disagree with the Assistant Secretary's response and call attention to the determination, in the contract record, to split the requirement and avoid the $100,000 order level. The record stated . . . "buyer advised immediate award could be made for PR less than $100,000 PR 86-29014 ($99,560.56) walk through 6-10-86." The above comment suggests that the motive to split the requirement was not to maintain stock replenishment levels but to avoid requirements for pricing the buy with certified cost or pricing data. Further, we maintain that prices negotiated on the basis of cost or pricing data submissions often result in lower prices. This is evidenced by the Defense Contract Audit Agency whose statistics show an average of 5.8 percent price reduction when prices are negotiated based on cost or pricing data.

The Air Force also misinterpreted our discussion of the OCALC policy letter. We agree that the policy letter was issued to lessen administrative lead time and enhance customer support. However, buyers were misinterpreting this guidance to circumvent consolidation requirements. We strongly agree with the Air Force statement to remind buyers of the intended purpose of the policy letter.

We do not agree with the Air Force statement that unlike items should not be consolidated. While many items that we analyzed involved the consolidation of like or similar items, there were also a substantial number of unlike purchases involving single contractors where lead times would not have been adversely affected, but where consolidation would have provided the Government the protection of the Truth in Negotiation Act. We believe that it is imperative that buying offices look for opportunities to afford the Government this protection and savings.

The monetary projection in Finding B is not claimed as a monetary benefit and does not require concurrence or resolution. The complete text of the Air Force comments is shown in Appendix S.

Army. The Army did not provide comments to draft report Recommendation B.2. and was in the process of preparing a consolidated Army response to the draft report at the time this final report was issued. See Appendix Q for the complete text of the Army's reply. Accordingly, we request that the Army provide a response to this recommendation in its reply to the final report.

Navy. The Assistant Secretary of the Navy (Shipbuilding and Logistics) concurred with Finding B and Recommendation B.3.a. but nonconcurred with Recommendation B.3.b. The Assistant Secretary of the Navy agreed that the Aviation Supply Office (ASO)

was not following its internal guidelines to ensure that purchase actions were combined. He agreed that procedures needed to be established for buyers to review procurement history files to determine the current status of existing requisitions for the same or similar parts. He did not agree that a system should be implemented to hold purchase requisitions for a reasonable period of time to consolidate quantities. He felt that because the Navy used forecasting techniques, it was unnecessary to hold requisitions to consolidate orders.

We do not agree with ASN's nonconcurrence with Recommendation B.3.b. Other buying commands use forecasting philosophies and techniques similar to those used by ASO, and one of these commands has a computer-based system that holds requisitions for 21 days. The volume of transactions at ASO is so large that even a minimal hold period of 7 days would generate consolidation savings and certainly would have little impact on administrative lead time.

We believe that the Navy should reconsider its response to Recommendation B.3.b. in reply to the final report. The complete text of the Navy's comments is shown in Appendix R.

C. Breakout of Spare Parts

FINDING

Two major buying commands included spare parts in pricing agreements when those parts should have been broken out for competitive procurement or direct buy from the actual manufacturer. This situation was caused by the buying offices' and prime contractors' failure to comply fully with Defense Federal Acquisition Regulation Supplement (DFARS) requirements. As a result, DoD has incurred additional costs of $42.5 million on orders placed in FY's 1984 through 1988 with four contractors for prime contractor burden and profit that were added to the cost of spare parts purchased from manufacturers. We estimated that $18.4 million of prime contractor costs could be avoided in the next 2 years if our recommendations are implemented. In addition, the Government has lost any savings that might have been achieved through competitive purchase.

DISCUSSION OF DETAILS

Background. Breakout of spare parts occurs when the Government purchases, directly from the original equipment manufacturer or other source, parts that were previously procured through the prime contractor. The Government may provide the spare parts to the prime contractor as Government-furnished material (GFM) or use the parts without further interaction with the prime contractor. Breakout decreases costs to the Government by eliminating charges for overhead and profit added by the prime contractor. Procurement offices are responsible for breakout reviews and decisions.

DFARS, Supplement No. 6 establishes the DoD Replenishment Parts Breakout Program and provides uniform policies and procedures for management and conduct of the program within and between the Military Departments and the Defense agencies.

DFARS 217.7203 provides that:

> Any part, subassembly, or component for military equipment, to be used for replenishment of stock, repair, or replacement, must be acquired so as to assure [sic] the requisite safe, dependable, and effective operation of the equipment. Where it is feasible to do so without impairing this assurance [sic], parts should be acquired on a full and competitive basis.

DFARS 217.7204 requires that the contractor identify the actual manufacturer or producer of the item or all sources of supply for the item and other pertinent data to assist the procurement office in the breakout decision.

Additional guidance is provided in the Armed Services Pricing Manual. Before spare parts can be considered for inclusion in pricing agreements, the manual requires screening of the parts under the DoD high dollar spare parts breakout program and a determination that those parts are not likely candidates for breakout, within the time period of the contract.

Details of the Audit. Pricing agreements in contracts of four contractors included parts that should have been broken out for direct buy from actual manufacturers or competitively purchased. Spare parts purchases are subject to screening if they exceed the annual buy criteria. The annual buy criteria are a forecast of parts to be purchased in the subsequent 12-month period. Buy requirements expected to exceed $10,000 must be properly screened. We identified 65 parts on 6 contracts at the San Antonio Air Logistics Center (SAALC) and the U.S. Army Aviation Systems Command (AVSCOM) that were not screened for breakout. Our review was limited to the parts that were manufactured entirely by other vendors. For clarity, the conditions at the four contractors are discussed separately.

Pratt and Whitney. SAALC issued call contract arrangement F41608-85-G-0004 to Pratt and Whitney on August 14, 1985. The arrangement included F100 aircraft engine spare parts and provided that orders could be issued until December 31, 1985. An option to extend the ordering period until March 3, 1986, was exercised through modification P0001 at an estimated cost of $51,250,000.

During the ordering period, between 168 to 252 items were included on the price list. The buying office was unable to provide the exact number of parts because parts were added and deleted from the list throughout the performance period. Our review of the vendor-furnished items and purchase history files showed that the buying office had done a commendable job in breaking out hundreds of items; however, SAALC still needed improvement. We identified six parts purchased from Pratt and Whitney that exceeded the annual buy criteria for performing screening procedures for parts breakout candidates. SAALC did not properly screen the parts before they were included in the call contract arrangement, and SAALC officials stated the parts were not identified for breakout because of a shortage of engineers during the early stages of the breakout program.

As a result, the Government incurred costs of $1,437,282 that represented Pratt and Whitney's burden and profit applied to the cost of the actual manufacturer. The six parts and the amounts of excessive cost are detailed in Appendix J.

General Motors Corporation - Allison Gas Turbine Division. SAALC issued letter contract F41608-85-D-A007 to General Motors Corporation - Allison Gas Turbine Division (Allison Division), dated March 31, 1985. The contract for T56 engine spare parts for the C130 aircraft consisted of about 362 items with delivery beginning in 1985 and ending in 1989. We identified 21 items purchased from the Allison Division that exceeded the annual buy criteria for performing screening procedures for parts breakout candidates. Our review of the screening procedures determined that these items were not identified as breakout candidates either before inclusion on the price list exhibit or during the period of contract performance. The buying offices did not identify potential breakout parts because of a shortage of engineers in the early stages of the breakout program and the prime contractor was reluctant to assist in the breakout process. While the prime contractor complied with some provisions of DFARS 217.7204, our review of the critical parts list that the prime contractor provided to the buying office for the 21 parts determined that the actual manufacturers of these items were not identified.

Excess costs of $31,339,557 were incurred for the 21 parts and represented Allison Division's burden and profit. A summary of the excessive costs is presented in Appendix K, and detailed computations are in Appendix L.

The internal controls on procedures for breaking out spare parts purchased by SAALC from Pratt and Whitney and General Motors Corporation - Allison Gas Turbine Division were inadequate. Internal controls could be improved by:

- having the competition advocate or other responsible party establish a timetable for screening those spare parts where purchase requirements are expected to exceed $10,000 and ensuring compliance with the timetable, and

- including a justification in the procurement files when spare parts, suitable for breakout, are purchased from prime contractors.

General Electric Company. The U.S. Army Aviation Systems Command (AVSCOM) issued BOA DAAJ09-85-G-A025 to the General Electric Company. The agreement included a price list exhibit containing 422 items for T-700 engine spare parts at an estimated value of $86.7 million. General Electric Company separately identified 239 items valued at $16.7 million and informed the procurement office, in a January 1985 letter, that these items were "non-sole source." This letter also indicated that the contractor had no proprietary claim to these items. In addition, the price negotiation memorandum for this procurement noted that the General Electric Company did not want to propose prices on parts that could be purchased directly from the actual manufacturer. However, these items were included in the price

list catalog and eventually were purchased from the prime contractor. Deliveries on the agreement were scheduled to begin in 1985 and end in 1987.

The Government stated in the price negotiation memorandum that the procurement office wanted the flexibility to procure all spare parts from the prime contractor because:

- the Government needs time to break out spare parts,

- the Government may need the ability to procure from the prime contractor on an emergency basis, and

- the prime contractor may have lower prices due to quantity buys.

An earlier BOA for the purchase of T-700 spare parts in 1984 and 1985 also included a supplemental price list that contained 20 items that appeared on the listing of the 239 parts. On November 24, 1987, AVSCOM issued a follow-on basic ordering agreement to BOA DAAJ09-85-G-A025. We determined that the AVSCOM continued to use the price list to issue orders against this agreement even though the General Electric Company informed AVSCOM almost 3 years earlier that parts on the price list should be bought from the actual manufacturer. In addition, 8 items from the list of 239 continue to be included on the proposed 1989 through 1991 price list.

The practice of purchasing spare parts from the prime contractor was not in accordance with the acquisition plan for the T-700 series engine. The acquisition plan included requirements that dual or multiple sourcing must be proposed for spare parts components and that all technical data resulting from the dual or multiple sourcing would belong to the Government to support breakout of spare parts. The plan showed that General Electric Company had produced T-700 engines since 1977.

We determined that 24 items had been broken out for direct buy from the actual manufacturer on contract DAAJ09-85-G-A025 and 2 other contracts, DAAJ09-79-G-0003 and DAAJ09-88-G-0001, and that actual savings of $599,089 were realized. This represented a 56.2 percent savings over the price list amount.

Our review also identified 26 items on contracts DAAJ09-88-G-0001, DAAJ09-85-G-A025, and DAAJ09-79-G-0003 that AVSCOM continued to purchase from General Electric Company at an excess cost to the Government of $1,971,236 (Appendix M). The excess represented General Electric Company's burden and profit. The remaining items had not been purchased during the period of the audit, but remained on the price list and still could be bought from the prime contractor.

Bell Helicopter Textron, Inc. AVSCOM issued BOA DAAJ09-85-G-A006 to Bell Helicopter Textron, Inc., on October 30, 1984. The period of the agreement was from October 30, 1984, through October 29, 1987. The agreement contained a list of spare parts for Bell Utility Helicopters. Deliveries extended from 1985 through 1991. Our review of vendor-furnished items identified 12 items that AVSCOM purchased from the prime contractor that should have been purchased from the original manufacturer because these items exceeded the annual buy criteria for performing screening procedures. The competition advocate stated that these parts were not broken out due to staff vacancies, which were estimated to be between 10 and 15 percent of normal staff levels. Excess costs of $7,728,196 were incurred and represented Bell Helicopter Textron, Inc.'s burden and profit. (Computations of the excessive costs are detailed in Appendix N.)

Internal Controls. Internal controls were not adequate to ensure that spare parts were purchased in accordance with the acquisition plan for the T-700 engine manufactured by General Electric Corporation. Breakout was accomplished for only a portion of the eligible spare parts. In addition, the parts purchased from Bell Helicopter Textron, Inc., were not screened for breakout. AVSCOM can improve internal control procedures over spare parts breakout by having the competition advocate review purchases of T-700 engine spare parts to determine whether the procurements are placed in accordance with the acquisition plan and by establishing a procedure where spare parts purchased from Bell Helicopter Textron, Inc., are screened for breakout. The contracting officer should include justifications in the procurement files for the spare parts that were not subjected to screening procedures and purchased from the prime contractor.

Statistical Projection. Using scientific statistical projection techniques, we estimated that $18.4 million will be incurred for prime contractors' costs over the next 2 years, unless corrective action is taken. The projection assumed the same annual level of procurement of spare parts in the contracts awarded to the four contractors reviewed. However, the six contracts in our review covered periods ranging from 3 to 5 years. The projection was only extended for 2 years.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Commanding Officers, San Antonio Air Logistics Center and U.S. Army Aviation Systems Command:

1. Screen all spare parts that exceed the annual buy criteria of $10,000 and break out parts for purchase from actual manufacturers or through competition in compliance with the Defense Federal Acquisition Regulation Supplement Parts 217.7203-04, and Supplement No. 6.

2. Improve internal controls over the process of identifying spare parts for breakout by:

a. Having the competition advocate or other responsible party review the proposed purchase of spare parts expected to exceed the annual buy criteria of $10,000, and document that spares acquisitions are consistent with programmed acquisition plans.

b. Requiring a justification to be included in the procurement files for the spare parts purchases not subjected to screening procedures and purchased from prime contractors.

MANAGEMENT COMMENTS

Air Force

The Assistant Secretary of the Air Force (Acquisition) concurred with a portion of Finding C that addressed prime contractor failure to identify actual manufacturers of subcontracted parts but nonconcurred with the remainder of Finding C. The Assistant Secretary did not concur or nonconcur with Recommendations C.1. and C.2. and suggested that the Recommendations and the entire accompanying Finding C be deleted from the report. The Air Force position is premised on the fact that Finding C fails to recognize the history and timing of the breakout program, the volume of items purchased and screened for breakout, and the number of personnel assigned to breakout activity. The Air Force response also takes issue with six Pratt and Whitney items the report identified as breakout candidates, disagrees with the position that the General Motors Corporation - Allison Gas Turbine Division did not object to purchase of parts from their suppliers, and takes exception to the "excessive costs" and forecast savings attributed to breakout items. The complete text of the Air Force's comments is shown in Appendix S.

Army

The Army did not submit comments on Finding C and Recommendations C.1. and C.2.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

Air Force

Our report does recognize the history and timing of the breakout program in relationship to SAALC's past efforts. We clearly document that the timing was early in the breakout program. However, the Armed Services Pricing Manual also provides guidance that parts be screened before being considered for inclusion in a price list. Therefore, even though it was early in the breakout program, if the commands chose to include parts on price lists, then these parts should have been screened before inclusion. We have modified our report to eliminate the statement that General

Motors Corporation had no objection to the procurement of these items from the actual manufacturer.

We believe that our report does give a fair presentation of SAALC's efforts and fully acknowledges that SAALC has done a commendable job. However, in regard to the Air Force's argument that parts were screened and approved for second sourcing or were broken out, our analysis showed that these parts remained on price lists after the breakout was supposed to have occurred and, in some cases, these parts continued to be bought off the price list at the time of our audit.

We believe that the reported excessive cost is based on correct assumptions. We assumed that the item could have been bought at the same price paid by the prime contractor. While this is not always true and the price may have been higher as the Air Force believes, it is also true that the price may have been lower. Barring any other reasonable basis, the price actually paid is the most supportable documentation available. Overhead, general and administrative expense and other administrative costs may or may not be absorbed into DoD contracts based on the contract mix, contract timeframes, and other contract provisions. In addition, our analysis was limited to those parts that were completely manufactured by other vendors and required no value added by the prime contractor. We did not attempt to force breakout of price list parts where the prime contractor added legitimate value to the part. We also believe that the future savings in our report are valid because the parts SAALC claimed to have screened and broken out, remain on the price list for future procurement. Some parts are still being procured from the prime contractor. Accordingly, we request that the Air Force reconsider its response to Finding C and Recommendations C.1. and C.2. and potential monetary benefits of Recommendation C.1.

Army

The Army is requested to respond to Finding C, Recommendations C.1. and C.2. and potential monetary benefits of Recommendation C.1.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics), Washington, DC

Department of the Army

Assistant Secretary of the Army (Financial Management), Washington, DC
U.S. Army Aviation Systems Command, St. Louis, MO
Army Plant Representative Office, Bell Helicopter Company, Inc., Fort Worth, TX

Department of the Navy

Assistant Secretary of the Navy (Financial Management), Washington, DC
U.S. Navy Aviation Supply Office, Philadelphia, PA
Navy Plant Representative Office, General Electric Company, Lynn, MA

Department of the Air Force

Comptroller of the Air Force, Washington, DC
San Antonio Air Logistics Center, San Antonio, TX
Oklahoma City Air Logistics Center, Oklahoma City, OK
Air Force Plant Representative Office, Pratt and Whitney, Inc., East Hartford, CT
Air Force Plant Representative Office, Pratt and Whitney Inc., West Palm Beach, FL

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Cameron Station, Alexandria, VA
Defense Contract Administration Services Plant Representative Office, General Motors Corporation, Indianapolis, IN
Defense Industrial Supply Center, Philadelphia, PA

ACTIVITIES VISITED OR CONTACTED (Continued)

Defense Contract Audit Agency

Headquarters, Defense Contract Audit Agency, Cameron Station, Alexandria, VA
Bell Helicopter Resident Office, Fort Worth, TX
General Electric Resident Office, Lynn, MA
Indianapolis Branch Office, Indianapolis, IN
Pratt and Whitney Resident Office, East Hartford, CT
Pratt and Whitney Resident Office, West Palm Beach, FL

Defense Contractors

Bell Helicopter Company, Inc., Fort Worth, TX
General Electric Company, Lynn, MA
General Motors Corporation, Indianapolis, IN
United Technologies Corporation (Pratt and Whitney), East Hartford, CT, and West Palm Beach, FL

SUMMARY LISTING OF CONTRACT ACTIONS CONTAINING PRICE LISTS

Procurement Office	Contractor	Contract Number	Number of Orders Reviewed	Type of Contract Action
SAALC [1]	Pratt & Whitney	F41608-84-G-0016	3 [2]	Call Contract Arrangement
SAALC	Pratt & Whitney	F41608-85-G-0004	3 [2]	Call Contract Arrangement
SAALC	General Electric	F41608-85-D-A011	1 [3]	Requirements Contract
SAALC	General Electric	F41608-87-D-A108	3 [4]	Requirements Contract
SAALC	General Motors	F41608-85-D-A007	14 [4]	Requirements Contract
AVSCOM [5]	Bell Helicopter	DAAJ09-85-G-A006	[6]	Basic Ordering Agreement
AVSCOM	Bell Helicopter	DAAJ09-88-G-A003	[6]	Basic Ordering Agreement
AVSCOM	Bell Helicopter	DAAJ09-85-G-A002	[6]	Basic Ordering Agreement
AVSCOM	General Electric	DAAJ09-88-G-0001	1 [3]	Basic Ordering Agreement
AVSCOM	General Electric	DAAJ09-85-G-A025	4 [3]	Basic Ordering Agreement
ASO [7]	Bell Helicopter	DAAJ09-79-G-0001	14 [2]	Basic Ordering Agreement
ASO	Bell Helicopter	N00383-84-G-4511	4 [2]	Basic Ordering Agreement

Footnotes

[1] SAALC - San Antonio Air Logistics Center

[2] Defective pricing reviews conducted by Defense Contract Audit Agency

[3] Department of Defense Inspector General conducted reviews to determine extent of overpricing. Defective pricing reports will be issued separately.

[4] Department of Defense Inspector General conducted reviews to determine extent of overpricing. Since the requirements contract did not have provisions for repricing orders, we could not provide a basis for defective pricing based on current cost data at the time orders were issued.

[5] AVSCOM - U.S. Army Aviation Systems Command

[6] Under review by Defense Contract Audit Agency at the time of our audit.

[7] ASO - U.S. Navy Aviation Supply Office

DEFECTIVE PRICING REPORTED ON SPARE PARTS PRICING AGREEMENTS WITH UNITED TECHNOLOGIES CORPORATION (PRATT AND WHITNEY)

DCAA Report Number*	Contract and Order Number	Order Amount	Defective Pricing
	F41608-84-G-0016		
2641-7D 420126	0041	$ 81,147,855	$ **
2641-7D 420013	0039	13,449,970	**
2641-7D 420016	0032	5,501,311	**
	F41608-85-G-0004		
2641-7D 420132	0001	44,954,617	**
2641-7D 420014	0012	10,989,910	**
2641-7D 420218	0106	8,893,894	**
Total		$164,937,557	$5,024,381

* The Defense Contract Audit Agency (DCAA) reviewed six orders issued under the call contract arrangements with Pratt and Whitney to determine if overpricing resulted from data being noncurrent at the time of the order. The DCAA found overpricing on all six orders. The details of these reviews have already been provided to the San Antonio Air Logistics Center in the above referenced defective pricing reports.

** Contractor Proprietary Data Deleted.

DEFECTIVE PRICING REPORTED ON SPARE PARTS PRICING AGREEMENTS WITH BELL HELICOPTER TEXTRON, INC.

DCAA Report Number*	Contract and Order Number	Order Amount	Defective Pricing
1301-7A 420002-7165	DAAJ09-79-G-0001 8053	$ 725,614	$ **
1301-7A 420002-7177	8045	724,000	**
1301-7A 420002-7186	GC8P,GC3Z	984,201	**
1301-7A 420002-7187	8044	815,137	**
1301-7A 420002-7193	8055	867,486	**
1301-7A 420002-7178	GC5C,GC6C, GCC4,GCF2	629,603	**
	GC29,GC2W		**
1301-7A 420002-7203	GC4A,GC8L	1,117,316	**
1301-7A-420005-7201	N000383-84-G-4511 68	2,175,416	**
1301-7A-420005-7202	66,83	3,353,929	**
1301-7A-420005-7198	84	667,737	**
Total		$12,060,439	$1,072,512

* Defense Contract Audit Agency (DCAA) performed defective pricing reviews of 18 orders issued to Bell Helicopter Textron, Inc., to determine if the failure to obtain current data at the time of the orders resulted in overpricing. DCAA found overpricing on the 18 orders and issued its findings to the U.S. Army Aviation Systems Command and the U.S. Navy Aviation Supply Office in the above referenced defective pricing reports. At the time of our audit, DCAA was reviewing other orders under Basic Ordering Agreements DAAJ09-85-G-A006, DAAJ09-85-G-A002, and DAAJ09-88-G-A003.

** Contractor proprietary data deleted.

DEFECTIVE PRICING/OVERPRICING OF GENERAL ELECTRIC COMPANY AIRCRAFT ENGINE BUSINESS GROUP CONTRACTS

Contract Number [1]	Order Number	Order Date [2]	Part Number	Price List Year	Price List Unit Price	Current Date At Order Date Material [3]	Material [4] Burdened (a)	Labor [2]	Labor [4] Burdened (b)	Total [2] (a)+(b)	Unit Overpricing	Quantity	Total Overpricing
DAAJ09-88-G-0001	0053	Mar 4, 1988	6034T62P1		$ 5,593.97	**	**			**	**	650	**
DAAJ09-85-G-A025	0108	Dec 18, 1985	6038T92G01		11,959.44					**	**	12	**
	0124	Jan 10, 1986	6035T07G09		843.37					**	**	602	**
									TOTAL CONTRACT A025				**
F41608-87-D-A108	0016	Sept 31, 1987	7R601214P118	1989	24,486.15					**	**	20	**
				1989	23,758.12					**	**	280	**
				1990	24,312.56					**	**	68	**
									TOTAL ORDER 0016				**
	0019	Oct 2, 1987	6051T44P01	1988	20.68					**	**	24,000	**
				1989	22.44					**	**	72,000	**
				1990	23.02					**	**	10,998	**
									TOTAL ORDER 0019				**
	0004	Oct 1, 1987	6900T53004	1989	4,005.75					**	**	350	**
				1990	4,194.39					**	**	600	**
									TOTAL ORDER 0004				**
									TOTAL CONTRACT A108				**

The footnotes are at end of chart.

** Contractor Proprietary Data Deleted.

DEFECTIVE PRICING/OVERPRICING OF GENERAL ELECTRIC COMPANY
AIRCRAFT ENGINE BUSINESS GROUP CONTRACTS (Continued)

Contract Number 1/	Order Number	Order Date 2/	Part Number	Price List Year	Price List Unit Price	Current Data At Order Date: Material 3/	Material Burdened (a) 4/	Labor 3/	Labor Burdened (b) 4/	Total (a)+(b)	Unit Overpricing	Quantity	Total Overpricing
F41608-85-D-A011	0099	Apr 22,1986	5040T48P01	1987	$ 11.79	**	**	**	**	**	**	34,089	**
				1988	12.20	**	**	**	**	**	**	51,918	**
			6029T00G01	1986	664.69	**	**	**	**	**	**	176	**
				1987	739.44	**	**	**	**	**	**	2,192	**
				1988	760.08	**	**	**	**	**	**	34	**
			5014T74G05	1986	72.70	**	**	**	**	**	**	1,548	**
				1987	82.81	**	**	**	**	**	**	820	**
				1988	85.88	**	**	**	**	**	**	588	**
			5013T83P01	1987	2,295.45	**	**	**	**	**	**	210	**
				1988	2,382.65	**	**	**	**	**	**	141	**
			500T80P01	1988	168.47	**	**	**	**	**	**	1,086	**
			500T81P01	1987	115.90	**	**	**	**	**	**	117	**
				1988	119.68	**	**	**	**	**	**	810	**
			5015T78G03	1987	86.01	**	**	**	**	**	**	5,545	**
				1988	89.22	**	**	**	**	**	**	199	**
			5018T16P01	1986	3,448.91	**	**	**	**	**	**	8	**
				1987	3,836.55	**	**	**	**	**	**	177	**
				1988	3,984.29	**	**	**	**	**	**	144	**
			646C574P4	1986	41.97	**	**	**	**	**	**	528	**
				1987	47.93	**	**	**	**	**	**	614	**
				1988	49.74	**	**	**	**	**	**	4	**
									Total Contract A011				**
											Total General Electric Company		$1,542,120

The footnotes are at end of chart.

** Contractor proprietary data deleted.

1/ Separate defective pricing reports will be issued for delivery orders issued under contracts DAAJ09-88-G-0001, DAAJ09-85-G-A025, and F41608-85-D-A011.

2/ Certifications were made at the time of the negotiation of the price list. Contract F41608-85-D-A011, order number 99, was issued on April 22, 1986; however, the price was reset each year for deliveries within that year. The certifications are shown below.

Contract Number	Certification Date
DAAJ09-88-G-0001	November 2, 1985
DAAJ09-85-G-A025	November 2, 1988
F41608-87-D-A108	August 19, 1987
F41608-85-D-A011	November 22, 1985

3/ Current material and labor costs were based on cost data available at the time of the order except for Contract F41608-85-D-A011, order number 99, which allowed for annual resetting of prices for the delivery during each year. Prices were reestablished on October 9, 1986, and February 10, 1987, for 1986 and 1987 deliveries, respectively. Prices for 1988 were being reestablished June 1988, but the modification had not been issued for revised 1988 prices. In our review of these orders, we used the cost data in effect at the time of the price change for each year. The data used in the review were the amount for average finished goods inventories.

4/ Burdened material and labor were the sell price factors negotiated by the Naval Plant Representatives Office at the time of the order date. For AVSCOM basic ordering agreement DAAJ09-88-G-0001, delivery order 0053, burdened material represents the January 1988 price for material multiplied by the sell price factor of ** percent.

5/ Total prices for contract F41608-87-D-A108 represented the average finished goods inventory as of the order date, adjusted for negotiated escalation. Prices for contract DAAJ09-85-G-A025, delivery orders 0106 and 0124, were priced in total, not by cost element.

** Contractor proprietary data deleted.

OVERPRICING OF GENERAL MOTORS CORPORATION-ALLISON GAS TURBINE DIVISION CONTRACT

Contract No. F41608-85-D-A007

Delivery Order	Part Number	Order Date [1]	Nomenclature	Price List [2] (Unit)	Current [3] Data at Order	Unit Overpricing	Order Quantity	Material Overpricing	Markup Factor	Total Overpricing
535	6897962	Aug 28, 1986	Thermocouple	**	**	**	14,835	**	**	**
1017	6876564	Sept 22, 1986	Blade, T-1	**	**	**	11,922	**	**	**
1034	23005961	Sept 30, 1986	Rear Turbine Bearing	**	**	**	232	**	**	**
1272	6809081	Dec 17, 1986	C Blade 1	**	**	**	29,214	**	**	**
1297	6809084	Dec 23, 1986	C Blade 4	**	**	**	29,913	**	**	**
							TOTAL			$329,693

[1] Certification of pricing for the price list occurred on February 18, 1986.

[2] Costs shown in the price list column represent the negotiated material prices.

[3] The contractor had annual material purchases. Data used represented the most current purchase order or average inventory values prior to the order date.

** Contractor proprietary data deleted.

SAMPLE OF UNCONSOLIDATED SPARE PARTS PURCHASE REQUESTS ISSUED BY THE OKLAHOMA CITY AIR LOGISTICS CENTER
Contract No. F34601-86-G-0254

Purchase Request Number	Request Date	Amount of Request
8762919	July 8, 1987	$ 27,400
8838207	July 10, 1987	42,100
8762930	July 1, 1987	77,600
	Consolidated Total	$147,100
8762518	May 20, 1987	$ 17,200
8762488	May 12, 1987	19,000
	Consolidated Total	$ 36,200
8656367	January 15, 1986	$ 44,100
8656538	January 15, 1986	11,500
	Consolidated Total	$ 55,600
8844846	October 1, 1987	$ 44,114
8844844	September 28, 1987	47,370
8844840	September 25, 1987	20,196
	Consolidated Total	$111,680
8844775	October 22, 1987	$ 43,300
8845226	October 23, 1987	92,000
	Consolidated Total	$135,300
8732533	August 26, 1987	$ 34,500
8732534	August 27, 1987	81,715
	Consolidated Total	$116,215

SAMPLE OF UNCONSOLIDATED SPARE PARTS PURCHASED REQUESTS ISSUED BY OKLAHOMA CITY AIR LOGISTICS CENTER (Continued)

Purchase Request Number	Request Date	Amount of Request
8732510	August 19, 1987	$ 46,200
8732509	August 19, 1987	84,600
8732414	August 14, 1987	21,800
	Consolidated Total	$152,600
8732223	August 13, 1987	$ 59,300
8732144	August 11, 1987	94,200
	Consolidated Total	$153,500
8732501	August 18, 1987	$ 17,700
8732493	August 18, 1987	13,800
8732403	August 18, 1987	27,700
	Consolidated Total	$ 59,200
8849953	October 27, 1987	$ 68,500
8849964	October 27, 1987	40,900
	Consolidated Total	$109,400

SAMPLE OF UNCONSOLIDATED ORDERS ISSUED BY THE U.S. NAVY AVIATION SUPPLY OFFICE

Procurement Contracting Officer Code	Date Orders Issued	Number of Orders	Dollar Amount of Unconsolidated Orders *
DAAJ09-88-G-A003			
209	January 23, 1988	15	$200,216
209	January 28, 1988	3	124,950
209	January 29, 1988	4	129,895
192	January 25, 1988	24	314,807
192	January 27, 1988	7	128,698
192	March 30, 1988	11	152,734
299	June 16, 1988	5	133,165
299	June 29, 1988	2	144,748
393	May 6, 1988	8	199,194
393	May 10, 1988	7	117,860
393	July 21, 1988	8	176,569
N00383-84-G-4511			
393	November 4, 1987	36	120,500
393	November 25, 1987	25	136,999
393	March 3, 1988	6	169,651
499	March 2, 1988	28	156,807
799	March 3, 1988	9	332,413

* Represents the dollar amount of orders that could have been consolidated by a particular buyer on a specific date.

COMPUTATIONS OF ESTIMATED LOST SAVINGS

COLUMN	(1)	(2)	(3)	(4)	(5)
Buying Office	Total Value (Billion)	Order Review (Million)	Potential Orders for Consolidation (Million)	Savings DCAA Audit (Million)	Projected (Million)
SAALC	$2.2	$ 81	$36	$2	$ 3.4
OCALC	2.1	71	44	3	4.1
ASO	1.7	74	58	3	5.4
AVSCOM	3.3	34	26	1	2.4
TOTAL	$9.3	$260	$164	$9	$15.3

COLUMN: (1) The $9.3 billion represents the total procurements issued for FY 1987 by the four buying commands according to the DD350 data base.

(2) This represents the total orders (less than $100,000) that were issued by the buying commands for FY 1987 according to the DD350 data base.

(3) This $164 million represents the value of FY 1987 orders under $100,000 issued within 10-day periods, which could have been considered for consolidation.

(4) The $9 million savings represents the application of the DCAA's 5.8 percent savings (historically achieved on preaward audits of certified cost or pricing data), to the orders that could have been consolidated ($164 million). The 5.8 percent DCAA savings was obtained from semiannual reports (Oct. 1985 to Sept. 1987) to Congress from the Department of Defense, Inspector General.

(5) Department of Defense, Inspector General, Quantitative Methods Division projected lost savings of $15.3 million if orders had been consolidated. The savings included a 95-percent confidence interval with a margin of error of plus or minus $1.99 million.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT PRATT AND WHITNEY

Contract F41608-85-G-0004

Year	Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup 1/ (A)	Quantity (B)	Total Excessive Cost (AxB)
1987	4057335	57	$ 182.60	**	**	30	**
1986	4057335	38	182.58	**	**	76	**
1986	4068106-01	106	1,812.98	**	**	1,823	**
1986	4070640	95	82.90	**	**	1,550	**
1986	4016241	34	25.21	**	**	746	**
1986	4016241	32	25.88	**	**	493	**
1986	4056312	64	21.03	**	**	194	**
1986	374416	71	19.12	**	**	2,921	**
						TOTAL	$1,437,282

1/ The markup is an aggregate factor, which represents the negotiated overhead, general and administrative expense, and profit. Rates for 1986 and 1987 are as follows:

1986 = percent
1987 = percent

2/ The markup of percent is an aggregate factor, which represents the negotiated overhead, general and administrative expense rate, and profit.

** Contractor proprietary data deleted.

SUMMARY OF EXCESSIVE COSTS ON BREAKOUT OF GENERAL MOTORS CORPORATION PARTS

Part Number	Quantity	Amount of Excessive Costs
6873624	1,924	$ **
6842689	80	**
6809081	201,700	**
6809088	537,100	**
6823821	6,083	**
6809086	576,800	**
6894068	320	**
6809084	206,950	**
6809093	378,900	**
6809090	710,400	**
6809087	606,500	**
6843949	3,710	**
6847331	1,745	**
6809083	264,780	**
6809089	685,000	**
6809085	314,550	**
6809091	520,200	**
6809092	475,800	**
6809094	431,462	**
6812618	51	**
6809082	105,150	**
	Total	$31,339,557

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL MOTORS CORPORATION

Contract F41608-85-D-A007

Year	Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup* (A)	Quantity (B)	Total Excessive Cost (AxB)
1985	6842689	0010	$5,551.40	**	**	1	**
	6809081	0016	30.08	**	**	3,961	**
	6809088	0019	11.10	**	**	12,624	**
	6823821	0021	31.82	**	**	324	**
	6809086	0049	11.12	**	**	4,742	**
	6894068	0052	988.27	**	**	44	**
	6809084	0067	28.94	**	**	9,000	**
	6842689	0081	5,551.40	**	**	10	**
	6809090	0093	11.12	**	**	1,890	**
	6809083	0157	28.90	**	**	11,000	**
	6809091	0209	11.12	**	**	7,560	**
	6809083	0232	28.90	**	**	3,000	**
1986	6873624	0009	1,534.63	**	**	81	**
	6842689	0010	5,913.85	**	**	10	**
	6809081	0016	32.14	**	**	14,989	**
	6809088	0019	11.84	**	**	99,576	**
	6823821	0021	33.90	**	**	279	**
	6873624	0045	1,534.63	**	**	61	**
	6809086	0049	11.84	**	**	34,758	**
	6894068	0052	1,070.60	**	**	18	**
	6809084	0067	30.85	**	**	17,000	**
	6842689	0081	5,913.85	**	**	12	**
	6809093	0091	11.84	**	**	36,000	**
	6809090	0093	11.84	**	**	67,610	**
	6809087	0094	11.84	**	**	97,900	**
	6873624	0100	1,534.63	**	**	59	**
	6843949	0129	28.23	**	**	700	**
	6847331	0134	59.01	**	**	758	**
	6809083	0157	30.82	**	**	28,400	**
	6873624	0168	1,534.63			60	

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL MOTORS CORPORATION (Continued)

Year	Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup* (A)	Quantity (B)	Total Excessive Cost (AxB)
1986	6843949	0173	$ 28.23	**	**	200	**
	6809089	0185	11.84	**	**	42,000	**
	6809085	0195	30.88	**	**	43,482	**
	6809091	0209	11.84	**	**	70,440	**
	6809086	0219	11.84	**	**	57,512	**
	6809092	0231	11.83	**	**	43,000	**
	6809083	0232	30.82	**	**	6,000	**
	6809094	0262	11.84	**	**	33,000	**
	6809094	0343	11.84	**	**	26,436	**
	6809091	0349	11.84	**	**	15,122	**
	6809084	0355	30.85	**	**	5,200	**
	6809082	0352	32.11	**	**	24,729	**
	6823821	0392	33.90	**	**	715	**
	6809085	0394	30.88	**	**	34,262	**
	6809089	0412	11.84	**	**	25,135	**
	6843949	0427	28.23	**	**	500	**
	6809092	0434	11.83	**	**	25,945	**
	6809087	0447	11.84	**	**	21,000	**
	6809085	0464	30.88	**	**	6,200	**
	6809083	0503	30.82	**	**	13,435	**
	6809084	0504	30.85	**	**	27,000	**
	6809082	0505	32.11	**	**	4,050	**
	6809090	0507	11.84	**	**	24,500	**
	6809081	0522	32.14	**	**	46,905	**
1987	6809088	0019	12.42	**	**	8,600	**
	6809088	0019	12.42	**	**	68,000	**
	6809084	0067	32.36	**	**	10,150	**
	6809093	0091	12.42	**	**	53,400	**
	6809090	0093	12.42	**	**	30,900	**
	6847331	0134	61.89			372	

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL MOTORS CORPORATION (Continued)

Year	Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup* (A)	Quantity (B)	Total Excessive Cost (AxB)
1987	6842689	0152	$6,203.20	**	**	9	**
	6873624	0168	1,609.71	**	**	111	**
	6843949	0173	29.61	**	**	860	**
	6842689	0179	6,203.20	**	**	5	**
	6809089	0185	12.42	**	**	45,300	**
	6809085	0195	32.39	**	**	35,718	**
	6809899	0199	12.42	**	**	122,000	**
	6809091	0209	12.42	**	**	102,000	**
	6809086	0219	12.42	**	**	108,000	**
	6809092	0231	12.41	**	**	107,000	**
	6809083	0232	32.33	**	**	48,000	**
	6809087	0233	12.42	**	**	120,000	**
	6809088	0246	12.42	**	**	43,500	**
	6809094	0262	12.42	**	**	120,000	**
	6842689	0323	6,203.20	**	**	7	**
	6873624	0323	1,609.71	**	**	235	**
	6809094	0343	12.42	**	**	224,326	**
	6809093	0345	12.42	**	**	60,000	**
	6809091	0349	12.42	**	**	91,278	**
	6809084	0355	32.36	**	**	72,000	**
	6812618	0358	292.10	**	**	51	**
	6809082	0382	33.68	**	**	23,271	**
	6823821	0392	35.56	**	**	4,765	**
	6809085	0394	32.39	**	**	99,838	**
	6809085	0402	32.39	**	**	60,050	**
	6809089	0412	12.42	**	**	81,165	**
	6847331	0421	61.89	**	**	615	**
	6843949	0427	29.61	**	**	450	**
	6809084	0429	32.36	**	**	25,000	**
	6809092	0434	12.41	**	**	99,455	**
	6873624	0437	1,609.71	**	**	26	**
	6809087	0447	12.42	**	**	68,700	**
	6809085	0464	32.39	**	**	35,000	**

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL MOTORS CORPORATION (Continued)

Year	Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup* (A)	Quantity (B)	Total Excessive Cost (AxB)
1987	6809083	0503	$ 32.33	**	**	38,215	**
	6809084	0504	32.36	**	**	9,600	**
	6809082	0505	33.68	**	**	15,000	**
	6809090	0507	12.42	**	**	269,800	**
	6873624	0508	1,609.71	**	**	205	**
	6809081	0522	33.71	**	**	66,745	**
	6894068	0538	1,104.31	**	**	258	**
	6809089	1008	12.42	**	**	60,598	**
	6809091	1014	12.42	**	**	26,400	**
	6809086	1019	12.42	**	**	52,396	**
	6809092	1026	12.41	**	**	36,681	**
	6809083	1027	32.33	**	**	20,000	**
	6809087	1028	12.42	**	**	39,457	**
	6809088	1035	12.42	**	**	65,012	**
	6809094	1045	12.42	**	**	27,700	**
	6809093	1070	12.42	**	**	62,370	**
	6842689	1094	6,203.20	**	**	12	**
	6873624	1153	1,609.71	**	**	259	**
	6809091	1167	12.42	**	**	35,158	**
	6809083	1183	32.33	**	**	19,352	**
	6809090	1190	12.42	**	**	12,614	**
	6809082	1195	33.68	**	**	22,411	**
	6842689	1231	6,203.20	**	**	3	**
	6809081	1272	33.71	**	**	29,214	**
	6843949	1273	29.61	**	**	400	**
	6809086	1296	12.42	**	**	15,600	**
	6809084	1297	32.36	**	**	29,913	**

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL MOTORS CORPORATION (Continued)

Year	Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup* (A)	Quantity (B)	Total Excessive Cost (AxB)
1988	6809089	1008	$ 11.77	**	**	65,902	**
	6809086	1019	11.77	**	**	67,604	**
	6809092	1026	11.77	**	**	70,719	**
	6809087	1028	11.77	**	**	80,543	**
	6809088	1035	11.77	**	**	54,988	**
	6809093	1070	11.77	**	**	20,430	**
	6873624	1090	1,615.86	**	**	129	**
	6873624	1153	1,615.86	**	**	92	**
	6809091	1167	11.77	**	**	55,842	**
	6809083	1183	30.69	**	**	12,648	**
	6809093	1184	11.77	**	**	5,000	**
	6809090	1190	11.77	**	**	123,086	**
	6809082	1195	31.96	**	**	15,689	**
	6842689	1231	5,881.60	**	**	11	**
	6809089	1235	11.77	**	**	62,900	**
	6809081	1272	31.99	**	**	3,186	**
	6843949	1273	30.08	**	**	600	**
	6809086	1296	11.77	**	**	30,000	**
	6809084	1297	30.69	**	**	2,087	**
1989	6809086	2000	12.34	**	**	12,488	**
	6809087	2002	12.34	**	**	28,300	**
	6809088	2005	12.34	**	**	63,200	**
	6809091	2050	12.34	**	**	116,400	**
	6809083	2064	32.15	**	**	17,650	**
	6809093	2068	12.34	**	**	141,700	**
	6809088	2076	12.34	**	**	121,600	**
	6809087	2077	12.34	**	**	76,700	**
	6809086	2082	12.34	**	**	133,700	**

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL MOTORS CORPORATION (Continued)

Year	Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup* (A)	Quantity (B)	Total Excessive Cost (AxB)
1989	6873624	2110	$ 1,692.29	**	**	538	**
	6809083	2116	32.15	**	**	47,080	**
	6809089	2117	12.34	**	**	180,000	**
	6809087	2136	12.34	**	**	73,900	**
	6809090	2157	12.34	**	**	180,000	**
	6809092	2158	12.34	**	**	93,000	**
	6809086	2159	12.34	**	**	60,000	**
	6809081	2161	33.52	**	**	36,750	**
	6873624	2163	1,692.29	**	**	68	**
						Total	$31,339,557

* Markup factors were negotiated for each delivery year and were composed of overhead, general and administrative expense, profit, and cost of money. The rates are shown below.

1985- ** percent
1986- ** percent
1987- ** percent
1988- ** percent
1989- ** percent

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL ELECTRIC COMPANY

Part Number [1]	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup [2] (A)	Quantity (B)	Total Excessive Cost (A X B)
3033T23P01 (1)	0025	$102.82	**	**	**	**
3033T23P01 (1)	0054	110.29	**	**	**	**
3033T23P01 (2)	0372	93.74	**	**	**	**
3046T09P01 (2)	0428	2.53	**	**	**	**
3046T09P01 (2)	0233	2.88	**	**	**	**
3052T77P02 (2)	0431	12.57	**	**	**	**
4052T77P02 (2)	0348	11.87	**	**	**	**
5035T27G04 (2)	0413	1,008.81	**	**	**	**
5035T27G04 (2)	0141	1,008.81	**	**	**	**
5044T67P03 (2)	0455	240.00	**	**	**	**
5044T67P03 (2)	0347	266.85	**	**	**	**
5044T67P03 (1)	GBN5	287.43	**	**	**	**
5051T79P01 (2)	0498	160.17	**	**	**	**
5051T79P01 (2)	0241	183.63	**	**	**	**
6034T62P13 (1)	0053	5,593.97	**	**	**	**
6034T62P13 (2)	0363	4,855.11	**	**	**	**
6039T37P01 (1)	0044	649.17	**	**	**	**

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL ELECTRIC COMPANY (Continued)

Part Number [1]	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup [2] (A)	Quantity (B)	Total Excessive Cost (A X B)
6039T37P01 (1)	0001	$ 630.86	**	**	**	**
6043T85G01 (2)	0250	376.65	**	**	**	**
6043T85G01 (2)	0359	376.65	**	**	**	**
6043T85G01 (2)	0232	514.37	**	**	**	**
5036T84P01 (2)	0451	593.21	**	**	**	**
6039T48G04 (2)	0049	258.42	**	**	**	**
6039T48G04 (2)	0406	239.97	**	**	**	**
5034T79P01 (2)	0523	575.56	**	**	**	**
3031T95P04 (2)	0231	4.35	**	**	**	**
4041T56G02 (2)	0311	26.51	**	**	**	**
3031T59P02 (2)	0072	6.31	**	**	**	**
3036T20P01 (2)	0035	43.23	**	**	**	**
4052T88P01 (2)	0065	344.36	**	**	**	**
5310-01-090-3076 (3)	0774	.21	**	**	**	**
2840-01-094-5536 (3)	0681	.53	**	**	**	**
2840-01-089-4126 (3)	0028	585.50	**	**	**	**
2840-01-089-4132 (3)	0729	848.56	**	**	**	**

** Contractor proprietery data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT GENERAL ELECTRIC COMPANY (Continued)

Part Number 1/	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup 2/ (A)	Quantity (B)	Total Excessive Cost (A X B)
2840-01-008-1809 (3)	0034	$ 6.98	**	**	**	**
2915-01-087-4114 (3)	0416	46.45	**	**	**	**
5360-01-087-4409 (3)	0176	7.01	**	**	**	**
2840-01-087-4221 (1)	0050	79.85	**	**	**	**
4710-01-109-3053 (3)	0438	78.80	**	**	**	**
				TOTAL		$1,971,236

1/ The part numbers are keyed to three basic ordering agreements: DAAJ09-88-G-0001, DAAJ09-85-G-A025, and DAAJ09-79-G-0003.

2/ The markup factor is a composite factor that represents General Electric Company's burden and profit. The factor represented ** percent of the vendor unit cost.

** Contractor proprietary data deleted.

COMPUTATIONS OF EXCESSIVE COSTS ON BREAKOUT PARTS AT BELL HELICOPTER TEXTRON, INC.

Contract DAAJ09-85-G-A006

Customer Part Number	Delivery Order Number	Unit Price	Negotiated Vendor Unit Cost	Contractor Markup */ (A)	Quantity (B)	Total Excessive Cost (A X B)
204-011-402-013	550	$ 1,896.01	**	**	**	**
204-011-403-001	550	1,110.79	**	**	**	**
204-040-433-101	9999	6,921.35	**	**	**	**
204-040-433-101	784	6,921.35	**	**	**	**
205-074-033-103	107	1,021.85	**	**	**	**
205-075-084-001	36	9,501.54	**	**	**	**
209-010-400-001	722	7,240.50	**	**	**	**
209-010-403-001	701	1,292.89	**	**	**	**
209-073-442-103	167	416.10	**	**	**	**
209-073-442-104	171	418.38	**	**	**	**
212-010-306-001	275	47.03	**	**	**	**
212-010-311-101	554	837.58	**	**	**	**
Engine Trim Test Sets	N/A	26,283.00	**	**	**	**
				TOTAL		$7,728,196

* Markup factors were negotiated for each delivery year and each product line. Markups were composed of burden and profit. Burden (indirect rates) is based on negotiated forward pricing rates. Average markup on the above 12 parts was ** percent.

** Contractor proprietary data deletd.

SCHEDULE OF MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Reference	Description of Benefit	Amount and Type of Benefit
Finding A Rec. 1. through 4.	Recurring future contract cost avoidance through more thorough analyses of contractors' proposal because of certified cost or pricing data.	Cost avoidance* of at least $4.8 million ($369,326 for Army programs, $136,655 for Navy programs and $4,272,363 for Air Force programs) during FY's 1990 and 1991.
Finding B Rec. 1., 2., and 3.	Recurring future contract cost reduction through quantity discounts, submission of certified cost or pricing data, and more thorough analyses of contractors' proposals.	Not quantifiable monetary benefit
Finding C Rec. 1.	Recurring future contract cost avoidance through compliance with Defense Federal Acquisition Regulation supplement 6 and part 217.	Cost avoidance* of $18.4 million ($5,145,631 for Army programs and $13,254,464 for Air Force programs)

* Appropriation program element and title could not be identified because there were no means of assessing the mix of users placing orders against the basic ordering agreements.

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D C 20301-8000

PRODUCTION AND
LOGISTICS
(P/CPF)

JAN 25 1990

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING

SUBJECT: Draft Report on the Audit of Spare Parts Pricing Agreements (Project No. 8CE-5001)

This is in further response to your subject draft audit report of September 27, 1989. Following your office's receipt of our December 4, 1989, memorandum, in which we indicated that we could not concur in Recommendation A.1. of your draft audit report, the Program Director and Program Manager for this effort requested a meeting with our staff to elaborate on their findings and concerns. During that meeting on December 14, 1989, we were told that the real problems disclosed during your audit involved the use of pre-priced basic ordering agreements (BOAs) over an inappropriately long time period (i.e., beyond the point at which the agreed to prices could reasonably be expected to remain stable) and the failure to include provisions for quantity discounts and/or maximum order quantities in certain pre-priced BOAs.

We continue to believe that your Recommendation A.1. (i.e., to amend the Defense Federal Acquisition Regulation Supplement to specifically state that BOAs should require pricing at the time the order is placed, rather than at the time each agreement is established) is unnecessarily restrictive. Moreover, we are not persuaded that the operational shortcomings detected in the extremely small sample of pre-priced BOAs examined during your audit are necessarily indicative of a widespread or systemic problem. However, in response to your findings, we would be willing to issue a policy letter to the Services and Defense Logistics Agency urging caution in the use of pre-priced BOAs, particularly with regard to their reasonable period of effectivity and obtaining adequate consideration for quantity purchases. We believe that this approach offers the most appropriate solution to the concerns at issue.

David J. Berteau
Principal Deputy

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

PRODUCTION AND
LOGISTICS
(P/CPF)

December 4, 1989

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING

SUBJECT: Draft Report on the Audit of Spare Parts Pricing Agreements (Project No. 8CE-5001)

In response to your request of September 27, 1989, we are providing the following comments regarding Recommendation A.1. of the subject draft audit report. That recommendation states:

"We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the DAR Council to revise the Defense Federal Acquisition Regulation Supplement, Part 16.703, to specifically state that basic ordering agreements should require pricing at the time the order is placed, rather than at the time each agreement is established."

We cannot concur in this recommendation or in the underlying finding in your draft report that alleges misuse of basic ordering agreements (BOAs) whenever the prices for spare parts are negotiated at the time a BOA is established, rather than at the time individual orders are issued against that BOA. We see no statutory or regulatory bar to the practice of using a previously agreed to, and certified, price list as the method for determining the fair and reasonable price of subsequent orders placed against a BOA. In this connection, we must take issue with the following two erroneous statements in your draft report which apparently constitute the basis for the finding and recommendation at issue:

"FAR 15.804 specifically requires the submission of a certificate of current cost or pricing data for each pricing action expected to exceed $100,000. A price list does not constitute agreement on contract price."

What FAR 15.804-2(a)(1) actually says is that "certified cost or pricing data are required before .... the award of any negotiated contract .... expected to exceed $100,000" (emphasis added). We submit that this requirement is fully satisfied when a contracting officer utilizes a previously negotiated and certified price list as the basis for pricing an order placed (i.e., a contract awarded) against a BOA. In such an

arrangement, the certified price list clearly constitutes the definitive final agreement on price, as contemplated by FAR 15.804-2(b)(2). Moreover, FAR 15.804-4(a) states that only one certificate shall be required by the Government and that the contractor shall submit it as soon as practicable after price agreement is reached.

We are particularly concerned that this recommendation would effectively negate the very significant administrative efficiencies which can currently be achieved through the judicious use of BOAs with certified price lists. The suggested new policy guidance would instead require burdensome and repetitious price negotiations/certifications for every noncompetitive order over $100,000 awarded against such an agreement. We are convinced that, when prudently employed, BOAs containing certified price lists represent an important contracting tool for placing large numbers of orders in a short amount of time, with a relatively small risk of overpricing.

Finally, we are disturbed by the fact that a number of separate defective pricing audit reports have been issued to the field by both your office and the Defense Contract Audit Agency, based on the erroneous conclusion that a second certification is required whenever an order is placed against a BOA containing a previously agreed to and certified price list. It must be recognized that when the contractor provided only an initial certification in such cases, it was simply following the contracting officer's proper direction regarding the appropriate method for complying with the FAR's certified cost or pricing data requirements. Certainly the contractor should be entitled to rely upon that Government position. Therefore, in addition to recommending that the draft audit report finding and recommendation discussed above be deleted, we must also recommend that all defective pricing audits which have been issued pursuant to this flawed interpretation of FAR be rescinded immediately.

Jack Katzen
Assistant Secretary of Defense
(Production and Logistics)

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
U S ARMY CONTRACTING SUPPORT AGENCY
WASHINGTON DC 20310 0103

REPLY TO
ATTENTION OF

SFRD-KAC

10 JAN 1990

MEMORANDUM FOR ACTING DIRECTOR, CONTRACT MANAGEMENT DIRECTORATE, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, 400 ARMY NAVY DRIVE, ARLINGTON, VA 22020

SUBJECT: Draft Report on the Audit of Spare Parts Pricing Agreements (Project No. 8CE-5001)

1. This is an interim reply to the findings and recommendations contained in the subject audit report. A command response has just been received from the U.S. Army Aviation Systems Command and is currently being staffed in order to prepare the Army's overall position.

2. A formal Army position regarding these findings and recommendations should be forthcoming within the next 30 days. Your consideration in this matter is appreciated.

3. The point of contact in this office for any questions and/or correspondence regarding this audit report is Mr. Peter Staples on 697-4474.

Encl

NICHOLAS R. HURST
Brigadier General, GS
Director, U.S. Army Contracting
Support Agency

CF:
AMCRM-IA
SAIG-PA
SARD-ZE

DEPARTMENT OF THE NAVY
THE ASSISTANT SECRETARY OF THE NAVY
(SHIPBUILDING AND LOGISTICS)
WASHINGTON, DC 20360 5000

18 DEC 1989

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE INSPECTOR GENERAL,
(DIRECTOR, CONTRACT MANAGEMENT DIRECTORATE)

Subj: DRAFT REPORT ON THE AUDIT OF SPARE PARTS PRICING AGREEMENTS (PROJECT NO. 8CE-5001)

Encl: (1) Navy Comments on 8CE-5001

Enclosure (1) contains the Navy comments on the subject report. We nonconcurred with recommendation A-1, which requires that items under a BOA be priced when the order is issued rather then when the agreement is established, and recommendation B.3.b. which requires that requisitions for the same or similar items be held in suspense for consolidation into economic order quantities. These recommendations, if mandated, would have serious detrimental effects on the Aviation Supply Office's (ASO) ability to perform its inventory supply function. The recommendations made in the report do not take into account the voluminous amount of business done at ASO (and other inventory control points) and the automated nature of meeting those requirements.

The services should be allowed to continue to use these two procedures which you recommend be eliminated. When used properly, they increase immeasurably the efficiency and ability of our inventory control points (as well as other buying offices) to meet their acquisition and supply objectives.

We are unable to concur or nonconcur on the projected $15.3M ($5.4 for ASO) in lost savings called out in finding B. The DODIG calculation methodology was not provided in the subject report.

Questions regarding this response should be directed to Mr. Anthony DeVico at 692-8657.

Frank Swofford

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

Copy to:
NAVINSGEN
NAVCOMPT (NCB-53)

I. Section A. Use of Spare Parts Pricing Agreements

Summary of Finding

DoD buying activities have misused call contract arrangements and basic ordering agreements (BOA's) by negotiating prices for spare parts when the arrangements or agreements were originally established rather than at the time individual contracts (BOA orders) were issued. Similar conditions existed in requirements contracts that incorporated the same clauses found in call contract arrangements. In addition, other requirements contracts were priced without obtaining current cost or pricing data. These conditions were caused by the activities' noncompliance with Federal Acquisition Regulation (FAR), subpart 16.7.

Navy comment

The above finding addresses current Army and Air Force practices. As pointed out in the finding, ASO has discontinued the practice called out in the finding. Nevertheless, we would like to comment on the use of BOAs. The Navy Aviation Supply Office (ASO) is in compliance with FAR 16.703 in that basic ordering agreements are established and used to contract for requirements for supplies or services when specific quantities and items are not known at the time the agreement is executed, but a substantial number of requirements covered by the agreement are anticipated to be purchased from the contractor. One of ASO's main missions as an Inventory Control Point (ICP) is to place the many thousands of purchase requirements generated throughout the year on contract in a timely manner in order to meet required delivery dates. ASO has identified those thousands of items/requirements that will be obtained from sole source contractors and placed those items on the same agreement to take advantage of ordering parts for equipment support and reducing administrative leadtime, inventory investment, and inventory obsolescence addressed in FAR 16.703.

Recommendation

We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the DAR Council to revise the Defense Federal Acquisition Regulation Supplement, Part 16.703, to specifically state that basic ordering agreements should require pricing at the time the order is placed, rather than at the time each agreement is established.

Navy Comment

Non-concur. Article Price Lists (APLs) are viewed as a valuable tool for pricing thousands of items/requirements projected over a finite period of time and ASO has benefited greatly from the use of APLs. An APL allows ASO to price the item up front, helps in contracting for recurring requirements over a period of time, and offsets ASO's spares pipeline in that PALT in establishing a price is calculated in our Procurement Request requirements. ASO receives a Certificate of Current Cost or Pricing Data at the time an agreement on price(s) has been reached. Any reported

deficiencies can be precluded with appropriate safeguards: i.e. periodic sampling to confirm continued validity of negotiated prices, finite life of pricing agreement, internal controls, etc., to ensure that the price(s) established are still considered to be current, complete, and accurate and established in the best interest of the Government. ASO procures thousands of purchase requirements. The absence of this vehicle for establishing prices would greatly affect ASO's ability to support the fleet by obtaining required items in a timely manner.

We have no comment on recommendations 2,3 and 4 as they do not pertain to the Navy.

II. Section B. Consolidating Spare Parts Purchase Requirements

Summary of Finding
Major buying commands repeatedly split purchase requisitions into single line item orders or failed to consolidate purchases and avoided the requirements for the submission of certified cost or pricing data under U.S.C., title 10, section 2306a. These conditions occurred because of inadequate internal control procedures.

Navy Comment
Concur. ASO was not following its internal guidelines to ensure purchase actions were combined.

Recommendation
We recommend that the Commander, U.S. Navy Aviation Supply Office, consolidate the same or similar purchase requirements into a single procurement action in compliance with established command policy and implement adequate controls to ensure compliance with that policy by:

a. Establishing procedures for the buyer to review the procurement history file to determine the current status of existing requisitions for the same or similar spare parts.

Navy Comment
Concur. ASO has issued a Policy and Procedure Memo #89-9 dated 03 March 1989 which directs buyers to make every effort to combine purchase requirements to reduce PALT and administrative processing costs. Buyers are required to review the procurement history file to determine the current status of existing requisitions for the same or similar spare parts. This review is documented in the contract file. The Contracting Officer's review of the contract file ensures compliance before the order is issued.

Recommendation
b. Implementing a system where purchase requisitions for the same or similar items are held in suspense for a reasonable period of time to consolidate into economic order quantities.

Navy Comment
Non-concur. The operation at an Inventory Control Point requires forecasting requirements. Such forecasting uses useage data, repair data, production leadtime, administrative leadtime and other factors in determining the requirement. The Procurement Request amount is based on calculating an economic order quantity based on the useage data. At the time of receipt of a requisition, there is no way to project when the next requisition will be received. Since the calculation relies on the procurement proceeding during the established leadtime goals there is no reasonable hold time. Any delay in processing the requirement would require an increased investment in inventory to cover change in reorder point. Additionally, through the use of pricing agreements the Government receives the benefit of combination, (i.e. pricing based on production run quantities and receipt of cost and pricing data) without actually combining the requirements.

We have no comment on Finding III Section C or its recommendations as they do not pertain to the Navy.

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

NOV. 28 1989

OFFICE OF THE ASSISTANT SECRETARY

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

SUBJECT: DOD/IG Draft Report on the Audit of Spare Parts Pricing Agreements (Project No. 8CE-5001) (Your Memo, September 27, 1989) - INFORMATION MEMORANDUM

This is in reply to your memorandum for Assistant Secretary of the Air Force (Financial Management and Comptroller) requesting comments on the findings and recommendations made in subject report. A summary of the draft DOD/IG findings and recommendations that impact Air Force locations, and our responses, are at Attachment 1.

DANIEL S RAK
Deputy Assistant Secretary
(Acquisition Management & Policy)

1 Atch
Management Comments

AIR FORCE
MANAGEMENT COMMENTS
ON
DRAFT REPORT ON THE AUDIT OF SPARE PARTS PRICING AGREEMENTS

FINDING A. USE OF SPARE PARTS PRICING AGREEMENTS

DOD buying activities have misused call contract arrangements and basic ordering agreements (BOA's) by negotiating prices for spare parts when the arrangements or agreements were originally established rather than at the time individual contracts (BOA orders) were issued. Similar conditions existed in requirements contracts that incorporated the same clauses found in call contract arrangements. In addition, other requirements contracts were priced without obtaining current cost or pricing data. These conditions were caused by the activities' noncompliance with Federal Acquisition Regulation (FAR), subpart 16.7. As a result, spare parts orders were priced with noncurrent data and overpriced by $8 million. We projected that at least $4.8 million and as much as $39 million could be saved over the next 2 years if our recommendations are implemented.

MANAGEMENT COMMENTS

Nonconcur. It appears from the draft audit that the auditors have a misunderstanding of how a requirements contract functions and the pricing requirements for BOA orders. Furthermore, it does not appear that they were fully aware of the reason why SA-ALC was using a "call contract" type arrangement.

Contrary to the inference of the audit report (see pages 9 and 10 of the draft report), certified cost or pricing data is not required when orders are issued against a requirements contract. Certified cost or pricing data is only required when negotiating the price lists used in the requirements contract. This is also true for BOAs in some circumstances. FAR 15.804-2, Requiring certified cost or pricing data, states in part:

> "(a)(1) Except as provided in 15.804-3, certified cost or pricing data are required before accomplishing any of the following actions:
>
> (i) The award of any negotiated contract (except for unpriced actions such as letter contracts) expected to exceed $100,000."

We concur that orders under BOAs constitute the contractual documents rather than the BOA itself. However, if the BOA contains a price list which is established through submission, analysis and negotiation of cost or pricing data, and if the subsequent orders then refer to this basic price list, the requirement to obtain cost or pricing data before award of any negotiated contract has been met. All of the Air Force contracts cited in the report contained price lists supported by certified cost or pricing data.

AIR FORCE
MANAGEMENT COMMENTS
ON
DRAFT REPORT ON THE AUDIT OF SPARE PARTS PRICING AGREEMENTS

FINDING A. USE OF SPARE PARTS PRICING AGREEMENTS

DOD buying activities have misused call contract arrangements and basic ordering agreements (BOA's) by negotiating prices for spare parts when the arrangements or agreements were originally established rather than at the time individual contracts (BOA orders) were issued. Similar conditions existed in requirements contracts that incorporated the same clauses found in call contract arrangements. In addition, other requirements contracts were priced without obtaining current cost or pricing data. These conditions were caused by the activities' noncompliance with Federal Acquisition Regulation (FAR), subpart 16.7. As a result, spare parts orders were priced with noncurrent data and overpriced by $8 million. We projected that at least $4.8 million and as much as $39 million could be saved over the next 2 years if our recommendations are implemented.

MANAGEMENT COMMENTS

Nonconcur. It appears from the draft audit that the auditors have a misunderstanding of how a requirements contract functions and the pricing requirements for BOA orders. Furthermore, it does not appear that they were fully aware of the reason why SA-ALC was using a "call contract" type arrangement.

Contrary to the inference of the audit report (see pages 9 and 10 of the draft report), certified cost or pricing data is not required when orders are issued against a requirements contract. Certified cost or pricing data is only required when negotiating the price lists used in the requirements contract. This is also true for BOAs in some circumstances. FAR 15.804-2, Requiring certified cost or pricing data, states in part: 5

> "(a)(1) Except as provided in 15.804-3, certified cost or pricing data are required before accomplishing any of the following actions:
>
> (i) The award of any negotiated contract (except for unpriced actions such as letter contracts) expected to exceed $100,000."

We concur that orders under BOAs constitute the contractual documents rather than the BOA itself. However, if the BOA contains a price list which is established through submission, analysis and negotiation of cost or pricing data, and if the subsequent orders then refer to this basic price list, the requirement to obtain cost or pricing data before award of any negotiated contract has been met. All of the Air Force contracts cited in the report contained price lists supported by certified cost or pricing data.

AIR FORCE
MANAGEMENT COMMENTS
ON
DRAFT REPORT ON THE AUDIT OF SPARE PARTS PRICING AGREEMENTS

FINDING A. USE OF SPARE PARTS PRICING AGREEMENTS

DOD buying activities have misused call contract arrangements and basic ordering agreements (BOA's) by negotiating prices for spare parts when the arrangements or agreements were originally established rather than at the time individual contracts (BOA orders) were issued. Similar conditions existed in requirements contracts that incorporated the same clauses found in call contract arrangements. In addition, other requirements contracts were priced without obtaining current cost or pricing data. These conditions were caused by the activities' noncompliance with Federal Acquisition Regulation (FAR), subpart 16.7. As a result, spare parts orders were priced with noncurrent data and overpriced by $8 million. We projected that at least $4.8 million and as much as $39 million could be saved over the next 2 years if our recommendations are implemented.

MANAGEMENT COMMENTS

Nonconcur. It appears from the draft audit that the auditors have a misunderstanding of how a requirements contract functions and the pricing requirements for BOA orders. Furthermore, it does not appear that they were fully aware of the reason why SA-ALC was using a "call contract" type arrangement.

Contrary to the inference of the audit report (see pages 9 and 10 of the draft report), certified cost or pricing data is not required when orders are issued against a requirements contract. Certified cost or pricing data is only required when negotiating the price lists used in the requirements contract. This is also true for BOAs in some circumstances. FAR 15.804-2, Requiring certified cost or pricing data, states in part:

> "(a)(1) Except as provided in 15.804-3, certified cost or pricing data are required before accomplishing any of the following actions:
>
> (i) The award of any negotiated contract (except for unpriced actions such as letter contracts) expected to exceed $100,000."

We concur that orders under BOAs constitute the contractual documents rather than the BOA itself. However, if the BOA contains a price list which is established through submission, analysis and negotiation of cost or pricing data, and if the subsequent orders then refer to this basic price list, the requirement to obtain cost or pricing data before award of any negotiated contract has been met. All of the Air Force contracts cited in the report contained price lists supported by certified cost or pricing data.

Based on our discussions with AFLC officials, a "call contract" arrangement is actually a combination of a requirements type contract and a basic ordering agreement. This type of a contractual arrangement was developed in order to allow breakout opportunities which, under a normal requirements type contract, is difficult to do since a normal requirements type contract requires the Government to buy all of their requirements under that contract (see FAR 52.216-21(c)). It was for this reason that the "call contracts" contained a provision stating that the contract was not a requirements contract. We believe it is important to point out that SA-ALC was trying to develop a contractual arrangement that allowed them to break out items that traditionally were bought on a sole source basis. Therefore, they were actually trying to protect the Government's best interests, and were not trying to avoid the requirement for certified cost or pricing data as implied by the audit report.

It is our understanding that the "call contract" was set up similar to a basic ordering agreement, but the pricing arrangement was like that used in a requirements type contract. All of the price lists negotiated for these "call contracts" were based on certified cost or pricing data. We do agree that each order issued against a basic ordering agreement is a separate contract and, therefore, each order technically should be supported by certified cost or pricing data. However, we believe that incorporation of the negotiated price list constitutes the required support by certified cost or pricing data.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Assistant Secretary of Defense for Procurement direct the DAR Council to revise the Defense Federal Acquisition Regulation, Part 16.703, to specifically state that basic ordering agreements should require pricing at the time the order is placed rather than at the time the agreement is established.

2. We recommend that the Assistant Secretary of the Air Force (Acquisition) direct buying commands to discontinue using existing call contract arrangements, and to discontinue placing future call contract arrangements to purchase spare parts.

3. We recommend that the Commander, U.S. Army Aviation Systems Command, require certified cost or pricing data on contracts (Basic Ordering Agreement orders) exceeding $100,000, issued against basic ordering agreements, in compliance with the Federal Acquisition Regulation, 15.804-2.

4. We recommend that the Commander, San Antonio Air Logistics Center:

a. Discontinue incorporating call contract arrangement clauses in indefinite delivery requirements contracts.

b. Obtain certified cost or pricing data to reprice orders under indefinite requirements contracts when the contracts allow resetting of fixed-unit prices or when prices are redetermined based on contractor accounting changes.

c. Obtain audit analysis of updated contractor proposals.

MANAGEMENT COMMENTS

1. Nonconcur. We believe that the current regulations are clear enough in this area. However, we will re-emphasize to Air Force field activities that BOA orders which meet the criteria of FAR 15.804-2 must be either be supported by a price list based on certified cost or pricing data or by certified cost or pricing data obtained prior to award of the order.

2. Partially concur. SA-ALC is no longer issuing call contract arrangements now that the AFFARS coverage on call contracts has been deleted. Furthermore, the call contracts cited in the audit report have now expired.

3. None. Recommendation is directed to the Army.

4. Partially concur. Call contract arrangement clauses are not being incorporated into requirements contracts. All of the contracts cited were priced properly using certified cost or pricing data at the time prices were established. They do not generally allow for resetting of fixed-unit prices during the life of the contract. Finally, we are not aware of any instances where SA-ALC is not complying with the FAR concerning updated audit assistance. This is largely a judgment call exercised by the contracting officer and based on the magnitude of the change to the proposal and the availability of current rates and factors.

FINDING B. CONSOLIDATING SPARE PARTS PURCHASE REQUIREMENTS

Major buying commands repeatedly split purchase requisitions into single line item orders or failed to consolidate purchases and avoided the requirements for submission of certified cost or pricing data under U.S.C., title 10, section 2306a. These conditions occurred because of inadequate internal control procedures. As a result, we estimated that $15.3 million was lost because orders were not consolidated.

MANAGEMENT COMMENTS

Nonconcur. The finding as written is misleading. First of all, at least for the Air Force activity highlighted in the report, there was only one instance found where the requirements for the same item were split. (There was a very good reason for such a decision which will be addressed later.) Secondly, decisions not to consolidate orders were made to protect schedule, not to circumvent the Truth-in-Negotiations Act. Finally, the purported loss of $15.3 million is not valid.

To begin with, the background section of the audit report cites FAR guidance as it relates to the purchase of the same item and who should be responsible for such purchases. These cites have

nothing to do with the consolidation of unlike items. The discussion of the Truth-in-Negotiations Act is inappropriate because nowhere does the Truth-in-Negotiations Act require us to consolidate the purchase of unlike items in order that we can exceed the $100,000 threshold.

The discussion surrounding the purchase of NSN 2840-00-406-2827PQ by OC-ALC is incomplete and implies that this isolated case is an example of a systemic condition which permeates OC-ALC.

The decision to initiate a purchase request for only a portion of the full requirement was made by the material management division at OC-ALC because of extenuating circumstances. Because of a drastic change in the monthly demand rate for this item, from .05 to 8.80, the center found it necessary to obtain additional items as soon as possible. The use of an undefinitized contractual action was considered but the contractor would not accept one. Realizing that an order which exceeded $100,000 would take longer to process, the item manager initiated a request to buy as many items as possible totaling less than $100,000. The purchase request from the item manager was received by the contracting division on June 10, 1986, and award was made on June 26, 1986. In addition, the buyer negotiated a delivery time of 8 months in lieu of the normal delivery time of 16 months for this item. Therefore, while such an action resulted in an award not supported by certified cost or pricing data, the purpose of splitting the requirement was to maintain the proper stock levels at the center, not to circumvent the Truth-in-Negotiations Act.

In addition, the report implies that if certified cost or pricing data was obtained, as it was on the follow-on purchase, the prices would have been lower. Such an implication is inaccurate. The reason the unit prices were lower for the follow-on acquisition was due to the greater number of units being purchased. Furthermore, in support of a proposal on even a later acquisition, the contractor provided actual cost data for labor, material and indirect costs incurred during the production of this acquisition which supported a price substantially higher than the unit price of $436.58 paid for the quantity of 184 each.

We also take exception with the report's discussion of the OC-ALC policy letter, dated January 17, 1987. Just prior to the issuance of the letter, consolidation of purchase requests received at different times for the same item had been determined to be a contributing cause of failure to meet purchase request need dates, and specifically, to timely support of engine overhaul line components. While consolidation of purchase requests is the preferred practice, judgment must be used in making that decision. The policy letter was issued to assist the decision making process by requiring buyers to consider the mission impact along with the price when making a decision to consolidate. It requires a sound business decision in the acquisition process.

It should be noted that the primary aim of the policy letter is to enhance customer support, not split purchase requirements as

alleged. Contrary to the assertion in the draft report that the letter was written to intentionally split requirements, paragraph 3.b. of the letter specifically requires that if by combining the purchase requests one could come close to meeting the required schedule, the buyer should coordinate such a consolidation with the item manager, combine the purchase requests and proceed with the buy. The purpose of the letter was customer support, not circumvention of the requirements of the Truth-in-Negotiations Act. If buyers are using this guidance inappropriately, they will be reminded of its intended purpose.

The audit report also misrepresents the intent of Air Force Logistics Command regulation 57-7, chapter 4. This specific chapter of the regulation is concerned with the consolidation of requirements at the point of purchase request initiation, not at the award stage. Paragraph 4-1d of this regulation states, "group the requirements for separate items on the same purchase request as much as possible if such a grouping won't cause a number of items to be held unnecessarily due to problems on a few items." Based on OC-ALC's experience, combining unlike items on purchase requests unnecessarily delays the acquisition. Therefore, as allowed by the regulation, OC-ALC does not combine items at the purchase request stage except for those that are so similar that actual manufacturing efficiencies can be obtained. Recent examples of such consolidations are turbine vanes and combustion chamber segments. Consolidation of items which do not provide such efficiencies do not typically result in any reductions in unit prices. However, the delays attendant to those consolidations frequently do increase prices due to the extension of production periods. OC-ALC does combine requirements for the same item whenever possible given mission support requirements. To assure compliance with this policy, a management information system product identified as JO41-4JJ is provided to supervisors monthly which identifies all items in the contracting division for which multiple purchase requests exist.

We also disagree with the statistical projections concerning the savings which could be realized through consolidation (Appendix I). To begin with, the report is deficient in that it does not provide details of the savings calculations, the sampling techniques used, and the universe examined. Furthermore, the report does not address the total contractor proposed values against which the figures in columns (2) and (3) of Appendix I must be compared. There was no attempt to measure the movement from proposed to negotiated prices. Therefore, applying a DCAA savings of 5.8 percent to final negotiated values as opposed to proposed values is totally inconsistent.

From verbal discussions with the auditor, it appears that the column (5) calculations were based on projecting the 5.8 percent savings on contracts under $25,000. This projection was made without any consideration of the number of line item audits this would require, nor any other consideration of administration costs to the buying activity or DCAA. Further, no consideration was given to the increased costs to the contractor for compiling and

providing additional cost and pricing data. These increased costs would be allocated to overhead accounts eventually driving up prices to be paid on future acquisitions.

The recommendation to consolidate purchase requests for the primary purpose of driving the submission of certified cost or pricing data would mean that field pricing resources (DCAA and cognizant CAS activities) would be required to review each line item of a proposal regardless of line item dollar value unless a statistical review method is employed. Neither DCAA nor the buying offices have unlimited resources to use on auditing submissions or certified cost or pricing data. The limited resources available are required for the largest dollar value contracts and programs where they can provide the greatest potential benefit.

The report also fails to recognize the inherent costs associated with administrative lead times and the significant costs associated with pipe line costs. The report scenario would require significantly longer administrative lead times which must be considered when weighing the benefits of consolidation.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Commander, Oklahoma Air Logistics Center (OC-ALC) consolidate spare parts items into single purchase requirements in compliance with the Headquarters, Air Force Logistics Command's procedures and establish internal controls to ensure compliance with that policy by:

a. Establishing procedures to ensure purchase requests are checked against other purchase requirements.

b. Establishing procedures to ensure spare parts orders are placed in economic order quantities.

c. Considering the use of a computer-based system for accumulating requirements.

MANAGEMENT COMMENTS

1. Concur. It is our belief that OC-ALC is in compliance with AFLC Regulation 57-7, Chapter 4. The regulation does not contemplate consolidation when such a procedure would result in the delay of award. Purchase request requirements are consolidated both in the initiation and solicitation stages when manufacturing efficiencies appear to exist. OC-ALC has adequate internal policy and procedures to ensure compliance with the regulation. OC-ALC will be encouraged to utilize the computer program currently available to them to the maximum extent that it can be used to support mission requirements.

FINDING C. BREAKOUT OF SPARE PARTS

Two major buying commands included spare parts in pricing agreements when those parts should have been broken out for competitive procurement or direct buy from the actual manufacturer. This situation was caused by the buying offices' and prime contractors' failure to comply fully with the Defense Federal Acquisition Regulation Supplement (DFARS) requirements. As a result, DOD has incurred additional cost of $42.5 million on orders placed in FY's 1984 through 1988 on four contractors for prime contractor burden and profit that were added to the cost of spare parts purchases from manufacturers. We estimated that $18.4 million of prime contractor costs could be avoided in the next 2 years if our recommendations are implemented. In addition, the government has lost any savings that might have been achieved through competitive purchase.

MANAGEMENT COMMENTS

We concur with that portion of the finding which states that contractors failed to comply with the Defense Federal Acquisition Regulation Supplement requiring identification of actual manufacturers. We nonconcur with the remainder of the finding.

The finding is deficient in that it fails to recognize the history and timing of the breakout program, the number of items that are bought and screened on an annual basis, and the number of personnel assigned to breakout activity. SA-ALC has done more than a "commendable" job in the area of breakout, whereas the report as written, implies they are not complying with the breakout program.

To begin with, the renewed emphasis on the breakout of spare parts within the DOD did not begin until late 1983 and early 1984. Increased authorization for the manpower needed to accomplish screening of spare parts for possible breakout was not received until sometime in 1984. Even with this increased authorization, full manning was not instantaneous. For example, at SA-ALC the number of people dedicated to the screening of spare parts grew from 30 people in 1984 to 87 people in 1989. Furthermore, even with increased manning, there was no way that each and every part could be screened in the first year.

All of the contracts cited in the audit report were awarded in 1985. Considering this was only the second year of intensified screening and breakout activity, it is not surprising that a number of items were included in the contract price lists that were breakout candidates. This is especially true on the Allison contract because Allison identified themselves as the only manufacturer for the items identified in the report.

We also take exception to the statement that Allison had no objection to the procurement of these parts from the actual manufacturer. Of the three prime engine contractors (Pratt & Whitney, General Electric, and Allison), Allison rates last as far as working with SA-ALC on breakout activity.

The report also fails to recognize the breakout efforts that have occurred on the items identified in the report since 1985. Even though Allison identified themselves as the only manufacturer, SA-ALC continued to pursue breakout of these items and were successful in identifying the actual manufacturer on 14 of the items. When the actual manufacturers were contacted by SA-ALC, they refused to sell directly to the Air Force. Only when SA-ALC started source development efforts to establish another source did the actual manufacturers reverse their position. The actual manufacturers are now listed as approved sources for the items. Because of SA-ALC's actions, all but 4 of the 21 parts now have a second source approved for manufacture of the item. Source development efforts on the remaining items are under way. In addition, of the 322 different items that were listed on the price list contained in the Allison contract, only 77 items are now being bought from Allison on a sole source basis. The remainder of the items are either being bought from the actual manufacturer or are bought competitively. Such success can hardly be categorized as a "failure" to comply with the DOD Breakout Program.

The audit report is also in error with regards to the Pratt & Whitney contract. The report identified six items as breakout candidates and stated that the Government incurred excessive costs of $1,437,282 because of their purchase from Pratt & Whitney. First of all, the item identified as 4068106-01 with a purported associated savings of ** was for the initial purchase of a modification kit. Engineering data for the kit was not available to SA-ALC until the development of this item had been completed. This kit was also purchased on an emergency basis to remedy problems that were causing engine blowouts and stalls. Part number 4070640 falls into the same category as the mod kit. It was a one time purchase of a non-stock listed item. It would have been nearly impossible to have broken out this item on its initial acquisition. Breakout on P/N 374166, for the J-60 engine has been hampered because of the proprietary rights claim by Pratt & Whitney. SA-ALC is working to have this restriction removed from the drawings. The other three items have been either broken out to the actual manufacturer or source development action has been initiated.

Finally, we take exception with the excessive costs which purportedly resulted from the purchase of the items identified in the report, and we also take exception to the forecasted savings. First of all, the calculation assumes the government could have bought the item at the same price as the prime. This is not always the case. Secondly, the overhead, general and administrative costs, and cost of money do not disappear. These costs are absorbed by other acquisitions; therefore, to include these costs in the calculations are misleading. Also, many of the unit prices listed in Appendix L are higher than those listed in our records. In addition, the calculations ignore warranty, inspection, product support costs, etc. that may have been provided by the prime and will now have to be bought from the actual manufacturer or provided by the government. Lastly, since we have already broken out a majority of the items identified in

** Contractor proprietary data deleted.

the report, any savings realized with those items are a direct result of SA-ALC's actions, they are not associated with this audit. Even on those items that have not been broken out, any savings associated with those items would still be attributed to SA-ALC's efforts because they have been actively working to break these items out prior to the audit.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Commanding Officers, San Antonio Air Logistics Center and U.S. Army Aviation Systems Command:

1. Screen all spare parts that exceed the annual buy criteria of $10,000 and break out parts for purchase from actual manufacturers or through competition in compliance with the Defense Federal Acquisition Regulation Supplement Parts 206 and 217.

2. Improve internal controls over the process of identifying spare parts for breakout by:

a. Having the competition advocate or other responsible party review the proposed purchase of spare parts expected to exceed the annual buy criteria of $10,000, and document that spares acquisitions are consistent with programmed acquisition plans.

b. Requiring a justification to be included in the procurement files for the spare parts purchases not subjected to screening procedures and purchased from prime contractors.

MANAGEMENT COMMENTS

These recommendations and the accompanying finding should be deleted from the final report. SA-ALC has always complied with the DOD breakout program and has done an outstanding job with limited resources in identifying breakout opportunities. Furthermore, the fact that the auditors were able to identify a few items that were potential breakout candidates on buys that were consummated early on in our breakout efforts hardly indicates a systemic condition of non-compliance. The finding and recommendations are unsupportable based on facts.

AUDIT TEAM MEMBERS

James J. McHale, Acting Director, Contract Management Directorate
Salvatore D. Guli, Program Director
Bruce Burton, Project Manager
Garry Hopper, Team Leader
Larry Zaletel, Team Leader
Richard Hanley, Auditor
Mary Smith, Auditor

FINAL REPORT DISTRIBUTION

Office of the Secretary of Defense

Comptroller of the Department of Defense, Deputy Comptroller, (Management Systems)
Comptroller of the Department of Defense, Deputy Comptroller, (Program/Budget)
Assistant Secretary of Defense (Production and Logistics)
Assistant Secretary of Defense (Public Affairs)
Defense Acquisition Regulatory Council

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Comptroller of the Army
Army Inspector General
U.S. Army Aviation Systems Command

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Comptroller of the Navy
Navy Inspector General
U.S. Navy Aviation Supply Office
Naval Audit Service

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Acquisition)
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Air Force Audit Agency
San Antonio Air Logistics Center
Oklahoma City Air Logistics Center

Defense Agencies

Defense Contract Audit Agency
Defense Logistics Agency

FINAL REPORT DISTRIBUTION (Continued)

Non-DoD Activities

Office of Management and Budget

General Accounting Office, NSIAD Technical Information Center

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations