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June 4, 2003

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# Acquisition

Diamond Jewelry Procurement  
Practices at the Army and Air Force  
Exchange Service  
(D-2003-097)

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Department of Defense  
Office of the Inspector General

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### **Acronyms**

AAFES                      Army and Air Force Exchange Service



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-4704

June 4, 2003

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR PERSONNEL  
AND READINESS  
COMMANDER, ARMY AND AIR FORCE EXCHANGE  
SERVICE

SUBJECT: Report on Diamond Jewelry Procurement Practices at the Army and Air  
Force Exchange Service (Report No. D-2003-097)

We are providing this report for your information and use. The audit was performed at the request of Senator Thad Cochran. No written response to this report was required, and none was received. Therefore, we are publishing this report in final form.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Joseph P. Doyle at (703) 604-9349 (DSN 664-9349) or Ms. Deborah L. Carros at (703) 604-9217 (DSN 664-9217). See Appendix C for the report distribution. The team members are listed inside the back cover.

*David K. Steensma*  
David K. Steensma  
Deputy Assistant Inspector General  
for Auditing

## Office of the Inspector General of the Department of Defense

Report No. D-2003-097  
(Project No. D2003CK-0030)

June 4, 2003

### Diamond Jewelry Procurement Practices at the Army and Air Force Exchange Service

#### Executive Summary

**Who Should Read This Report and Why?** DoD and Army and Air Force Exchange Service (AAFES) procurement officials and others who are responsible for overseeing or have an interest in AAFES procurement of diamond jewelry should read this report because it discusses procurement practices for diamond solitaire rings.

**Background.** In September 2002, Senator Thad Cochran requested that the Inspector General of the Department of Defense initiate an investigation of procurement practices at AAFES. Specifically, Senator Cochran asked for verification of full-and-open competition on a solicitation for diamond solitaire rings (AAFES Solicitation No. SD-99-016-02-001) and that we report any cases where proposals were not given full consideration. Senator Cochran was concerned about possible exclusionary procurement practices relating to a current procurement of diamond solitaire rings.

The AAFES mission is to provide quality merchandise and services for soldiers, airmen, and their families wherever they are stationed around the world and to generate reasonable earnings that support Army and Air Force morale, welfare, and recreation programs. For 2002, AAFES reported revenues totaling \$7.1 billion. AAFES Solicitation No. SD-99-016-02-001 had an estimated value of \$10 million for a 2-year contract period.

**Results.** AAFES Solicitation No. SD-99-016-02-001 was processed in accordance with AAFES procurement policies and was intended to be a competitive award. Only 5 of the 15 prospective vendors responded to the solicitation. However, none of the five vendors included three samples of each item as required in the solicitation. As a result, the AAFES contracting officer canceled the solicitation on November 6, 2002, for lack of responsive vendors and reissued the solicitation on February 7, 2003, with a lesser sample requirement. The audit did not identify any exclusionary or unfair procurement practices by AAFES against any vendor during the solicitation process for the procurement of diamond solitaire rings.

**Management Comments.** We provided a draft of this report on May 14, 2003. No written response to this report was required, and none was received. Therefore, we are publishing this report in final form.

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## Background

In September 2002, Senator Thad Cochran requested that the Inspector General of the Department of Defense initiate an investigation of the procurement practices at the Army and Air Force Exchange Service (AAFES) (Appendix B). Specifically, Senator Cochran asked for verification of full-and-open competition on a solicitation for diamond solitaire rings (Solicitation No. SD-99-016-02-001) and that we report any cases where proposals were not given full consideration. Senator Cochran was concerned about possible exclusionary procurement practices relating to a current procurement of diamond solitaire rings.

During 2001 and 2002, AAFES conducted two internal audits and an investigation related to AAFES diamond procurement practices. (See the Finding section of the report for detailed discussion.)

**Army and Air Force Exchange Service.** AAFES is a nonappropriated fund activity established and operated for the benefit of DoD Components. The AAFES mission is to provide quality merchandise and services for soldiers, airmen, and their families wherever they are stationed around the world and to generate reasonable earnings to support Army and Air Force morale, welfare, and recreation programs. AAFES has more than 12,000 facilities in more than 25 countries and in all 50 states. The facilities are operated either directly or by way of contract with local businesses. For 2002, AAFES reported a net worth of \$3.1 billion and generated revenue totaling \$7.1 billion. The Under Secretary of Defense for Personnel and Readiness prescribes the procurement policies to be followed by AAFES.

**Solicitation for Diamond Solitaire Rings.** Our audit focused on the solicitation and supporting documentation relating to a procurement of diamond solitaire rings. On July 30, 2002, an AAFES contracting officer issued a contract solicitation (Solicitation No. SD-99-016-02-001) for the procurement of 135 pieces of different sizes and shapes of diamond solitaire rings. The solicitation, estimated at \$10 million for a 2-year contract period, required offerors to submit a price for each of the 135 items and 3 samples of each item that would be used for quality inspection.

## Objectives

The audit objective was to determine if full-and-open competition existed and proposals were fairly evaluated for diamond jewelry procurements to include the Solitaire program. Specifically, we determined whether the diamond solitaire ring solicitation was processed in accordance with AAFES procurement policies and procedures. See Appendix A for a discussion of the audit scope and methodology.

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## Procurement of Diamond Solitaire Rings

AAFES Solicitation No. SD-99-016-02-001 was processed in accordance with AAFES procurement policies and was intended to be a competitive award. Although 5 of the 15 prospective vendors responded to the solicitation, only three vendors met the solicitation requirement to submit a price for each of the 135 items solicited. In addition, none of the five vendors that submitted proposals included three samples of each item as required in the solicitation. As a result, the AAFES contracting officer canceled the solicitation on November 6, 2002, for lack of responsive vendors and reissued the solicitation on February 7, 2003, with a lesser sample requirement. The audit did not identify exclusionary or unfair procurement practices against any vendor during the solicitation process for the procurement of diamond solitaire rings.

### AAFES Procurement Guidance

**DoD Directive 4105.67, “Nonappropriated Fund (NAF) Procurement Policy,” May 2, 2001.** The directive prescribes procurement policies for nonappropriated fund activities like AAFES and requires nonappropriated fund procurements to use competitive negotiation procedures to the maximum extent practicable. The directive also requires that offers shall be solicited from a reasonable number of sources except when noncompetitive procurement is justified and contracts are awarded to responsible offerors with the best value for AAFES. The directive specifically provides that the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation do not apply to AAFES procurements.

**Exchange Service Regulation 65-1, “Exchange Service Purchasing Policies,” January 2001.** The regulation implements and supplements DoD Directive 4105.67. The regulation prescribes policies and provides guidance for AAFES personnel in performing purchasing functions. The regulation requires that AAFES purchase by full and free competition to the maximum extent practical. The regulation states:

the normal method of purchasing is by written multiple source solicitation of a reasonable number of eligible sources to obtain adequate competition so the purchase will be to AAFES’ best advantage. Determining a reasonable number of sources is a contracting officer’s judgment decision based on the dollar amount of the purchase, competitiveness of the market, and number of interested offerors.

Also, the regulation requires review of all proposed solicitations, contracts or amendments with estimated value of \$1 million or more, regardless of type (except proposed customer service contracts with estimated sales over \$1.5 million), by the designated review authority.

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**Exchange Operating Procedure 65-2, “Purchasing Commodities,” December 1992.** Exchange Operating Procedure 65-2 establishes procedures for purchasing commodities (merchandise, supplies, equipment, and food). The procedure provides guidance to AAFES personnel for performing the purchase function and serves as a guide for selecting the type of contract and forms used. The procedure authorizes the purchase of commodity samples for product evaluations and also instructs the buyer to “keep the quantity of samples requested to the minimum required to make an objective product evaluation.”

## Diamond Solitaire Ring Competitive Solicitation

We reviewed the diamond solitaire ring solicitation and found no basis for allegations of possible exclusionary or unfair practices against any vendor during the solicitation process. On July 30, 2002, AAFES issued a multiple source solicitation to 15 prospective vendors for the procurement of 135 pieces of different sizes and shapes of diamond solitaire rings. The solicitation required offerors to submit a price for each of the 135 items solicited and 3 samples of each item to be used for quality inspection. The solicitation also required prospective vendors to submit their proposals to AAFES by 2:00 p.m. on September 4, 2002.

**Vendor Proposals and Responses.** The contracting officer received proposals from five vendors as shown in the following table.

Vendors	Original Date/Time Received	Total Number of Items for Which Price Proposed	Total Number of Items for Which 3 Samples Provided
Vendor A	Sept. 3, 2002 9:27 a.m.	20	20
Vendor B	Sept. 4, 2002 8:13 a.m.	135	54
Vendor C	Sept. 4, 2002 11:32 a.m.	135	19
Vendor D	Sept. 4, 2002 4:28 p.m.	135	72
Vendor E	Sept. 6, 2002 7:28 a.m.	15	15

Of the five vendors that made a proposal, only three vendors (Vendors A, B, and C) made their proposals in time for the September 4, 2002, 2:00 p.m. deadline. Vendors A and E did not propose a price for each item solicited. In addition, none of the five vendors that made a proposal met the solicitation requirement for providing three samples of each item. Although the solicitation required that the vendors submit 3 samples of each of the 135 ring items, none of the 5 vendors submitted 3 samples for all of the items. As a result, the contracting officer determined that none of the vendor proposals were responsive to the solicitation.

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Matrix Creations, Incorporated was one of the five vendors who submitted a proposal to the solicitation.

**Cancellation of the Solicitation.** The AAFES contracting officer decided to cancel the solicitation for lack of responsive vendors. On November 6, 2002, the five vendors that made proposals were notified. According to AAFES personnel, the primary reason for the cancellation was that none of the vendors met the requirement to submit 3 samples for each of the 135 items solicited. The contracting officer reissued the solicitation to 15 prospective vendors on February 7, 2003. The new solicitation was the same as the original solicitation, except that the new solicitation changed the sample requirement to 1 sample for each of the 135 items solicited. Contract award was estimated for June 2003.

## Internal Reviews and Investigation

In May 2001, Senator Thad Cochran along with Representatives Tom Delay, Jerry Lewis, and Carolyn Maloney sent a letter to the Secretary of Defense requesting a thorough review of AAFES buying practices. Their concern was that one organization was treated unfairly in the evaluation of bids, which may indicate systemic buying practice failures that result in lower value products throughout the AAFES system. The Assistant Secretary of the Army (Manpower and Reserve Affairs) directed that AAFES internal audit staff review the congressional concerns.

**AAFES Internal Audit.** AAFES Report No. 2001-09, "Diamond Procurement Process," July 2001, states that allegations of biased or unfair treatment of Matrix Creations, Incorporated were unsubstantiated and that Matrix Creations, Incorporated did not submit proposed prices for all the items solicited. In addition, Matrix Creations, Incorporated proposals were higher than other responsive vendor prices. The report notes that administrative documentation related to the procurement process was not always adequate. However, the report discusses that the inadequate documentation did not affect Matrix Creations, Incorporated, and the report does not contain recommendations. The Assistant Secretary of the Army (Manpower and Reserve Affairs) requested that the Army Audit Agency evaluate the reasonableness of the audit work and the extent to which the audit work can be relied. The Army Audit Agency concluded that the AAFES report was appropriate and reliable.

**AAFES Expanded Audit.** On April 1, 2002, the Commander, AAFES requested that the Audit Division, AAFES perform an expanded audit of the diamond jewelry procurement process and determine if the procurement actions were properly evaluated and awarded. The audit scope included procurement actions since July 2001. AAFES Report No. 2002-08, "Diamond Jewelry Procurement Process," July 2002, states that the diamond jewelry procurement process was basically sound. However, the audit found that some diamond jewelry procurement actions were not completed in accordance with established policies and procedures. One multiple source solicitation contract was awarded to a low bidder even though the mountings on all six of the vendor's samples failed quality assurance inspection. In addition, the buyer's contracting dollar limit authority

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was exceeded for 8 of 21 contracts, and contract documentation justifying sole source procurement actions was missing for all 21 contracts. The auditors also noted jewelry quality certifications by commercial firms were not required to provide the same level of quality assurance as the Atlanta Distribution Center Gemological Laboratory provided. The audit report recommended corrective actions for resolving the issues. Recommendations included ensuring that: future buyers receive training on proper procurement practices, contracting dollar authority is not exceeded, and procurement justification documents are completed and included in the contract files. The AAFES management concurred with the audit findings and initiated or planned actions to implement the recommendations. The report states that management actions planned or taken in response to the audit recommendations should resolve the concerns identified in the report. The Audit Division planned to perform a followup audit of AAFES diamond jewelry procurement in June 2003.

**AAFES Internal Investigation.** On April 25, 2002, the Commander of AAFES directed an investigation by the Senior Policy Specialist, Corporate Policy Division, AAFES of the business relationship between the AAFES jewelry contracting officer and the President, Matrix Creations, Incorporated. The investigation focused on Matrix Creations, Incorporated allegations that the jewelry contracting officer:

- improperly demanded that Matrix Creations, Incorporated take back merchandise that had been ordered,
- dropped Matrix Creations, Incorporated products from the stock assortments in retaliation for refusal to take back merchandise,
- withheld information necessary to the bid process from Matrix Creations, Incorporated for its refusal to take back merchandise,
- required excessive documentation relative to the bid process from Matrix Creations, Incorporated for refusing to take back merchandise, and
- provided false or misleading information about the bid process for refusing to take back merchandise.

The investigation found no basis for the allegations and concluded that the allegations were unsubstantiated. The investigation found that the jewelry contracting officer's lack of training and knowledge of the details required for conducting multiple source solicitations contributed to the Matrix Creations, Incorporated allegations. In addition, the report states that the overwhelming workload compounded by the detailed nature of bid processes resulted in confusion and misstatements by all parties involved. We confirmed that the former jewelry contracting officer had been reassigned to a different position since November 22, 2002.

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## Conclusion

The diamond solitaire rings solicitation was processed in accordance with AAFES procurement policies and procedures. Although 3 vendors proposed a price for each of the 135 ring items solicited, none of the vendors met all the solicitation requirements. Therefore, the review did not find exclusionary or unfair procurement practices against Matrix Creations, Incorporated or any other vendors for the procurement of diamond solitaire rings under AAFES Solicitation No. SD-99-016-02-001.

The results of this audit, the AAFES audits, and the AAFES investigation did not substantiate the allegations of biased or unfair treatment of Matrix Creations, Incorporated in the procurement of diamond jewelry. The July 2001 AAFES report notes that administrative documentation related to the procurement process was not always adequate. However, the deficiencies did not affect Matrix Creations, Incorporated. The July 2002 AAFES report states that the diamond jewelry procurement process was basically sound. However, diamond procurement actions were not completed in accordance with established policies and procedures. The report includes three recommendations, and AAFES management was working to resolve the deficiencies. The AAFES Audit Division planned to perform a followup audit of AAFES diamond jewelry procurement in June 2003.

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## Appendix A. Scope and Methodology

**Work Performed.** We visited AAFES headquarters, Dallas, Texas, and interviewed personnel from the Audit Division, General Counsel, Sales Directorate, Procurement Support and Policy, and Corporate Planning and Communications. We also interviewed the president of Matrix Creations, Incorporated.

We reviewed AAFES policies and procedures for procurement of resale merchandise. We reviewed the AAFES 2003 audit plan and other audits and investigations performed by AAFES in response to allegations made by the president of Matrix Creations, Incorporated.

We performed this audit from November 2002 through April 2003 in accordance with generally accepted government auditing standards. We focused the review on AAFES Solicitation No. SD-99-016-02-001 and supporting documentation relating to the procurement of diamond solitaire rings. The solicitation had an estimated value of \$10 million for a 2-year contract period. The solicitation was the only procurement instrument concerning the procurement of diamond solitaire rings AAFES had issued at the time of review. We did not perform a review of the AAFES management control program because the audit was conducted in response to a congressional request.

**Use of Computer-Processed Data.** We did not use computer-processed data to perform this audit.

**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the DoD high-risk area identified as “Improve processes and controls to reduce contract risk.”

### Prior Coverage

During the last 5 years, AAFES issued two reports related to the diamond jewelry procurement process.

### Army and Air Force Exchange Service

AAFES Report No. 2002-08, “Diamond Jewelry Procurement Process,” July 2002

AAFES Report No. 2001-09, “Diamond Procurement Process,” July 2001

# Appendix B. Congressional Request

THAD COCHRAN  
MISSISSIPPI

United States Senate  
WASHINGTON, DC 20510-2402

COMMITTEE ON  
AGRICULTURE, NUTRITION,  
AND FORESTRY  
COMMITTEE ON  
APPROPRIATIONS  
COMMITTEE ON  
GOVERNMENTAL AFFAIRS  
COMMITTEE ON  
RULES AND  
ADMINISTRATION

September 25, 2002

The Honorable Joseph E. Schmitz  
Inspector General  
Department of Defense  
400 Army Navy Drive  
Arlington, Virginia 22202

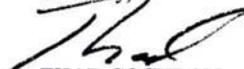
Dear Mr. Schmitz:

On May 22, 2001, I signed a letter with several of my colleagues to the Secretary of Defense highlighting concerns with Army and Air Force Exchange Service (AAFES) buying practices and requesting a through review of this situation.

It is my understanding there is currently a major open bid on the Solitaire program for the first time in several years, and I am informed that possible exclusionary procurement practices that prompted my May 2001 letter may be continuing against one of the vendors, Matrix Creations, Inc. If these unfair procurement practices exist and continue, our military personnel will suffer by not having access to high quality products at reasonable prices within the Exchange System.

I request that you commence an investigation into the current procurement practices at AAFES. As part of your investigation, I ask that you verify full and open competition on the Solitaire solicitation and that you report any cases where proposals were not given full consideration. Thank you for your interest and attention to this matter.

Sincerely,

  
THAD COCHRAN  
United States Senator

TC/we

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
Director, Defense Procurement and Acquisition Policy  
Under Secretary of Defense (Comptroller)/Chief Financial Officer  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Under Secretary of Defense for Personnel and Readiness

### **Department of the Army**

Assistant Secretary of the Army (Financial Management and Comptroller)  
Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Auditor General, Department of the Air Force

### **Other Defense Organizations**

Commander, Army and Air Force Exchange Service

### **Non-Defense Federal Organization**

Office of Management and Budget

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

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 Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform  
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform  
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Congressman Thad Cochran

## **Team Members**

The Contract Management Directorate, Office of the Deputy Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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