Audit Report

OFFICE OF THE INSPECTOR GENERAL

QUICK-REACTION AUDIT REPORT ON CONDITIONAL ACCEPTANCE OF MEDIUM TACTICAL VEHICLES

Report No. 96-005 October 12, 1995

Department of Defense

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Acronyms

FMTV	Family of Medium Tactical Vehicles
GAO	General Accounting Office
PEO	Program Executive Officer

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

October 12, 1995

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Quick-Reaction Audit Report on Conditional Acceptance of Medium Tactical Vehicles (Report No. 96-005)

We are providing this quick-reaction report for review and comments. This report addresses conditional acceptance of incomplete vehicles, which could result in additional premature payments to a contractor. Also, the matter could continue to increase the Army cost risk on the Family of Medium Tactical Vehicles (FMTV) Program. Comments on a draft report were considered in preparing this report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that the Army provide additional comments on the Recommendation by November 13, 1995.

If you have questions on this audit, please contact Mr. Rayburn H. Stricklin, Program Director, at (703) 604-9051 (DSN 664-9051) or Mr. D. Michael Welborn, Project Manager, at (703) 604-9042 (DSN 664-9042). The distribution of this report is in Appendix F.

David K. Steensma

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Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-005 **October 12, 1995**
(Project No. 5AL-0003)

QUICK-REACTION AUDIT REPORT ON CONDITIONAL ACCEPTANCE OF MEDIUM TACTICAL VEHICLES

EXECUTIVE SUMMARY

Introduction. We are issuing this quick-reaction report about conditional acceptance of incomplete vehicles because the conditional acceptance could result in additional premature payments to a contractor. Also, the matter could continue to increase the Army cost risk on the Family of Medium Tactical Vehicles (FMTV) Program.

The Army's medium tactical truck inventory, which consisted of approximately 95,460 2-1/2-ton and 5-ton vehicles, is costly to maintain and operate. Also, the 2-1/2-ton truck has key operational limitations. The Army planned to modernize the medium tactical truck inventory through the FMTV Program.

The FMTV Program was structured to acquire 85,401 medium tactical vehicles by 2021. The Army estimated that the total cost of the Program would be $16.3 billion (then-year dollars). In October 1991, the Army awarded a 5-year, firm-fixed-price contract, valued at $1.2 billion, to Stewart and Stevenson Services, Incorporated (the Contractor), for the production of 10,843 trucks. The FMTV Program was about 18 months behind schedule, as of April 30, 1995. As of August 10, 1995, the Army had paid the Contractor about $340.5 million but had not yet received a complete vehicle. On August 14, 1995, the Army approved the FMTV Program for full-rate production.

Objectives. The overall audit objective was to evaluate the Army efforts to acquire and field medium tactical vehicles. We also evaluated the adequacy of management controls related to critical program management elements for a system in the production and deployment phase of the acquisition cycle.

Audit Results. The FMTV Program Office had conditionally accepted 552 incomplete vehicles from the Contractor and planned to conditionally accept additional vehicles, although such acceptance was not in the best interest of the Government. Conditional acceptance of the vehicles resulted in the Army prematurely paying the Contractor $7.1 million for vehicles for which the Army received no benefit. Further, continued conditional acceptance of incomplete vehicles could result in the Army prematurely paying the Contractor an additional $17.0 million for incomplete vehicles. Conditional acceptance also unnecessarily increased the Army cost risk on the FMTV Program and reduced the incentive for the Contractor to finish incomplete vehicles.

Implementation of the Recommendation in this report should prevent premature payments of $17.0 million for conditional acceptance of incomplete vehicles and would enable the Army to avoid certain cost risks on the FMTV Program. Appendix D summarizes the potential benefits of the audit.

Summary of Recommendation. We recommend that the Army stop conditionally accepting vehicles under the FMTV Program.

Management Comments. The Director for Combat Service Support (the Director), Office of the Assistant Secretary of the Army (Research, Development and Acquisition), nonconcurred with the Recommendation. The Director stated that most concerns outlined in the draft report had been recently overcome since all testing had been completed. The Director also stated that the Army had not incurred any additional costs as a result of conditionally accepting vehicles.

The Program Executive Officer (PEO) for Tactical Wheeled Vehicles questioned the quantity of vehicles that the draft report cited as being inappropriately accepted. The PEO also did not agree with the Recommendation because conditional acceptance was needed to maintain the production build line, to improve the production processes, and to improve the supplier-based deliveries of components and assemblies to the levels necessary to support full-rate production. The comments are summarized in Part II, and the complete text of the comments is in Part IV.

Audit Response. The Director's comments do not present a complete context of the problems. Except for conditionally accepting a quantity of vehicles to perform testing, the completion of testing and the establishment of a final configuration do not impact whether or not the Army should conditionally accept the incomplete vehicles. Conditional acceptance should be based on whether such action is in the best interest of the Government. As we stated in this report, the Army prematurely paid $7.1 million for the vehicles that it had conditionally accepted. Such payments cost the Government about $388,370 in annual interest costs. Additionally, payments for conditional acceptance prematurely increased the cost risks on the FMTV Program.

Based on the PEO comments, we revised the number of vehicles that the Army should not have conditionally accepted. However, as discussed in summary form in our Audit Response in the Finding and in detail in Appendix B, we are convinced that, except for vehicles used for testing, none of the reasons specified by the PEO made conditional acceptance imperative. We also believe that the Army realized no benefit in conditionally accepting the vehicles. Therefore, we ask the PEO to reconsider his position on the Recommendation and provide additional comments to this report.

Further, if the PEO still does not agree with the Recommendation after considering our audit responses, we ask that the PEO not conditionally accept any additional vehicles until his disagreement with the Recommendation is resolved. As shown in Appendix C, the Deputy Secretary of Defense stated that:

> Managers should be aware of the need to maintain an effective, credible audit decision process to preclude preemptive actions, such as proceeding with activities questioned in undecided audit reports.

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Part I - Introduction

Background

The Family of Medium Tactical Vehicles (FMTV) consists of a family of vehicles based on a common truck chassis that is designed to perform line haul, local haul, and unit resupply. The Army plans to field 2-1/2-ton tactical vehicles in cargo and van variants and 5-ton trucks in cargo, material-handling, dump truck, wrecker, van, tanker, and tractor configurations. The FMTV is to operate worldwide as multi-purpose transportation and unit mobility vehicles on primary and secondary roads, trails, and cross-country terrain.

As of February 1, 1995, the Army planned to acquire 85,401 vehicles. The FMTV Program is in the Production and Deployment phase of the acquisition cycle. In October 1991, the Army awarded a 5-year contract, valued at $1.2 billion, to Stewart and Stevenson Services, Incorporated (the Contractor), for the production of 10,843 vehicles. On August 14, 1995, the Army approved the FMTV Program for full-rate production.

The FMTV Program Office, located at the Army's Tank-automotive and Armaments Command, Warren, Michigan, manages the FMTV Program under the direction of the Program Executive Officer (PEO) for Tactical Wheeled Vehicles.

Objectives

The overall objective of the audit was to evaluate the Army efforts to acquire and field medium tactical vehicles. The audit was conducted in accordance with the critical program management element approach of the Office of the Inspector General, DoD. We also evaluated the adequacy of management controls related to the program management elements.

Scope and Methodology

We conducted this economy and efficiency audit from October 1994 through May 1995. 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 management controls as were deemed necessary. We reviewed records and supporting documentation, dated from October 1991 through May 1995, concerning issues relating to the conditional acceptance of vehicles. We did not rely on computer-processed data to develop our audit conclusions. Appendix E lists the organizations that we visited or contacted during the audit.

Management Controls

The results of our evaluation of management controls related to the acquisition of the FMTV will be addressed in a later report on this audit.

Prior Audits

Since August 1993, the General Accounting Office had issued three reports addressing the FMTV Program. The reports addressed the quantity of vehicles for low-rate initial production, the use of commercial components in the vehicles, and attainability of program goals. More details on the reports are provided in Appendix A.

Other Matters of Interest

On May 12, 1995, representatives of the San Antonio Air Logistics Center suspended all divisions of Stewart and Stevenson Services, Incorporated, from future business with the Government. The Air Force suspended the Contractor, pending the outcome of a grand jury indictment of corporate officers for conspiracy, major fraud against the Government, making false statements to an agency of the Government, and aiding and abetting in the alleged crimes on an Air Force contract. This action does not directly affect the FMTV Program.

Part II - Finding and Recommendation

Conditional Acceptance

The FMTV Program Office had conditionally accepted 552 incomplete vehicles from the Contractor and planned to conditionally accept additional vehicles, although such acceptance was not in the best interest of the Government. The FMTV Program Office provided for conditional acceptance based on an unvalidated need to have the vehicles available for deployment and to smooth out the workload of accepting and fielding vehicles. Also, officials in the FMTV Program Office contended that the Army refusal to accept vehicles created a perception that the Army was punitive over trivial issues. Conditional acceptance of the vehicles resulted in the Army prematurely paying the Contractor $7.1 million for vehicles for which the Army received little or no benefit. Continued conditional acceptance of incomplete vehicles could result in the Army prematurely paying the Contractor an additional $17.0 million for incomplete vehicles. Conditional acceptance also unnecessarily increased the Army cost risk on the FMTV Program and reduced the incentive for the Contractor to finish incomplete vehicles.

Background

The production contract for the FMTV Program provided the Army discretionary authority to conditionally accept vehicles. The contract also specified that the Contractor could invoice for conditionally accepted vehicles at 90 percent of contract price.

To administer conditional acceptance, the procuring contracting officer for the FMTV Program provided the Defense Plant Representative Office with criteria for conditionally accepting vehicles. The procuring contracting officer established criteria for four basic categories of acceptance. Each category covered a portion of the production run for the FMTV Program and contained different criteria for conditional acceptance. The criteria permitted conditional acceptance of vehicles with increasing numbers of missing and nonconforming parts.

Vehicles Accepted to Date

As of April 30, 1995, the Army had conditionally accepted 675 incomplete vehicles from the Contractor. The Army conditionally accepted 123 of the vehicles for the purpose of Government testing. The Army conditionally accepted the 675 vehicles over 24 months as shown in the table.

Conditionally Accepted Vehicles

Calendar Year	Quarter of Acceptance	Number of Vehicles
1993	Second	7
1993	Third	57
1993	Fourth	23
1994	First	7
1994	Second	29
1994	Third	241
1994	Fourth	207
1995	First	37
1995	Second	67
Total		**675**

All 552 of the vehicles that were not used for testing lacked certain parts and had nonconforming parts. As such, the vehicles must be completed and retrofitted. The retrofit efforts on 525 of the 552 vehicles will be extensive because the Contractor must disassemble and rebuild the vehicles.

Vehicles Awaiting Acceptance

As of April 30, 1995, the Contractor also had an additional 1,122 incomplete vehicles that were awaiting acceptance. The vehicles came off the production line over a 26-month period.

The vehicles, like the 552 conditionally accepted vehicles, lacked certain parts and had nonconforming parts. Extensive retrofit efforts will be necessary on 850 of the 1,122 vehicles. The Contractor will have to disassemble and rebuild the vehicles. The other 272 vehicles will be subject to limited retrofit efforts that the Contractor planned to accomplish separate from the production line.

Reasons for Accepting Vehicles

The Weapons System Manager of the FMTV Program specified various reasons why the Army should conditionally accept vehicles from the Contractor. Specifically, he maintained that the Army needed to conditionally accept the vehicles so that the vehicles would be available for deployment, if needed, and so that the Army could smooth out the workload of accepting the increasing number of vehicles awaiting acceptance and fielding. The Weapons System Manager explained that if the number of vehicles awaiting acceptance continues to increase and if conditional acceptance does not occur, a large number of

vehicles would overload Government resources used to accept the vehicles. He added that the overload might delay fielding. Also, the Weapons System Manager was concerned that the Army's refusal to accept vehicles would create a perception that the Army was punitive over trivial issues.

Audit Evaluation of Conditional Acceptance

The Army reasons for conditional acceptance were not valid. Conditional acceptance did not provide a deployable vehicle, did not smooth out workload, and would not create a misleading perception concerning the Army's refusal to accept incomplete vehicles.

Deployment of Vehicles. Although the Weapon Systems Manager maintained that the possible need for the FMTV in deployments justified conditional acceptance, the vehicles that the Army conditionally accepted had not been delivered to a deploying unit. The Army, after conditionally accepting the vehicles, merely moved them from one area of the Contractor's facility to another area at the Contractor's facility designated as the Army's area. Then, the vehicles stayed in that area without being completed, retrofitted, or used. As indicated in the table on page 7, the vehicles had stayed in the area for as long as 2 years.

Since the vehicles were not delivered to deploying units, the vehicles were not in the Army deployment plans. Further, the FMTV was not deployable in its current state for the following additional reasons.

o The Program Office had not stabilized the design for vehicles in the FMTV Program. The Contractor continued to make design changes, as evidenced by 5,587 open test incident reports that required the Contractor to take corrective action; 263 engineering change proposals; and 1,372 notices of revisions to engineering drawings.

o The FMTV was not yet supportable. The continuous design changes that the Contractor experienced delayed validation, verification, and delivery of the technical manuals needed to operate and maintain the vehicles. The Army had no assurance that the conditionally accepted vehicles would be reliable and supportable because the vehicles had not passed operational tests. Also, the Army had not established a final configuration baseline for the vehicles; therefore, the conditionally accepted vehicles would not be retrofitted to the final configuration. Additionally, after producing about 1,800 vehicles, the Contractor continued to experience extensive problems with shortages of parts. Therefore, the availability of parts to support a deployment would be questionable. The Contractor had acquired about $10 million in spare parts for the vehicles. However, the parts may require replacement or extensive rework because of continuing design changes.

o Parts missing from the vehicles precluded safe operation of the vehicles. For example, two of the missing items, the fan shrouds and

alternators, were essential to the safe operation of the vehicle. Representatives of the Safety Office at the Tank-automotive and Armaments Command also stated that if the vehicles were deployed, limitations would be placed on their operation.

Smoothing Out Workload. The Weapons System Manager did not fully address the issue in concluding that conditional acceptance smoothed out the workload of accepting and fielding vehicles. Conditional acceptance actually increased workload because it did not eliminate additional inspections but was an optional procedure under the terms of the production contract. After conditional acceptance of incomplete vehicles, the vehicles would still require retrofit, the Army's oversight of the retrofits, and final acceptance.

A large number of vehicles awaiting inspection would not overload Government resources used to accept the vehicles. Representatives of the Defense Plant Representative Office did not foresee a significant backlog of vehicles awaiting acceptance. Further, the representatives did not expect a significant backlog of vehicles due to the Contractor's inability to achieve the low-rate initial production rate of 200 vehicles per month. Additionally, any delay in fielding vehicles due to a backlog of vehicles awaiting acceptance cannot be reduced by conditional acceptance of vehicles. The conditionally accepted vehicles still must pass final acceptance. Conditional acceptance of incomplete vehicles only aggravates the situation. About 82 percent of the vehicles (1,474 of the 1,797 vehicles) built through April 30, 1995, must be disassembled down to the chassis and rebuilt, resulting in new vehicles requiring new acceptance tests.

Perception of the Army. We do not believe that anyone other than the Contractor would perceive the Army to be trivial for refusing to accept incomplete vehicles. The Army should be perceived as protecting the Government's interest by not conditionally accepting incomplete vehicles that for the most part must be torn down and rebuilt to correct deficiencies.

Effect of Conditional Acceptance

Conditional acceptance of 552 vehicles resulted in the Army prematurely paying the Contractor about $7.1 million for vehicles for which the Army received no benefit. The $7.1 million represented the difference between the amounts paid for cost incurred on progress payments and the contract price paid for conditional acceptance. The contract provided for the Contractor to receive 85 percent of eligible cost incurred for progress payments. For each conditionally accepted vehicle, the Contractor was entitled to 90 percent of the contract price, and the Army liquidated prior progress payments at the rate of 85 percent of the 90 percent of contract price allowed for a conditionally accepted vehicles. Therefore, for conditionally accepted vehicles, the Contractor received an additional 15 percent of 90 percent of the contract price.

Continued conditional acceptance of incomplete vehicles could result in the Army prematurely paying the Contractor an additional $17.0 million for

incomplete vehicles for which it would receive no benefit. Also, since the Army pays the Contractor 90 percent of the contract price for conditionally accepted vehicles, the Contractor has less incentive to complete the vehicles. Given the extent and unknown cost of retrofit efforts, the Contractor may benefit by continuing to produce new vehicles rather than incurring cost to complete the vehicles already produced. As of July 25, 1995, the retrofit effort was scheduled to begin in November 1995. However, the retrofits have been rescheduled three times since 1993.

Another effect of conditional acceptance is that the Army cost risk on the FMTV Program unnecessarily increased. By prematurely paying the Contractor $7.1 million to $24.1 million for vehicles that are incomplete, the Army was unnecessarily increasing its cost risk on the FMTV Program.

Conclusions

The FMTV Program Office's conditional acceptance of incomplete vehicles was not in the best interest of the Government as the Contractor received premature payments and program risk unnecessarily shifted from the Contractor to the Government. Conditional acceptance of 552 incomplete vehicles through April 30, 1995, resulted in the Army prematurely paying the Contractor $7.1 million for vehicles for which the Army received no benefit. Further, continued conditional acceptance of incomplete vehicles could result in the Army prematurely paying the Contractor $17.0 million for additional incomplete vehicles for which it would receive no benefit. The accepted vehicles were not suitable for deployment and were not in the Army deployment plans. Further, conditional acceptance of incomplete vehicles unnecessarily increased acceptance workload due to the extensive retrofit program necessary to complete the vehicles. Conditional acceptance of incomplete vehicles also reduced the incentive for the Contractor to complete the vehicles.

Recommendation, Management Comments, and Audit Response

We recommend that the Program Executive Officer for Tactical Wheeled Vehicles direct the Project Manager for the Family of Medium Tactical Vehicles Program to stop conditionally accepting vehicles.

Management Comments. The Director for Combat Service Support (the Director), Office of the Assistant Secretary of the Army (Research, Development and Acquisition), nonconcurred with the Recommendation. The Director maintained that most of the concerns outlined in the draft report had been recently overcome since all testing had been completed and the production

configuration can be finalized. The Director also maintained that the Army had not incurred any additional costs as a result of conditionally accepting vehicles. The full text of the Director's comments is in Part IV.

The Program Executive Officer (PEO) for Tactical Wheeled Vehicles did not agree with the Recommendation for several reasons.

o The PEO disputed the number of vehicles that we specified in the draft report as being inappropriately conditionally accepted. The PEO stated that the multiyear production contract required the Army to conditionally accept all vehicles that would be used for testing.

o The PEO stated that the report failed to address the root issue of the audit: the concern of the Inspector General, DoD, over the use of conditional acceptance of hardware on defense contracts. The PEO further maintained that if the Inspector General, DoD, "deemed" it improper to conditionally accept vehicles during low-rate initial production and testing, then the Inspector General, DoD, should recommend that the entire DoD not conditionally accept vehicles during those times.

o The PEO stated that debate over conditional acceptance on the current FMTV production contract served no purpose because the contract provides for conditional acceptance of production vehicles.

The full text of the PEO comments is in Part IV.

Audit Response. Except for conditionally accepting vehicles to perform testing, the completion of testing and the establishment of a final configuration do not impact whether or not the Army should conditionally accept the incomplete vehicles. Conditional acceptance should be based on whether such action is in the best interest of the Government.

The Army did incur additional costs as a result of conditionally accepting the vehicles. The Army prematurely paid $7.1 million for the vehicles that it had conditionally accepted. Such payments cost the Government about $388,370 in annual interest costs. Additionally, payments for conditional acceptance prematurely increased the cost risks on the FMTV Program. We realize that some officials believe the FMTV Program has little risk since the vehicles tested so well during initial production test and operational test and evaluation completed on June 12, 1995. The test vehicles were not production vehicles. Instead, the Contractor installed modifications after the vehicles came off the production line and specially prepared the vehicles used for testing. The Contractor has yet to produce a vehicle in the configuration tested. As of August 10, 1995, the Army had paid the Contractor about $340.5 million but had not yet received a complete vehicle.

Based on the PEO comments, we reduced the number of vehicles that the draft report specified as being conditionally accepted without any benefits. Specifically, the draft report stated that the Army conditionally accepted

675 vehicles although such acceptance was not in the best interest of the Government. Since 123 of the vehicles were used for testing, we reduced the 675 to 552 vehicles.

We disagree with the PEO claim that the report failed to address the root issue of the audit. The objective of the audit pertained only to matters involving the FMTV Program, not all hardware on defense contracts. As such, it would be inappropriate for us to make a recommendation for the entire DoD based on an audit of the FMTV Program.

We also disagree with the PEO comment that debating the benefits of conditional acceptance on the current FMTV production contract served no purpose. Although the production contract for the FMTV Program provides for conditional acceptance, the Army is not required to conditionally accept vehicles. Again, conditional acceptance should be based on whether or not such action is in the Government's best interest.

In Appendix B, we provide detailed responses to all PEO comments.

The Government received no benefit from conditional acceptance of incomplete vehicles that remained at the Contractor's facility. We believe that our Recommendation is valid. Therefore, we ask the PEO to reconsider his position on the Recommendation and provide additional comments by November 13, 1995.

Further, if the PEO still does not concur with the Recommendation after considering our audit responses, we ask that the PEO not conditionally accept additional vehicles until his disagreement with the Recommendation is resolved. Continuing to conditionally accept vehicles after the receipt of this report would be contrary to guidance provided by the Deputy Secretary of Defense. As shown in Appendix C, the Deputy Secretary of Defense stated that "Managers should be aware of the need to maintain an effective, credible audit decision process to preclude preemptive actions, such as proceeding with activities questioned in undecided audit reports."

Part III - Additional Information

Appendix A. Summary of Prior Audits

General Accounting Office (GAO) Report No. GAO/NSIAD-95-77R (Office of the Secretary of Defense Case 9839), "Low-Rate Initial Production," December 21, 1994. The report stated that the Army was planning to modify its FMTV contract to increase the number of vehicles authorized for low-rate initial production from 3,085 to 3,858 vehicles, an increase of 773 vehicles. Although the Army stated that the increase was needed to prevent a break in production, the GAO concluded that the contract should not be modified because testing of the FMTV had not demonstrated that the Contractor produced operationally suitable vehicles and the current contract authorized a sufficient number of vehicles under low-rate initial production to maintain production until scheduled testing can be completed.

The GAO recommended that the Assistant Secretary of the Army (Research, Development and Acquisition) direct the FMTV Project Manager to cancel plans to modify the contract and delay the planned increase of 773 vehicles until the system successfully completes operational testing.

The Army partially concurred with the GAO recommendation. The Army agreed that significant successful test results should be accumulated before increasing the number of vehicles under low-rate initial production. However, the Army believed limiting test experience to only the completion of operational testing was not necessary and possibly not contractually feasible. The Army was considering whether other test results justified increasing the number of trucks ordered under low-rate initial production.

GAO Report No. GAO/NSIAD-94-240 (Office of the Secretary of Defense Case 9571), "Army Acquisition: Commercial Components Used Extensively in Tactical Trucks," September 26, 1994. The objectives of the audit were to determine whether the Army could meet its tactical truck requirements through purchasing purely commercial or "off-the-shelf items," whether "off-the-shelf" procurement was feasible or what modifications were needed, and whether the Army requirements limited the use of commercial trucks. The GAO concluded that key operational requirements prevented the Army from using strictly commercial items to meet its tactical truck needs. However, the GAO found that contractors used commercial items as a baseline for meeting tactical truck requirements. The GAO also concluded that the Army policies placed higher demands on contractors by requiring rigorous testing, more detailed technical manuals, and the use of standard Army parts. The GAO did not make any recommendations.

GAO Report No. GAO/NSIAD 93-232 (Office of the Secretary of Defense Case 9461), "Army Acquisition: Medium Truck Program Is Not Practical and Needs Reassessment," August 5, 1993. The objectives of the audit were to determine the feasibility of the Army meeting program and fleet management goals under its 30-year acquisition strategy, the extent to which the Army considered other medium truck alternatives in deciding to move forward with the truck replacement program, and whether more cost-effective alternatives existed.

The GAO concluded that the Army 30-year strategy could impair the Army ability to meet key management and program goals and expectations, such as significantly reducing the average age of the fleet and lowering the fleet's operation and support costs. The GAO also identified several alternatives to the current program that could provide a more cost-effective medium tactical truck acquisition.

The GAO recommended that the Secretary of the Army reassess the cost effectiveness of the 30-year acquisition strategy for the Army FMTV Program, especially in light of the negative impact of the program's length on program and fleet management goals and expectations. The GAO added that the assessment, at a minimum, should consider the:

- DoD final unannounced force structure reductions,
- impact of the Army's new operational doctrine on requirements,
- air deployability of the 2-1/2-ton truck in the FMTV Program, and
- need for more trailers in the FMTV Program.

The GAO also recommended that the Army not proceed to full-rate production on the FMTV Program until the reassessment was complete and alternatives were considered.

Although the Army generally disagreed with the GAO conclusions and recommendations, the Under Secretary of Defense for Acquisition and Technology concurred with the recommendation except for delaying the FMTV Program from proceeding to full-rate production. The Under Secretary believed it was more prudent that the assessment be completed to support the solicitation for the follow-on production contract. Also, the Under Secretary stated that the Army would update the cost and operational effectiveness assessment for the FMTV Program. The Under Secretary further stated that the update would be used to support the Army System Acquisition Review Milestone IIIB review to decide whether the FMTV Program should proceed to full-rate production. On August 14, 1995, the Army approved the FMTV Program for full-rate production. Further, following the Milestone IIIB review, the Army Training and Doctrine Command would perform a program assessment of the cost-effectiveness of a 30-year procurement program. That assessment would be completed by FY 1996, before the award of the second multiyear production contract.

Appendix B. Comments by the Program Executive Officer for Tactical Wheeled Vehicles on the Finding and Audit Responses

The Program Executive Officer (PEO) for Tactical Wheeled Vehicles disagreed with various conclusions and statements in the finding. Specific comments by the PEO and our audit responses to his comments follow. The full text of his comments is in Part IV.

PEO Comments. The PEO stated the report erroneously suggests that the FMTV Program Office had conditionally accepted 675 incomplete vehicles from the Contractor. Further, the PEO stated that:

> The report fails to define "incomplete" as it was used to describe the vehicles. The report further fails to acknowledge that the multiyear production contract required government conditional acceptance of all test vehicles prior to shipment to the various government test sites. The total IPT [initial production testing] and IOT&E [initial operational test and evaluation] test fleet is over 100 vehicles. Therefore, the DODIG contention should be based on a number less than 575 vehicles, not 675 as stated as fitting the undefined "incomplete" category.

Audit Response. Since the Army used 123 vehicles for testing, we reduce the quantity of vehicles on which we questioned conditionally acceptance from 675 to 552 vehicles.

We explained the term "incomplete" by stating that all incomplete vehicles lacked certain parts or had nonconforming parts. Also, the Contractor must retrofit the vehicles before they are complete. The retrofit effort will be extensive. Specifically, the Contractor will have to disassemble the vehicles down to the chassis and rebuild 525 of the 552 vehicles that the Army conditionally accepted without benefits and 81 of the 123 vehicles that the Army conditionally accepted for testing purposes.

PEO Comments. The PEO stated the report erroneously suggests that conditional acceptance of the vehicles resulted in the Army prematurely paying the Contractor $9.3 million for vehicles for which the Army received no benefit. The PEO explained that "The report distorts the fact that this is a level priced, fixed price multiyear procurement contract and the term 'additional' suggests that the Contractor is being paid more than contractually acceptable."

The PEO added that the $9.3 million was overstated because the amount was based on 675 vehicles, which included 123 vehicles that the Army had to conditionally accept for testing.

Audit Response. We disagree that the report suggests that the Contractor was being paid more than contractually acceptable. The report did not state that the Army paid the Contractor more than contractually acceptable. We accurately stated that the Army prematurely paid the Contractor additional amounts for vehicles that the Army conditionally accepted.

We reduced the $9.3 million to $7.1 million because 123 vehicles that the Army conditionally accepted were for testing. On May 11, 1995, we notified the Deputy Project Manager for the FMTV Program that we questioned the benefit that the Army received in conditionally accepting vehicles and requested that the Army stop conditionally accepting vehicles. Subsequent to our notification, the Army conditionally accepted an additional 521 vehicles and advanced the Contractor an additional $6.4 million.

PEO Comments. The PEO stated the report erroneously suggests that the Army received no benefit from conditionally accepting the vehicles. Specifically, the PEO stated that:

> The DODIG [Inspector General, DoD] contention that the Army received little or no benefit from conditional acceptance is also without merit. The benefit to the Army was the maintenance of the production build line, improvement of the production processes through the feedback loop with DPRO [Defense Plant Representative Office] on-site participation, and improvement of the supplier based deliveries of components/assemblies to support increased vehicle build rates once a full-rate production decision is received. In recognition of the remaining contractor effort for retrofit, the contract requires that 10% of the vehicle price be withheld until completion of retrofit prior to final acceptance.

Audit Response. We still maintain that the Army did not benefit by conditionally accepting the 1,073 vehicles (552 plus 521 vehicles). The matters cited by the PEO as benefits resulting solely from conditional acceptance did not result from conditional acceptance. The matters stemmed from the normal production process of any contract. Had the Contractor not kept the production line going, it would have been in default on the contract. Similarly, the PEO statement that the contract requires the Army to withhold 10 percent of the contract price in recognition of remaining retrofits is not relevant. The main issue is not what the Army is withholding but how much money the Army is providing the Contractor prematurely without receiving any benefits.

As a matter of information, the contract does not require 10 percent of the contract price to be withheld in recognition of needed retrofits.

PEO Comments. The PEO stated the report erroneously suggests that conditional acceptance also reduced the incentive for the Contractor to finish incomplete vehicles. In this regard, the PEO stated that:

> This statement exemplifies the lack of understanding of the PM's [Project Manager's] position on the retrofit program as tied to the near-term production call-up. The retrofit schedule for the conditionally accepted vehicles as well as the others built but not accepted was an integral part of the in-process contract modification. The retrofit schedule to be contractually finalized will ensure that the

> contractor places maximum emphasis on the retrofit program by requiring completion prior to build of the 4th program year vehicles. It is universally acknowledged that test deficiencies found during testing may require hardware retrofit prior to final DD250 acceptance and subsequent hand-off to field units. Also, the 10% of vehicle price being withheld until final acceptance provides the incentives for the contractor to complete the retrofit program.

Audit Response. We agree that the contract modification requires the Contractor to place high priority on the retrofit program. However, we still maintain that it would be more financially attractive for the Contractor to produce complete vehicles for final acceptance and receive 100 percent of contract price rather than receiving 10 percent of contract price for incurring costs in retrofitting the vehicles. The Contractor was operating at a loss on the contract at the time of our audit.

PEO Comments. The PEO stated the report erroneously suggests that the Recommendation in the report should prevent premature payments of $17.0 million for conditional acceptance of incomplete vehicles and would enable the Army to avoid certain cost risks on the FMTV Program. Further, the PEO stated:

> Outside of general comment, there has been no data provided by the DODIG [Inspector General, DoD], which showed that delaying conditional acceptance and disbursement of program funds was in the best interest of the Army's modernization efforts on the medium truck fleet.

Audit Response. The report, as well as the PEO comments to the report, clearly state that the Army would not have prematurely paid $7.1 million if the vehicles were not conditionally accepted. The report also states that we are not aware of any benefits that the Army received that would exceed the consequences of the premature payments. Also, the PEO did not specify a benefit that the Army received by conditionally accepting the vehicles.

PEO Comments. The PEO questioned the report conclusion that the FMTV Program Office conditionally accepted vehicles on the basis of an unvalidated need to have vehicles available for deployment. The PEO explained that:

> The FMTV PMO [Project Management Office] does not now nor has ever based conditional acceptance on a need to have vehicles available for emergency deployment. What the PMO stated was that any decision to conditionally accept vehicles took into account the extent the conditionally accepted vehicles could be made ready for emergency deployment *should* the occasion arise prior to successful IPT [Initial Production Testing] completion, incorporation of test fixes, and resubmittal for DD250 *Final Acceptance*.

Audit Response. The Army did conditionally accept the vehicles for deployment purposes. In a February 27, 1995, memorandum, the Weapon System Manager for the FMTV Program listed deployment as one reason that it would be in the Government's best interest for the Army to conditionally accept vehicles. Specifically, the Weapon System Manager stated:

> Conditional acceptance of these vehicles [FMTVs] is in the best interest of the Government for the following reasons:
>
> a. Vehicles which meet the criteria established in the TR-Q [Engineering Business Group, Tank-Automotive Research, Development and Engineering Center] memo [memorandum] dated 27 Feb 95 are considered to be safe in operation and functionally deployable.

We agree with the concept of conditional acceptance as evidenced by our recognition of the Army need to conditionally accept vehicles for testing. However, the Army had no justification for conditionally accepting vehicles that must be retrofitted before the vehicles will be suitable for fielding. Since the Army did not conditionally accept the 1,073 vehicles for a justifiable purpose, such as testing or deployment, the Army received no apparent benefit.

PEO Comments. On the stabilized design of the vehicles, the PEO stated:

> In the context of conditional acceptance this section clearly shows some misunderstanding of the definition of vehicle configuration during Low Rate Initial Production in terms of IPT [Initial Production Testing] / FPVI [First Production Vehicle Inspection].

Audit Response. We concluded that the designs of the FMTVs were not stable because no variant of the FMTV Program had passed first production vehicle inspection and the Contractor cannot establish production baseline for the FMTVs until initial production testing and operational test and evaluation were completed.

PEO Comments. The PEO stated that parts missing from the vehicles did not preclude safe operation of the vehicles. Specifically, the PEO stated:

> The PMO [Project Management Office] never stated that conditionally accepted vehicles would be deployed "as is" without review prior to an "emergency deployment." The three examples given clearly show a misconception regarding conditional acceptance as well as deployment. First, a fan shroud's primary function is to maximize the efficiency of the radiator cooling system and secondarily can be construed as a safety feature only when the cab is tilted while the engine is running. Second, wiper blades are not installed on a vehicle for shipment unless it is to be transported by driveaway carrier. Blades are normally stored onboard the vehicle. The PMO has not approved driveaway as a transportation mode allowable for FMTV. Finally, the alternator's primary function is for recharge of the batteries and is not considered a safety item unless it is in the context of providing power to headlights through discharge of the batteries. In conclusion, the PMO does not concur with the technical accuracy of the statement in the finding and further believes it is a distortion of the PMO position on deployment.

Audit Response. Based on the PEO comment, we deleted the comment that was in the draft report on windshield wipers. As for the fan shrouds and alternators, we still maintain that those items are necessary for safe operation of the vehicles. In reaching this conclusion, we provided representatives of the Safety Office at the Tank-automotive and Armaments Command with a list of parts that we had determined were missing from the vehicles produced. The representatives agreed that the parts would have to be installed on the vehicle in order to operate the vehicles safely.

PEO Comments. The PEO stated that the report failed to address the root issue of the audit: the concern of the Inspector General, DoD, over the use of conditional acceptance of hardware on defense contracts. The PEO further maintained that if the Inspector General, DoD, "deemed" it improper to conditionally accept vehicles during periods for low-rate initial production and testing, then the Inspector General, DoD, should recommend that the entire DoD not conditionally accept vehicles during those periods. Also, the PEO stated that debating conditional acceptance on the current FMTV production contract served no purpose because the contract provides for conditional acceptance of production vehicles.

Audit Response. We disagree with the PEO. The objective of the audit was to evaluate the Army efforts to acquire and field medium tactical vehicles, not the use of conditional acceptance of hardware on defense contracts. The audit determined that the Army was prematurely paying for incomplete vehicles for which the Army was receiving no benefit. As such, it would be inappropriate for us to make a recommendation for the entire Department of Defense based on the audit of one program. Last, the production contract for the FMTV Program permits conditional acceptance but does not require the Army to conditionally accept incomplete vehicles.

Appendix C. Guidance From the Deputy Secretary of Defense on Department of Defense Internal Audit Decision and Followup Process

THE DEPUTY SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

18 SEP 1993

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARIES OF DEFENSE
DIRECTOR, DEFENSE RESEARCH AND ENGINEERING
ASSISTANT SECRETARIES OF DEFENSE
COMPTROLLER
GENERAL COUNSEL
INSPECTOR GENERAL
DIRECTOR, OPERATIONAL TEST AND EVALUATION
ASSISTANTS TO THE SECRETARY OF DEFENSE
DIRECTOR OF ADMINISTRATION AND MANAGEMENT
DIRECTOR OF PROGRAM ANALYSIS AND EVALUATION
DIRECTORS OF THE DEFENSE AGENCIES

SUBJECT: Department of Defense Internal Audit Decision and Followup Process

In view of the constrained fiscal situation, DoD internal audit resources need to be used effectively to identify opportunities to reduce costs, avoid unnecessary expenditures and improve management processes. To achieve full benefits from the internal audit process, I ask that you ensure audit reports are thoroughly reviewed, explicit and well-documented decisions are made on all disputed audit findings and recommendations, agreed-upon corrective actions are promptly implemented, and the status of agreed-upon actions, including their financial impact, is accurately tracked and reported in accordance with the requirements of DoD Directive 7650.3, "Followup on General Accounting Office, DoD Inspector General and Internal Audit Reports."

As the decision official for Inspector General, Department of Defense, audit reports, I will adjudicate issues that cannot be settled at other staff levels. Each Military Department has a similar procedure for deciding its disputed audit issues.

Managers should be aware of the need to maintain an effective, credible audit decision process to preclude preemptive actions, such as proceeding with activities questioned in undecided audit reports. Timely decisions on audit findings and recommendations are necessary to ensure management actions are not needlessly deferred.

William J. Perry

Appendix D. Summary of Potential Benefits Resulting From Audit

Description of Benefit	Amount and/or Type of Benefit
Program Results. Should prevent premature payments of $17.0 million for conditional acceptance of incomplete vehicles and would enable the Army to avoid certain cost risks on the FMTV Program.	Nonmonetary.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Under Secretary of Defense for Acquisition and Technology, Washington, DC

Department of the Army

Office of the Assistant Secretary of the Army (Research, Development and Acquisition), Washington, DC
Office of the Assistant Secretary of the Army (Program Analysis and Evaluation), Washington, DC
Office of the Deputy Chief of Staff for Operations and Plans, Washington, DC
U.S. Army Tank-automotive and Armaments Command, Warren, MI
Office of the Program Executive Officer for Tactical Wheeled Vehicles, Warren, MI
Office of the Project Manager for the Family of Medium Tactical Vehicles, Warren, MI
Tactical Wheeled Vehicles Requirements Management Office, Fort Eustis, VA
Army Materiel Systems Analysis Agency, Aberdeen Proving Ground, MD
Army Cost and Economic Analysis Center, Falls Church, VA

Defense Agencies

Defense Contract Audit Agency, Houston Branch Office, Houston, TX
Defense Plant Representative Office, Stewart and Stevenson Services, Incorporated, Sealy, TX

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Assistant Secretary of the Army (Research, Development and Acquisition)
Auditor General, Department of the Army
Commander, U.S. Army Tank-automotive and Armaments Command
Program Executive Officer for Tactical Wheeled Vehicles
Project Manager for the Family of Medium Tactical Vehicles Program

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
  Branch Manager, Houston Branch, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Commander, Defense Plant Representative Office, Stewart and Stevenson Services, Incorporated
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, U.S. General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Committee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part IV - Management Comments

Assistant Secretary of the Army (Research, Development and Acquisition) Comments

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH DEVELOPMENT AND ACQUISITION
103 ARMY PENTAGON
WASHINGTON DC 20310-0103

REPLY TO
ATTENTION OF

SARD-ZCS

11 July 1995

MEMORANDUM THROUGH SAAG-PRF-E, ROOM 1C711

FOR IG, DOD (Auditing)

SUBJECT: Draft Quick Reaction Audit Report on Conditional Acceptance of Medium Tactical Vehicles (Project No. 5AL-0003)

1. The draft Quick Reaction Audit Report requested that the Program Executive Officer for Tactical Wheeled Vehicles (PEO-TWV) provide comments to the draft report.

2. The PEO-TWV has provided an Information Paper to address the findings outlined in the draft report.

3. The majority of the concerns outlined in the draft report have been recently overcome due to the fact that all testing has now been completed and the final production configuration has been finalized. The production contract is a firm fixed price contract and the prime contractor, Stewart & Stevenson, is responsible for completing all vehicles in accordance with the final approved configuration. A full rate production decision is scheduled for 21 August 1995.

4. The point of contact within ASA(RDA) for this action is Mr. Steven Martin, DSN 224-3978.

ROY D. LEWIS
Colonel, GS
Director for Combat
Service Support

Printed on Recycled Paper

Final Report Reference

SARD-ZCS 11 July 1995

INFORMATION PAPER

SUBJECT: DODIG Draft Report on the Acquisition of the Family of Medium Tactical Vehicles (FMTV), Project # 5AL-0003.00

AUDIT RECOMMENDATION: We recommend that the Program Executive Officer for Tactical Wheeled Vehicles direct the Program Manager for the Family of Medium Tactical Vehicles Program to stop conditionally accepting vehicles. Page 10

RESPONSE: Non-concur. The draft report suggests that "The FMTV Program Office had conditionally accepted 675 incomplete vehicles from the contractor...". Once First Production Vehicle Inspection (FPVI) is achieved on a production contract during Low Rate Initial Production (LRIP) phase, build per the contract is maintained to that baseline. While subsequent testing may reveal part deficiencies, no change to the build configuration baseline can be made without authorization from the government. Thus vehicles under contract can be built to FPVI configuration and conditionally accepted even though known part changes will occur due to test failure corrections. These changes are worked into the production line and retrofit is required on all previously built vehicles. The multiyear production contract requires that the contractor retrofit the vehicles prior to final acceptance by the government. The government has not incurred additional costs as a result of conditionally accepting vehicles. Page 6 Revised

Program Executive Officer for Tactical Wheeled Vehicles Comments

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Page 10

DEPARTMENT OF THE ARMY
PROGRAM EXECUTIVE OFFICE, TACTICAL WHEELED VEHICLES
WARREN, MI 48397-5000

REPLY TO ATTENTION OF

SFAE-TWV-P

17 JUL 1995

MEMORANDUM FOR Inspector General, Department of Defense, ATTN: Mr. Rayburn H. Stricklin, 400 Army Navy Drive, Arlington, VA 22202-2884,

SUBJECT: Draft Quick-Reaction Report on Conditional Acceptance of Medium Tactical Vehicles (Project No. 5AL-0003.00)

1. Reference, draft report, June 12, 1995, SAB.

2. The auditor's "Recommendation for Corrective Action" states, "We recommend that the Program Executive Officer for Tactical Wheeled Vehicles direct the Program Manager for the Family of Medium Tactical Vehicles (FMTV) Program to stop conditionally accepting vehicles." The recommendation is based on the conclusion that the FMTV Program Office's conditional acceptance of incomplete vehicles was not in the best interest of the Government as the contractor received premature payments and program risk unnecessarily shifted from the contractor to the Government.

3. For reasons outlined in the enclosed information paper, I non-concur with the audit's Recommendation for Corrective Action.

4. Questions regarding this matter may be directed to Mr. Nicholas Anastasi, SFAE-TWV-PO, commercial(810)574-6478.

Walter P. Wynbelt

Encl

WALTER P. WYNBELT
Program Executive Officer,
Tactical Wheeled Vehicles

Final Report Reference

SFAE-TWV-FMTV 7 July 1995

INFORMATION PAPER

SUBJECT: DODIG Draft Audit Report on the Acquisition of the Family of Medium Tactical Vehicles (FMTV), Project # 5AL-0003.00

Revised

AUDIT CONCLUSION: The DODIG draft report concludes that the Army has conditionally accepted 675 incomplete vehicles which were not in the best interest of the Government. It furthermore concludes that not only should conditional acceptance of "incomplete vehicles" be discontinued but all conditional acceptance should stop.

DISCUSSION: The draft report suggests that past and current conditional acceptance was and is unwarranted.

a. The draft report (Executive Summary page i, para 5) erroneously suggests that, "The FMTV Program Office had conditionally accepted 675 *incomplete* vehicles from the contractor ...". The report fails to define "incomplete" as it is used to describe the vehicles. The report further fails to acknowledge that the multiyear production contract requires government conditional acceptance of all test vehicles prior to shipment to the various government test sites. All the test vehicles were "by definition" complete, test-ready vehicles and, as such, were conditionally accepted for shipment and subsequent government testing. The total IPT and IOT&E test fleet total is over 100 vehicles. Therefore, the DODIG contention should be based on a number less than 575 vehicles, not 675 as stated as fitting the undefined "incomplete" category. Generally, once First Production Vehicle Inspection (FPVI) is achieved on a production contract during the Low Rate Initial Production (LRIP) phase, build per the contract is maintained to that baseline. While subsequent testing may reveal parts deficiencies, no change to the build configuration baseline can be made without authorization from the government which would be based on technical and/or successful test fix data submittal. Thus, vehicles under contract can be built to the FPVI configuration and conditionally accepted even though known parts changes will occur due to test failure corrections. These changes would be worked into the production line and require retrofit on all previously built vehicles (conditionally accepted or not). If conditional acceptance as a concept were not allowed, there would

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never be test hardware delivered for the government Initial Production Test per the FMTV contract.

Revised

b. The report (Executive Summary page i, para 5) erroneously suggests that, "Conditional acceptance of the vehicles resulted in the Army prematurely paying the contractor an *additional* $9.3 million for vehicles for which *the Army received no benefit.*" The report distorts the fact that this is a level priced, fixed price multiyear procurement contract and the term "additional" suggests that the contractor is being paid more than contractually allowable. This is an untrue statement. The actual DODIG contention being made is that the Army released dollars to the contractor prematurely, but not beyond that authorized in the contract. The $9M figure used also appears to be overstated per item a. above. The DODIG contention that the Army received little or no benefit is also without merit. The benefit to the Army was the maintenance of the production build line, improvement of the production processes through the feedback loop with DPRO on-site participation, and improvement of the supplier based deliveries of components/assemblies to support increased vehicle build rates once a full-rate production decision is received. In recognition of the remaining contractor effort for retrofit, the contract requires that 10% of the vehicle price be withheld until retrofit is complete prior to final acceptance.

c. The report (Executive Summary page i, para 4) erroneously suggests that, "Conditional acceptance also reduced the incentive for the contractor to finish incomplete vehicles ...". This statement exemplifies the lack of understanding of the PM's position on the retrofit program as tied to the near-term production call-up. The retrofit schedule for the conditionally accepted vehicles as well as the others built but not accepted is an integral part of the in-process contract modification. The retrofit schedule to be contractually finalized will ensure that the contractor places maximum emphasis on the retrofit program by requiring completion prior to build of the 4th program year vehicles. It is universally acknowledged that test deficiencies found during testing may require hardware retrofit prior to final DD250 acceptance and subsequent hand-off to field units. Also, the 10% of vehicle price being withheld until final acceptance provides the incentive for the contractor to complete the retrofit program. The alternative to not

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accepting production (FPVI configuration) vehicles conditionally during government testing is to 1) stop production and lose the learning curve established or lose the workforce due to temporary layoff or permanently incurring idle plant facilities cost (this has a similar domino effect on the supplier base), 2) require the contractor to bear all risk on the delta cost of money to continue production build. While alternative 2 is appealing, it is unrealistic if one understands the competitive forces that seem to limit medium tactical vehicles sources of production competition to contractors like AM General, BMY, and Stewart and Stevenson. None of those companies mentioned produce any commercial Class 6,7, or 8 type trucks. The reasons that GM, Ford, and Navistar do not compete are due to the small quantities the government requires (compared to their production capability); the government unique quality, accounting, and materials procedures invoked which push contractors to provide separate facilities from their commercial base; and finally, the government's unstable record on realized budgets for tactical vehicle procurement programs.

d. The report (Executive Summary page i, para 6) erroneously suggests that, "The recommendation in this report should prevent premature payments of $17M for conditional acceptance of incomplete vehicles and would enable the Army to avoid certain cost risks on the FMTV Program." Outside of general comment, there has been no data provided by the DODIG which shows that delaying conditional acceptance and disbursement of program funds is in the best interest of the Army's modernization efforts on the medium truck fleet.

e. The report (Part II - Findings and Recommendations, page 6, para 1) states that, "The FMTV Program Office provided for conditional acceptance based on an unvalidated need to have the vehicles available for deployment ..." The FMTV PMO does not now nor has ever based conditional acceptance on a need to have vehicles available for emergency deployment. What the PMO stated was that any decision to conditionally accept vehicles took into account the extent the conditionally accepted vehicles could be made ready for emergency deployment <u>should</u> the occasion arise prior to successful IPT completion, incorporation of test fixes, and resubmittal for DD250 <u>Final Acceptance</u>. The term "unvalidated need" for deployment in this case is therefore not applicable and misused. As a result, the associated paragraphs

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Pages 8-9

on page 10 and 11 (paragraphs in total under the subtitle, Deployment of Vehicles) are also not applicable and misused.

Page 8

f. The report (Part II - Findings and Recommendations, page 9, para 2) erroneously suggests that, "The Program Office had not stabilized the design for vehicles in the FMTV Program." In the context of conditional acceptance this section clearly shows some misunderstanding of the definition of vehicle configuration during Low Rate Initial Production in terms of IPT/FPVI as previously stated in paragraph a. above.

Revised

g. The report (Part II - Findings and Recommendations, page 9, para 4) erroneously suggests that, "Parts missing from the vehicles precluded safe operation ..." The PMO never stated that conditionally accepted vehicles would be deployed "as is" without review prior to an "emergency deployment". The three examples given clearly show a misconception regarding conditional acceptance as well as deployment. First, a fan shroud's primary function is to maximize the efficiency of the radiator cooling system and secondarily can be construed as a safety feature only when the cab is tilted while the engine is running. Second, wiper blades are not installed on a vehicle for shipment unless it is to be transported by driveaway carrier. Blades are normally stored onboard the vehicle. The PMO has not approved driveaway as a transportation mode allowable for FMTV. Finally, the alternator's primary function is for recharge of the batteries and is not considered a safety item unless it is in the context of providing power to headlights through discharge of the batteries. In conclusion, the PMO does not concur with the technical accuracy of the statement in the finding and further believes it is a distortion of the PMO position on deployment.

Page 9

h. The report (Part II - Findings and Recommendations, Perception of the Army, page 10, 2nd para) states that, "We do not believe that anyone other than the contractor would perceive the Army to be trivial for refusing to accept incomplete vehicles." The PMO does not concur with the DODIG position and their aversion to the concept of conditional acceptance as well as their use of the term <u>incomplete vehicle</u>.

Page 10

i. The report (Part II - Findings and Recommendations, Conclusions, page 11) states that, "The FMTV Program Office's conditional acceptance of incomplete vehicles was not in the best

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Page 10 Revised

interest of the Government..." Conditional acceptance of 675 incomplete vehicles through April 30, 1995, resulted in the Army paying the contractor an *additional* $9.3 million for vehicles that the Army received little or no benefit." Besides the PMO's general non-concurrence with the DODIG's misconceptions, concerning conditional acceptance, the PMO is disturbed with the continual impression from the audit report that the contractor is getting any additional funds through conditional acceptance - they are not. The DODIG has never quantified at any time how conditional acceptance of incomplete vehicles reduced the incentive for the contractor to complete the vehicles. The PMO has previously stated that the contractor, as part of the new contract modification, will retrofit all vehicles built (year 1-3) prior to build of program year four vehicles.

SUMMARY: The PMO believes that the DODIG report has failed to address the root issue of the audit which is their concern over the use of "Conditional Acceptance" of hardware on defense contracts. This audit has consumed an enormous amount of time of countless TACOM matrix, DPRO, and contractor personnel which diverted them from performing their main duties on the FMTV production contract. The value added of this audit is highly questionable if the root issue is not addressed.

If the idea of conditional acceptance of hardware during LRIP and government testing is deemed by the DODIG not to be a stable environment during which to conditionally accept hardware - it should make that recommendation to the whole Defense Department. Using DODIG's definition of incomplete vehicles as all production up to the point in testing where a part pattern failure occurs (requiring a subsequent fix) makes all previously built vehicles incomplete (since the design is no longer "stable") requiring subsequent retrofit of the subject part.

It serves no purpose to debate over the current FMTV production contract (as well as all past tactical vehicle production contracts) which supports the use of conditional acceptance of production vehicles during the LRIP time period between government FPVI approval and government full-rate production approval. The only way this audit provides any value added is if the root issue of the use of conditional acceptance prior to full-rate approval in future contracts is addressed. This PMO welcomes suggested constructive changes for future production hardware contracts.

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Audit Team Members

This report was prepared by the Acquisition Management Directorate, Office of the Assistant Inspector General, DoD.

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