October 16, 2003

Acquisition

Sole-Source Spare Parts Procured From an Exclusive Distributor
(D-2004-012)

This special version of the report has been revised to omit contractor proprietary data.

Department of Defense
Office of the Inspector General

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Report Documentation Page

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This report should be of particular interest to DoD acquisition, logistics, and contracting officials because it concerns procuring and supplying sole-source spare parts at fair and reasonable prices.

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Acronyms

AMCOM	Army Aviation and Missile Command
DCAA	Defense Contract Audit Agency
DCMO	Defense Contract Management Office
DLA	Defense Logistics Agency
DSCC	Defense Supply Center Columbus
DSCP	Defense Supply Center Philadelphia
DSCR	Defense Supply Center Richmond
FAR	Federal Acquisition Regulation
GAO	General Accounting Office
NSN	National Stock Number
OEM	Original Equipment Manufacturer
SSA	Strategic Supplier Alliance

INSPECTOR GENERAL
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October 16, 2003

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Report on Sole-Source Spare Parts Procured From an Exclusive Distributor (Report No. D-2004-012)

We are providing this audit report for review and comment. This report is one in a series involving commercial and noncommercial pricing of spare parts and other logistics support initiatives. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all issues be resolved promptly. The Army comments were generally not responsive. We request additional comments on Recommendations 2., 3., and 4. We request that the Army provide comments by December 15, 2003. The Defense Logistics Agency comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audcm@dodig.osd.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Henry F. Kleinknecht at (703) 604-9324 (DSN 664-9324) or Mr. Ronald W. Hodges at (703) 604-9592 (DSN 664-9592). See Appendix E for the report distribution. The audit team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

Robert K. West

Robert K. West
Deputy Director
Contract Management Directorate

Office of the Inspector General of the Department of Defense

Report No. D-2004-012 **October 16, 2003**
Project No.(D2002CH-0029.000)

Sole-Source Spare Parts Procured From an Exclusive Distributor

Executive Summary

Who Should Read This Report and Why? This report should be of particular interest to DoD acquisition, logistics, and contracting officials because it concerns procuring and supplying sole-source spare parts at fair and reasonable prices.

Background. This report is one in a series of reports issued during the last 6 years that involve commercial and noncommercial pricing of spare parts and other logistics support initiatives. This report discusses the reasonableness of prices paid for spare parts from AAR Defense Systems, an exclusive distributor for Hamilton Sundstrand, which is a subsidiary of United Technologies Corporation. In FY 2001, United Technologies Corporation was the sixth largest contractor for DoD with about $3.7 billion in contract awards.

Starting in 1996, Hamilton Sundstrand entered into multiple agreements with AAR Defense Systems as the exclusive distributor of designated spare parts. Under the agreement, contracting officers for the Army Aviation and Missile Command and the Defense Logistics Agency procure sole-source Hamilton Sundstrand parts directly from AAR Defense Systems. Our review focused on 35 orders (29 contracts) for 11 sole-source Hamilton Sundstrand spare parts (National Stock Numbers) procured from AAR Defense Systems during March 1999 through August 2002 with a total value of $16.8 million. In that same period, DoD awarded 311 orders for 89 sole-source Hamilton Sundstrand spare parts to AAR Defense Systems with a total value of $57.6 million.

Results. Contracting officers for the Army Aviation and Missile Command and the Defense Supply Centers followed established procedures and with available information generally determined prices fair and reasonable for sole-source spare parts procured from AAR Defense Systems. However, based on information we obtained not available to contracting officers for the Army Aviation and Missile Command and the Defense Supply Centers, the prices were too high. As a result, DoD paid $16.8 million instead of $ [1] million, or [1] percent ($ [1] million), more than fair and reasonable prices. Based on annual demand and the most recent prices paid, we calculate that DoD will pay about $22.2 million, or [1] percent, more than fair and reasonable prices for the same items in FY 2004 through FY 2009, if the problems are not corrected. The AAR Defense Systems average pass-through costs of [1] percent represent $ [1] million of the $22.2 million. The Commander, Army Aviation and Missile Command and the Director, Defense Logistics Agency should emphasize with their contracting officers the need to revisit procuring sole-source Hamilton Sundstrand spare parts from a distributor versus directly from the original equipment manufacturer unless the distributor can provide sufficient value to DoD in line with the additional pass-through costs. Contracting officers should also

[1]This figure was calculated using contractor proprietary data and has been deleted.

obtain information that is adequate to evaluate reasonableness of price in accordance with Federal Acquisition Regulation requirements. The information--information other than cost or pricing data--includes uncertified cost or pricing data that can be used to perform cost analysis. The Army and the Defense Logistics Agency should also emphasize with their contracting officers the need to document and escalate negotiations in instances where the original equipment manufacturer is either unreasonable or uncooperative and refuses to quote an item or refuses to supply information other than cost or pricing data, as required. The Army and the Defense Logistics Agency, in conjunction with the Air Force, should consider initiating action that implements a new Strategic Supplier Alliance with either AAR Defense Systems or Hamilton Sundstrand. (See the Finding section of the report for the detailed recommendations.)

Management Comments and Audit Response. The Defense Logistics Agency concurred with the audit finding and intent of the recommendations. Specifically, the Director of Logistics Operations agreed that based on the Hamilton Sundstrand cost data supplied to the Office of the Inspector General of the Department of Defense, prices paid were more than what could be considered fair and reasonable. However, the Director of Logistics Operations emphasized that the data were not available to the contracting officers. We agreed and revised the finding to reflect that the information was not made available to contracting officers. The Defense Logistics Agency is implementing a Strategic Supplier Alliance with Hamilton Sundstrand and believes the success of the alliance will satisfy the intent of our recommendations. We agree and consider the Defense Logistics Agency comments responsive. The Army did not agree with either the finding or the recommendations and the comments were generally not responsive. Specifically, the Deputy Assistant Secretary of the Army (Policy and Procurement) did not agree that fair and reasonable prices were not obtained for the four Army National Stock Numbers referenced in the report. The Army asserted that the Army Aviation and Missile Command complied with all the regulatory and statutory requirements in negotiating fair and reasonable prices. In addition, Army contracting officers requested, received, and used "information other than cost and pricing data" in support of determining price reasonableness. We agreed that Army Aviation and Missile Command contracting officers followed established procedures for determining prices fair and reasonable and revised the finding to reflect this. However, as discussed in the report, the information other than cost or pricing data requested, received, and upon which the Army relied were inaccurate and misleading. Consequently, based on the data we obtained from the original equipment manufacturer, we calculated that the Army should have paid $ [2] million versus $3.8 million, a difference of $ [2] million or [2] percent more than fair and reasonable prices. Accordingly, we request that the Army provide additional comments on the final report by December 15, 2003. See the Finding section of the report for a discussion of the management comments on the recommendations, Appendix D for management comments on the finding and our audit response, and the Management Comments section of the report for the complete text of the comments.

[2]This figure was calculated using contractor proprietary data and has been deleted.

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Background

During the last 6 years, the Office of the Inspector General of the Department of Defense (IG DoD) has worked closely with the Defense Logistics Agency (DLA) and other DoD Components to achieve fair and reasonable pricing for sole-source commercial and noncommercial spare parts. This report discusses the reasonableness of prices paid for spare parts procured from AAR Defense Systems, an exclusive distributor for Hamilton Sundstrand, which is a subsidiary of United Technologies Corporation. United Technologies was the sixth largest DoD contractor with $3.7 billion in DoD contracts in FY 2001.

Hamilton Sundstrand. Hamilton Sundstrand designs, manufactures, and supports aerospace and industrial products to include spare parts, overhaul and repair, and engineering and technical support. Hamilton Sundstrand is an original equipment manufacturer (OEM) of sole-source spare parts the Army Aviation and Missile Command (AMCOM), DLA, and other DoD Components procured. Starting in 1996, Hamilton Sundstrand entered into multiple agreements with AAR Defense Systems as the exclusive distributor of designated sole-source spare parts, where DoD would procure the parts directly from AAR Defense Systems.

AAR Defense Systems. AAR Defense Systems, a military supplier, dealer, distributor, and maintenance program manager for aircraft and engine parts and components, is the exclusive distributor of designated spare parts for Hamilton Sundstrand. The distributor agreement applies to sales only for U.S. Government requirements. As a result, both AMCOM and the DLA Defense Supply Centers procured spare parts from AAR Defense Systems, which was acting as a distributor for Hamilton Sundstrand. AAR Defense Systems representatives stated they have various agreements with Hamilton Sundstrand as an exclusive distributor of sole-source spare parts for users other than DoD.

Army Aviation and Missile Command. AMCOM is a major subordinate command of the Army Materiel Command. AMCOM is headquartered at Redstone Arsenal in Huntsville, Alabama. In partnership with Program Executive Offices and Program Managers, AMCOM ensures the Army's readiness by developing, acquiring, and fielding Army aviation and missile systems. AMCOM provides engineering, logistics, and acquisition services to accomplish those tasks. AMCOM services cover more than 90 major systems, about half of the systems in the Army today, which includes critical Army aviation spare parts. For FY 2001, the AMCOM budget at Redstone Arsenal exceeded $7.1 billion. AMCOM is the leader in the Army's foreign military sales and accounts for more than 50 percent of total Army sales to allied forces and to friendly foreign nations.

Defense Logistics Agency. DLA provides worldwide logistics support for the Military Departments and the unified combatant commands in peace and war. DLA has 11 field offices, 3 of which are involved in the procurement of spare parts. The three field offices are the Defense Supply Center Columbus (DSCC), the Defense Supply Center Philadelphia (DSCP), and the Defense Supply Center Richmond (DSCR). DSCC supplies weapon systems spare parts and end items and manages almost 1.8 million different construction and electronic spare parts.

DSCP provides U.S. Service members with food, clothing, textiles, medicines, medical equipment, and general and industrial supplies, and supports U.S. humanitarian and disaster relief efforts. DSCR is the lead center for aviation weapon systems and environmental logistics support and is the primary supply source for nearly 930,000 repair parts and operating items. DSCC, DSCP, and DSCR have each contracted for spare parts Hamilton Sundstrand manufactured.

Spare Parts Reviewed. We reviewed 35 orders (29 contracts) for 11 sole-source Hamilton Sundstrand spare parts (National Stock Numbers [NSNs]) procured from AAR Defense Systems from March 1999 through August 2002 with a total value of $16.8 million. Table 1 shows the buying activity and spare parts reviewed.

Table 1. Buying Activity and NSNs Reviewed

Item No.	Buying Activity	NSN	Item Description	Weapon System
1	AMCOM	2835-01-106-9153	Shaft Assembly	UH-60 Helicopter
2	AMCOM	2835-01-106-9156	Turbine Nozzle Assembly	UH-60 Helicopter
3	AMCOM	2835-01-419-2118	Housing Reduction	UH-60 Helicopter
4	AMCOM	2835-00-176-8867	Air Inlet and Sleeve	CH-47 Helicopter
5	DSCC	2520-00-153-2652	Cylinder Block Assembly	Amphibious Assault Vehicle
6	DSCP	3595-01-446-8522	Jet Fuel Starter Repair Kit	F-16 Fighter Aircraft
7	DSCR	2835-00-015-8599	Combustion Chamber Case	CH-46, CH-47, and H-3 Helicopters
8	DSCR	2835-01-462-3375	Compressor Wheel	CH-47 Helicopter
9	DSCR	2835-00-104-7376	Turbine Nozzle	CH-53 Helicopter
10	DSCR	2835-00-962-5838	Turbine Nozzle	CH-46 Helicopter
11	DSCR	2835-00-963-1393	Pinion Accessory Drive	CH-46 and CH-53 Helicopters

Objectives

The overall objective was to determine whether DoD is paying fair and reasonable prices for sole-source commercial and noncommercial spare parts procured from AAR Defense Systems. We also reviewed the management control program as it related to our overall objective. See Appendix A for a discussion of the audit scope and methodology and management controls. See Appendix B for prior coverage related to the objectives.

Spare Parts Prices

Contracting officers for AMCOM and DLA followed established procedures and with available information generally determined prices fair and reasonable for sole-source spare parts procured from AAR Defense Systems--an exclusive distributor for Hamilton Sundstrand. However, based on information we obtained that was not available to the contracting officers for AMCOM and DLA, the prices were too high. The prices for commercial or noncommercial spare parts were too high because contracting officers:

- were directed by the OEM, Hamilton Sundstrand (which declined to give a quote) to procure spare parts through its exclusive distributor, AAR Defense Systems, even though the distributor provided limited value to DoD;
- relied on inaccurate and misleading information other than cost or pricing data AAR Defense Systems provided that originated from Hamilton Sundstrand and failed to perform cost analysis of OEM prices to determine price reasonableness; and
- failed to sufficiently document and escalate negotiations in cases where the behavior of the OEM was either unreasonable or uncooperative.

AMCOM and DLA also did not establish a Strategic Supplier Alliance (SSA) with either AAR Defense Systems or Hamilton Sundstrand. As a result, AMCOM and DLA paid $16.8 million instead of $ [3] million, or [3] percent ($ [3] million), more than fair and reasonable prices on 35 orders (29 contracts) for 11 sole-source Hamilton Sundstrand spare parts procured from AAR Defense Systems from March 1999 through August 2002. Based on annual demand and the most recent prices paid, we calculate that DoD will pay about $22.2 million, or [3] percent more than fair and reasonable prices for the same items in FY 2004 through FY 2009, if the problems are not corrected. The AAR Defense Systems average pass-through costs ([3] percent) represent $ [3] million of the $22.2 million.

Guidance on Commercial Items

Commercial Item Definition. The Federal Acquisition Regulation (FAR) Subpart 2.1, "Definitions," defines commercial items.

> "Commercial item" means—

[3]This figure was calculated using contractor proprietary data and has been deleted.

(1) Any item, other than real property, that is of a type **customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and— [Emphasis added.]**

(i) Has been sold, leased, or licensed to the general public; or

(ii) Has been offered for sale, lease, or license to the general public;

(2) Any item that evolved from an item described in paragraph (1) of this definition through advances in technology or performance and that is not yet available in the commercial marketplace, but will be available in the commercial marketplace in time to satisfy the delivery requirements under a Government solicitation;

(3) Any item that would satisfy a criterion expressed in paragraphs (1) or (2) of this definition, but for—

(i) Modifications of a type customarily available in the commercial marketplace; or

(ii) Minor modifications of a type not customarily available in the commercial marketplace made to meet Federal Government requirements. Minor modifications means modifications that do not significantly alter the nongovernmental function or essential physical characteristics of an item or component, or change the purpose of a process. Factors to be considered in determining whether a modification is minor include the value and size of the modification and the comparative value and size of the final product. Dollar values and percentages may be used as guideposts, but are not conclusive evidence that a modification is minor;

"Information Other Than Cost or Pricing Data." FAR Subpart 2.1, "Definitions," also defines "information other than cost or pricing data."

"Information other than cost or pricing data" means any type of information that is not required to be certified in accordance with 15.406-2 and is necessary to determine price reasonableness or cost realism. For example, such information may include pricing, sales, or **cost information, and includes cost or pricing data for which certification is determined inapplicable after submission. [Emphasis added.]**

FAR 15.403-3, "Requiring Information Other Than Cost or Pricing Data," provides additional guidance on information necessary for evaluating the reasonableness of prices.

(a) General. (1) The contracting officer is responsible for obtaining information that is adequate for evaluating the reasonableness of the price or determining cost realism, but the contracting officer should not obtain more information than is necessary (see 15.402(a)). If the

contracting officer cannot obtain adequate information from sources other than the offeror, the contracting officer must require submission of information other than cost or pricing data from the offeror that is adequate to determine a fair and reasonable price (10 U.S.C. 2306a(d)(1) and 41 U.S.C. 254b(d)(1)). Unless an exception under 15.403-1(b)(1) or (2) applies, the contracting officer must require that the information submitted by the offeror include, at a minimum, appropriate information on the prices at which the same item or similar items have previously been sold, adequate for determining the reasonableness of the price. To determine the information an offeror should be required to submit, the contracting officer should consider the guidance in Section 3.3, Chapter 3, Volume I, of the Contract Pricing Reference Guide cited at 15.404-1(a)(7).

(2) The contractor's format for submitting the information should be used (see 15.403-5(b)(2)).

(3) The contracting officer must ensure that information used to support price negotiations is sufficiently current to permit negotiation of a fair and reasonable price. Requests for updated offeror information should be limited to information that affects the adequacy of the proposal for negotiations, such as changes in price lists.

(4) As specified in Section 808 of Public Law 105-261, an offeror who does not comply with a requirement to submit information for a contract or subcontract in accordance with paragraph (a)(1) of this subsection is ineligible for award unless the HCA [Head of Contracting Activity] determines that it is in the best interest of the Government to make the award to that offeror, based on consideration of the following:

(i) The effort made to obtain the data.
(ii) The need for the item or service.
(iii) Increased cost or significant harm to the Government if award is not made. [Emphasis added.]

(b) Adequate Price Competition [Omitted]

(c) Commercial items. (1) At a minimum, the contracting officer must use price analysis to determine whether the price is fair and reasonable whenever the contracting officer acquires a commercial item (see 15.404-1(b)). The fact that a price is included in a catalog does not in and of itself, make it fair and reasonable. If the contracting officer cannot determine whether an offered price is fair and reasonable, even after obtaining additional information from sources other than the offeror, **then the contracting officer must require the offeror to submit information other than cost or pricing data to support further analysis (see 15.404-1). [Emphasis added.]**

FAR 15.404-1, "Proposal Analysis Techniques," provides that the objective of proposal analysis is to ensure that the final agreed-to-price is fair and reasonable and addresses cost analysis of "information other than cost or pricing data."

(a) General. [Omitted.]

(4) Cost analysis may also be used to evaluate information other than cost or pricing data to determine cost reasonableness or cost realism. [Emphasis added.]

Additional Guidance on Commercial Items. The Under Secretary of Defense for Acquisition and Technology (renamed Acquisition, Technology, and Logistics) provided clarification of FAR guidance on commercial items for consistency including "Of a Type" and "Sole-Source Situations," in a memo dated January 5, 2001, on "Commercial Acquisition."

"Of a Type": The phrase "of a type" is not intended to allow the use of FAR Part 12 to acquire sole-source, military unique items that are not closely related to items already in the marketplace. Instead, "of a type" broadens the commercial item definition so that qualifying items do not have to be identical to those in the commercial marketplace. The best value offer in a competitive Part 12 solicitation can be an item that has previously satisfied the Government's need but has not been sold, leased, licensed, nor offered for sale, lease or license to the general public (a nondevelopmental item as defined in 10 USC 403 (13)). In this scenario, the phrase "of a type" allows the best value offer to qualify for a Part 12 contract as long as it is sufficiently like similar items that meet the government's requirement and are sold, leased, licensed, or offered for sale, lease or license to the general public. In such instances, **"of a type" broadens the statutory commercial item definition to allow Part 12 acquisition of a government-unique item that can compete with commercial items that meet the government's requirement. This avoids the undesirable result of shutting out otherwise price-competitive preexisting suppliers of government-unique items from Part 12 solicitations. [Emphasis added.]**

Sole-Source Situations: Contracting officers and requirements personnel should work together to avoid sole-source situations. Competition is enabled when needs are broadly stated in terms of performance outcomes. However, a sole-source situation may be unavoidable, presenting pricing challenges. Tools and techniques are available for assisting in the price reasonableness determination for sole-source commercial item procurements. **Sometimes, sole-source suppliers may attempt to exploit the lack of competitive markets and demand unreasonable prices.** In such circumstances, the team should consider revising negotiation strategies to consider innovative solutions (e.g., strategic supplier alliances); buying the bare minimum quantities and working to restate the need to expand possible solutions and qualify alternate suppliers; and ultimately upgrading systems to current, commercial technology. **In some cases, it may be necessary to escalate negotiations. The first escalation should be to the Procurement Executive, then, if necessary, to the Head of the Agency. [Emphasis added.]**

Commercial or Noncommercial Items

AAR Defense Systems, the prime contractor, classified each of the 11 sole-source Hamilton Sundstrand spare parts as commercial or commercial "of a type" items and performed no cost analysis of the OEM prices. We compared military and commercial sales of the parts for January 2000 through June 2002 to determine if a sufficient commercial market existed that would indicate whether the items were "customarily used by the general public or by non-governmental entities for purposes other than governmental purposes." Hamilton Sundstrand could provide only commercial sales data on the same items for parts 2, 3, 7, and 11; commercial sales data for "of a type" items for parts 1, 4, 8, and 10; and could not provide commercial sales data for parts 5, 6, and 9. The commerciality of the parts is questionable based on guidance because the commercial market is clearly insufficient to support any price reasonableness determination.

Figure 1 shows that the volume of military sales were substantially higher than commercial sales for the same and "of a type" items.

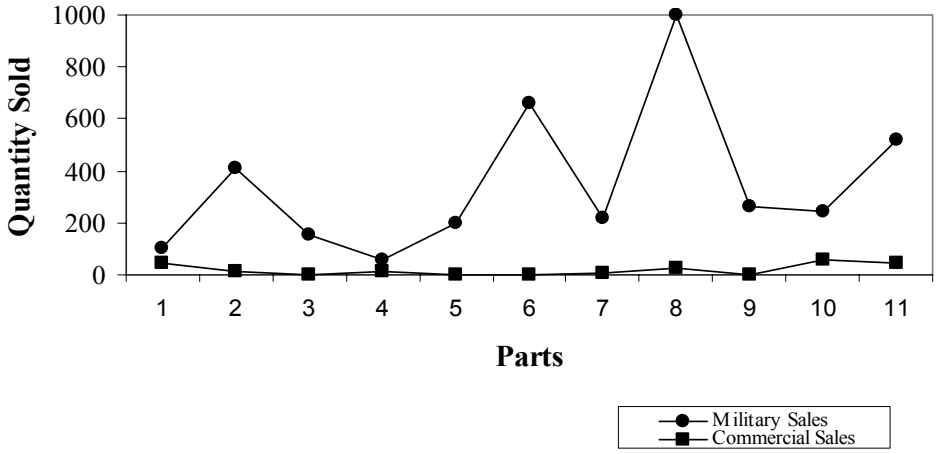

Figure 1. Comparison of Military to Commercial Sales

Fair and Reasonable Prices

Although contracting officers for AMCOM and DLA followed established procedures and with available information generally determined prices fair and reasonable for sole-source spare parts procured from AAR Defense Systems, based on information we obtained that was not available to the contracting officers for AMCOM and DLA, the prices were too high. We obtained 2000, 2001, and 2002 cost standards (total manufacturing costs) from Hamilton Sundstrand for the 11 spare parts reviewed and calculated fair and reasonable prices from the OEM by adding approved military general and administrative

rates along with a profit margin (cost build-up price) determined by the auditors. Hamilton Sundstrand did not make the cost data available to either AAR Defense Systems or the DoD contracting officers. We compared OEM prices to the prices DoD paid to the exclusive distributor, AAR Defense Systems. The DoD prices ranged from [4] to [4] percent above the fair and reasonable price.

Figure 2 shows the percentages above a fair and reasonable price that AMCOM, DSCC, DSCP, and DSCR paid for the 35 orders (29 contracts) and 11 parts reviewed.

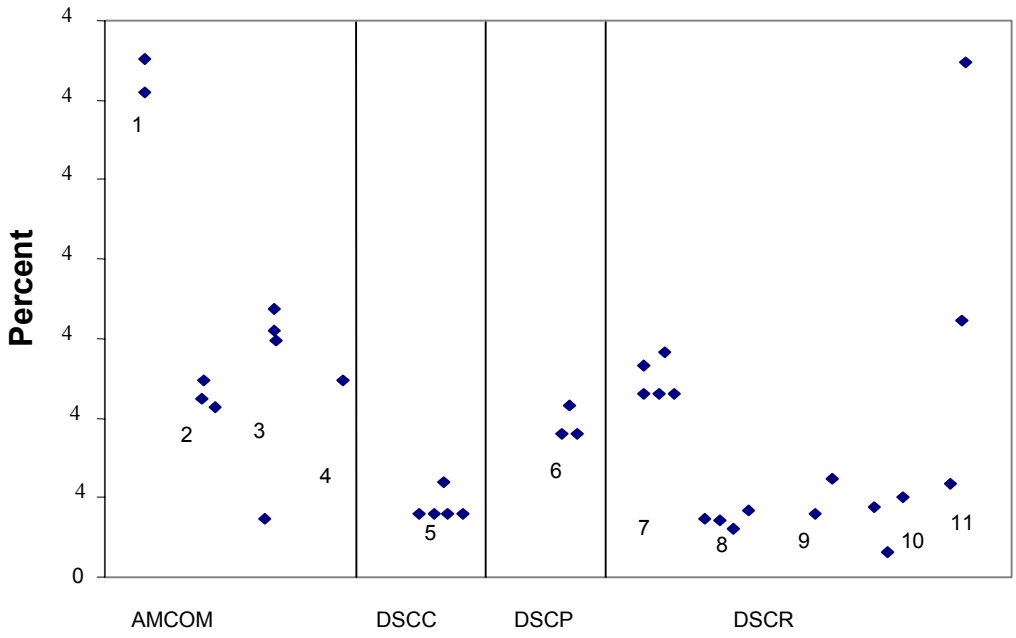

Figure 2. Percent Prices Were Above Fair and Reasonable Price

See Appendix C for a detailed comparison of DoD prices with fair and reasonable prices (cost build-up prices).

Procuring Spare Parts From a Distributor

The OEM, Hamilton Sundstrand (which declined to give a quote) directed that contracting officers for AMCOM and DLA procure spare parts through its distributor, AAR Defense Systems, even though AAR Defense Systems provided limited value to DoD. The AAR Defense Systems average pass-through costs (cost recovery and fee) added [4] percent to the DoD price.

[4]This figure was calculated using contractor proprietary data and has been deleted.

AAR Defense Systems and Hamilton Sundstrand Distributor Relationship. Starting in 1996, Hamilton Sundstrand entered into multiple agreements identifying AAR Defense Systems as its "exclusive distributor" for Government sales. The intent of the distributor relationship was for AAR to stock and distribute the parts as a support alternative other than DoD stockage. Specifically, the 1996 agreement stated:

> Whereas, the various DoD buying agencies and other users of Sundstrand equipment, in efforts to reduce costs, are looking to industry to provide the stocking and distribution function, including the delivery of material directly to the user organizations, within days of requisition.

DoD Policy on Support Alternatives. The DoD Materiel Management Regulation, DoD 4140.1-R, "Support Alternatives Other Than DoD Stockage," May 20, 1998, provides guidance on support alternatives other than DoD stockage. Section C3.4.2.1.1. states:

> All alternatives for obtaining materiel support directly from commercial sources, consistent with weapon system readiness goals, shall be used wherever practical to minimize inventory stockage requirements and achieve cost-effective distribution of materiel. Commercial alternatives include satisfying demands by placing orders with vendors for direct shipment to customers, use of commercial distribution systems, GSA [General Services Administration] Federal Supply Schedules, and new or existing contractor logistics support arrangements.

OEM and Distributor Lead Times. AAR Defense Systems provided only limited stock and distribution functions and was not responsible for delivery of the parts directly to user organizations within days of requisition because these requirements were not in the Army or DLA contracts. Consequently, the Army and DLA had responsibility for these requirements.

Table 2 shows that the quoted delivery lead times from the OEM, Hamilton Sundstrand, to the distributor, AAR Defense Systems, were exactly the same as the delivery lead times from the distributor to the Government. We did not have the OEM proposal to AAR Defense Systems for parts 7 and 9.

Table 2. OEM and Distributor Quoted Lead Times Are the Same (after receipt of order)

		OEM to Distributor		Distributor to Government	
Item No.	NSN	Quantity	Delivery	Quantity	Delivery
1	2835-01-106-9153	100 - 200	[5] months	100	[5] months
2	2835-01-106-9156	90	[5] months	90	[5] months
3	2835-01-419-2118	3-80	[5] months	75	[5] months
4	2835-00-176-8867	5-40	[5] months	30	[5] months
5	2520-00-153-2652	75	[5] months	75	[5] months
6	2835-01-446-8522	5-400	[5] months	90	[5] months
8	2835-01-462-3375	1-400	[5] months	380	[5] months
10	2835-00-962-5838	10-50	[5] months	39	[5] months
11	2835-00-963-1393	5-110	[5] months	97	[5] months

Contracting officers for AMCOM and DLA need to initiate action that procures sole-source Hamilton Sundstrand spare parts directly from the OEM or develops a business case supporting the use of an exclusive distributor to provide inventory stockage and materiel distribution requirements. In June 2002, we visited AAR Defense Systems headquarters. During the visit, we performed a physical inventory and did not identify any on-hand inventory that would enable AAR Defense Systems to ship inventory within days of requisition to satisfy Government requirements.

AAR Defense Systems personnel stated that they have provided added value in their role as an exclusive distributor of sole source spare parts. In February 2003, AAR Defense Systems had 14 units in inventory for only 1 of the 11 spare parts we reviewed. AAR Defense Systems also stated that they improved lead times by expediting deliveries of sole-source Hamilton Sundstrand spare parts prior to DoD awarding a signed contract to AAR Defense Systems. We agree that AAR Defense Systems has provided limited value added in situations when they anticipated the award of a future DoD contract.

[5]This represents contractor proprietary data that has been deleted.

However, using both DoD and AAR Defense Systems infrastructure for stocking spare parts is not an effective use of resources when both add similar costs to the price of the parts.

"Information Other Than Cost or Pricing Data"

Contracting officers relied on inaccurate and misleading information other than cost or pricing data AAR Defense Systems provided that originated from Hamilton Sundstrand and did not perform cost analysis of OEM prices that would determine price reasonableness. AAR Defense Systems did not provide contracting officers for AMCOM and DLA adequate information other than cost and pricing data that included uncertified cost or pricing data from Hamilton Sundstrand.

Price Reasonableness Determinations. AMCOM contracting officers determined that prices for each of the spare parts were fair and reasonable. DSCR contracting officers, lacking sufficient information and data to make price reasonableness determinations, classified prices for orders on four out of the five DSCR parts reviewed as either unreasonable or could not determine price reasonableness. Unfortunately, there were critical requirements for the parts so the procurements were made at unreasonable prices. Catalog prices with price analysis supported other orders.

Information Other Than Cost or Pricing Data Provided by AAR. The information other than cost or pricing data that AAR Defense Systems provided to DoD contracting officers contained inaccurate and misleading information because the data were irrelevant to the Hamilton Sundstrand price. The data indicated that Hamilton Sundstrand prices were based on some type of cost buildup. Hamilton Sundstrand stated during the audit that prices were price-based and not based on any type of cost buildup where profit was evaluated. DoD contracting officers questioned price increases; however, AAR Defense Systems provided information that supported the increases by stating that Hamilton Sundstrand had revised its material acquisition rate, rates utilized in the proposal had been negotiated with Defense Contract Management Office (DCMO) and Defense Contract Audit Agency (DCAA) offices, and price increases reflected escalation, profit, and increases in material handling.

For example, an AMCOM contracting officer questioned the price for NSN 2835-01-106-9153 on contract DAAH23-00-P-0066. The Government had paid a unit price of $613.81 for the shaft assembly in June 1992; the new unit price for 30 shaft assemblies was $2,372 for a total contract price of $71,160. AMCOM had a critical requirement for the part, and the contracting officer relied on information other than cost or pricing data for pricing the item and determining price reasonableness.

Table 3 shows the data AAR Defense Systems provided that supported price reasonableness where no cost analysis of the Hamilton Sundstrand price was performed.

Table 3. AAR Other Than Cost or Pricing Data		
Description	Percent	Amount
AAR Cost (Hamilton Sundstrand Price)		$ [6]
Selling/General and Administrative Expense	[6]	$ [6]
Subtotal		**$ [6]**
Fee	[6]	$ [6]
Unit price before economic concession		$ [6]
AAR economic price concession		($ [6])
Net Price		**$2,371.77**

To support the Hamilton Sundstrand price, AAR Defense Systems provided the following information from Hamilton Sundstrand:

Hamilton Sundstrand Material Acquisition Rate

[7]

The statement submitted in relationship to the price implies that Hamilton Sundstrand used some type of a cost buildup. While the statement was technically correct, no relationship existed between the statement and the Hamilton Sundstrand price. Consequently, the information AAR Defense Systems provided to the AMCOM contracting officer was irrelevant and of no value because the Hamilton Sundstrand price was not based on a cost buildup. Using a cost buildup, we calculated that the fair and reasonable unit price for the item from Hamilton Sundstrand was $ [8] versus the AAR Defense Systems distributor price of $2,372.00 or a difference of [8] percent.

An AMCOM contracting officer also questioned the price for NSN 2835-01-106-9156 on contract DAAH23-00-P-1175. The contract was for 90 turbine nozzles at a unit price of $4,815.84 for a total contract price of $433,426.

Table 4 shows the data AAR Defense Systems provided that supported price reasonableness. Again, no cost analysis of the Hamilton Sundstrand price was performed.

[6]This figure represents contractor proprietary data that has been deleted.

[7]This area of the report represents contractor proprietary data that has been deleted.

[8]This figure was calculated using contractor proprietary data and has been deleted.

Table 4. AAR Other Than Cost or Pricing Data

Description	Percent	Basic	Option*
AAR Cost (Hamilton Sundstrand Price)		$ [9]	$ [9]
Selling/General and Administrative Expense	[9]	[9]	[9]
Subtotal		**$ [9]**	**$ [9]**
Fee	[9]	[9]	[9]
Unit price before economic concession		[9]	[9]
AAR economic price concession		([9])	([9])
Net Price		**$4,815.84**	**$4,936.24**
Extended Price		**$433,425.62**	**$444,261.78**

*The AAR source document contained mathematical errors for the option year.

To support the Hamilton Sundstrand price, AAR Defense Systems provided the AMCOM contracting officer with the following information AAR Defense Systems received from Hamilton Sundstrand that was included in the price negotiation memorandum.

[10]

The statement again implies that the Hamilton Sundstrand price was based on a cost buildup. However, the information AAR Defense Systems provided to an AMCOM contracting officer was irrelevant and of no value because the Hamilton Sundstrand price was not based on a cost buildup. We calculated, using a cost buildup, that the fair and reasonable unit price for the item from Hamilton Sundstrand was $ [11] in 2000 and $ [11] in 2001 versus the AAR Defense Systems' price of $4,815.84 and $4,936.24, a difference of [11] and [11] percent, respectively.

The DSCR contracting officer questioned the price for NSN 2835-00-962-5838 on contract SP0480-00-G-0001 (delivery order TY66). The order was for 39 turbine nozzles at a unit price of $4,567.75 for a total contract price of $178,142. The order also included an option quantity of 39 items at a unit price of $4,796.15 for a total option price of $187,050. Table 5 shows the data provided by AAR Defense Systems to support price reasonableness without cost analysis of the Hamilton Sundstrand price.

[9]This figure represents contractor proprietary data that has been deleted.

[10]This area of the report represents contractor proprietary data that has been deleted.

[11]This figure was calculated using contractor proprietary data and has been deleted.

Table 5. AAR Other Than Cost or Pricing Data			
Description	Percent	Amount	
		Basic	Option
Quantity		39	39
AAR Cost (Hamilton Sundstrand Price)		$ [12]	$ [12]
Selling/General and Administrative Expense	[12]	[12]	[12]
Subtotal		**$ [12]**	**$ [12]**
Fee	[12]	[12]	[12]
Unit price before economic concession		[12]	[12]
AAR economic price concession		([12])	([12])
Net Price		**$4,681.00**	**$4,915.05**

On April 12, 2001, AAR Defense Systems lowered its basic unit price to $4,567.75 and option unit price to $4,796.15. AAR Defense Systems provided the following information it received from Hamilton Sundstrand:

[13]

The DSCR contracting officer determined that the price was fair and reasonable using price analysis and the information AAR Defense Systems provided. Again, the information AAR Defense Systems provided to the DSCR contracting officer had no reasonable relationship to the Hamilton Sundstrand cost to manufacture the part. We calculated that a fair and reasonable unit price for the item from Hamilton Sundstrand was $ [14] versus the AAR Defense Systems distributor prices of $4,567.75 and $4,796.15, or differences of [14] and [14] percent, respectively.

Contracting officers for AMCOM and DLA need to comply with FAR requirements for obtaining information that is adequate for evaluating the reasonableness of price. This information--information other than cost or pricing data--includes uncertified cost or pricing data that can be used to perform cost analysis that supports price reasonableness determinations.

Document and Escalate Negotiations

Contracting officers for AMCOM and DLA failed to sufficiently document and escalate negotiations in cases where the behavior of the OEM was either

[12]This figure represents contractor proprietary data that has been deleted.

[13]This area of the report represents contractor proprietary data that has been deleted.

[14]This figure was calculated using contractor proprietary data and has been deleted.

unreasonable or uncooperative. No documented instances were present for the 35 orders reviewed where the contracting officers escalated negotiations to support price reasonableness determinations. The unreasonable and uncooperative cases included declining to quote or refusing to provide information other than cost or pricing data that includes uncertified cost or pricing data for cost analysis to support price reasonableness determinations. As provided in the January 2001 memorandum from the Under Secretary of Defense for Acquisition and Technology on commercial items, "Sometimes, sole-source suppliers may attempt to exploit the lack of competitive markets and demand unreasonable prices."

IG DoD Report No. D-2001-129, "Contracting Officer Determinations of Price Reasonableness When Cost or Pricing Data Were Not Obtained," May 30, 2001, recommends that the Under Secretary of Defense for Acquisition, Technology, and Logistics emphasize to contracting officers the responsibility for identifying contractors that refuse to provide data contracting officials request and then institute corrective measures that include involving the head of the contracting activity. The report identifies the same problems at both AMCOM and DLA relating to commercial items with little or no sales outside DoD. The report states that the contracting officers were accepting commercial prices from contractors and not obtaining sufficient cost information to perform cost analysis to determine price reasonableness.

In response to the report, the Director, Defense Procurement agreed that circumstances leading to customer dissatisfaction, such as the denial of data contracting officials request, should be a part of the overall past performance evaluation of a contractor.

FAR 42.1501 states that past performance information includes "the contractor's history of reasonable and cooperative behavior and commitment to customer satisfaction; and generally, the contractor's business-like concern for the interest of the customer."

The Director, Defense Procurement also provided a memorandum to the acquisition community on March 21, 2002, "Price Analyses and Price Reasonableness Determinations When Cost or Pricing Data Are Not Obtained," that states:

> A contractor that refuses to provide necessary information may be rendered ineligible for award unless the Head of the Contracting Activity determines otherwise, in accordance with FAR 15.403-3 (a)(4). As such, it is important that contractor refusals to provide requested pricing information receive the attention of levels of management higher than the contracting officer, and that contracting officers document the extent of their efforts to obtain needed information.

When an OEM refuses to quote an item and requires that DoD contracting officers procure the item from an exclusive distributor that provides limited value to DoD or when an OEM refuses to provide information other than cost or pricing data that includes uncertified cost or pricing data for cost analysis as required by the FAR clearly demonstrates unreasonable and uncooperative behavior by the

contractor. Cases of unreasonable and uncooperative behavior by the OEM should be documented and elevated for resolution to the Senior Procurement Executive and, if necessary, to the head of the agency.

Strategic Supplier Alliance

Contracting officers for AMCOM and DLA had not established an SSA with either AAR Defense Systems or Hamilton Sundstrand. An SSA is a framework implemented at the senior level that has been used successfully to develop a consensus of better contracting processes to produce optimum performance and price. In a memorandum dated May 13, 2002, the Director, Acquisition Initiatives stated that the Principal Deputy, Under Secretary of Defense for Acquisition, Technology, and Logistics met with the Senior Acquisition Executives for the DoD Components and discussed opportunities for SSAs. In conjunction with the first SSA award, which was made to Honeywell in June 2000, the total number of SSA partnerships executed or planned through FY 2004 is now 19 and includes Boeing, AVIBANK Manufacturing, and Lockheed-Martin. The Director, DLA together with the Commander of the Air Force Materiel Command jointly signed charters for alliances with Pratt and Whitney and General Electric in September 2002.

DLA had initiated an SSA with Hamilton Sundstrand in August 2000; however, the first attempt was unsuccessful. In light of the other successful SSAs, we believe that AMCOM and DLA, in conjunction with the Air Force, should initiate action to implement a new SSA with either AAR Defense Systems or Hamilton Sundstrand.

Conclusion

Contracting officers for AMCOM and DLA were unable to procure spare parts directly from the OEM and obtain adequate information other than cost or pricing data. As a result, AMCOM and DLA paid $16.8 million instead of $ [15] million, or [15] percent ($ [15] million) more than fair and reasonable prices on 35 orders (29 contracts) for 11 sole-source Hamilton Sundstrand spare parts procured from AAR Defense Systems from March 1999 through August 2002. Based on annual demand and the most recent prices paid, we calculate that DoD will pay about $22.2 million, or [15] percent more than fair and reasonable prices for the same items in FYs 2004 through 2009 if the problems are not corrected. Of the $22.2 million, [15] percent or $ [15] million represents the average pass-through costs from AAR Defense Systems. Table 6 shows the funds that could be put to better use if AMCOM and DLA can negotiate fair and reasonable prices.

Table 6. Summary of Funds Put to a Better Use With Fair and Reasonable Prices

		Current Prices		Fair and Reasonable Prices		
NSN	ADQ[1]	Unit Price	Total	Unit price	Total	Difference
AMCOM						
2835-01-208-7789[2]	45	$ 2,579.73	$ 116,088	$ [15]	$ [15]	$ [15]
2835-01-106-9156	144	4,936.24	710,819	[15]	[15]	[15]
2835-01-419-2118	41	8,813.40	361,349	[15]	[15]	[15]
2835-00-176-8867	41	3,664.98	150,264	[15]	[15]	[15]
Subtotal			**$ 1,338,520**		**$ [15]**	**$ [15]**
DSCC						
2520-00-153-2652	77	4,411.55	339,689	[15]	[15]	[15]
Subtotal			**$ 339,689**		**$ [15]**	**$ [15]**
DSCP/DSCR						
3895-01-446-8522	280	15,573.07	$4,360,460	[15]	[15]	[15]
Subtotal			**$4,360,460**		**$ [15]**	**$ [15]**
DSCR						
2835-00-015-8599	20	8,285.31	165,706	[15]	[15]	[15]
2835-01-462-3375	226	4,166.58	941,647	[15]	[15]	[15]
2835-00-104-7376	50	3,813.16	190,658	[15]	[15]	[15]
2835-00-962-5838	77	5,269.99	405,789	[15]	[15]	[15]
2835-00-963-1393	154	1,184.20	182,367	[15]	[15]	[15]
Subtotal			**$1,886,167**		**$ [15]**	**$ [15]**
Total			**$7,924,836**		**$ [15]**	**$ [15]**
Calculated cost difference from FY 2004 to FY 2009 ([15])						**$ [15]**

[1]Annual Demand Quantity.
[2] NSN 2835-01-208-7789 replaces NSN 2835-01-106-9153.

[15] This figure was calculated using contractor proprietary data and has been deleted.

Management Comments on the Finding and Audit Response

Summaries of management comments on the finding and our audit response are in Appendix E.

Recommendations, Management Comments, and Audit Response

We recommend that the Commander, Army Aviation and Missile Command and the Director, Defense Logistics Agency emphasize with their contracting officers the need to:

1. Revisit procuring sole-source Hamilton Sundstrand spare parts from a distributor versus directly from the original equipment manufacturer or develop a business case that supports the use of an exclusive distributor to provide inventory stockage and materiel distribution requirements.

Defense Logistics Agency Comments. The Director of Logistics Operations concurred, stating that the DSCR Integrated Supplier Team for Hamilton Sundstrand has had several discussions with Hamilton Sundstrand managers on this recommendation and advised that the company is willing to provide pricing information for approximately 50 to 70 sole-source NSNs for stock support as well as agrees to pursue a long-term corporate contract. A solicitation is expected to be issued in the near future and will include provisions for adding more sole-source Hamilton Sundstrand spare parts DSCC, DSCP, DSCR, and possibly the Services manage.

Army Comments. The Deputy Assistant Secretary of the Army (Policy and Procurement) did not concur, stating that AMCOM contracting officers initiated action to procure spare parts directly from Hamilton Sundstrand with a goal for contract award in March 2004 "months" before receiving the IG DoD draft audit report.

Audit Response. Although the Army did not concur, we consider the comments responsive. The actions the contracting officers for AMCOM took to procure items directly from Hamilton Sundstrand satisfy the intent of the recommendation.

2. Obtain information that is adequate for evaluating reasonableness of price in accordance with Federal Acquisition Regulation requirements. The information--information other than cost or pricing data--includes uncertified cost or pricing data from the original equipment manufacturer that can be used to perform cost analysis to support price reasonableness determinations.

Defense Logistics Agency Comments. The Director of Logistics Operations partially concurred, stating that although contracting officers have a responsibility for determining price reasonableness, they individually have little leverage in

obtaining uncertified cost data from companies other than those with whom they are contracting. However, the course of action addressed in response to Recommendation 4. should enhance DLA ability to obtain such information.

Audit Response. We consider the DLA comments responsive.

Army Comments. The Deputy Assistant Secretary of the Army (Policy and Procurement) did not concur, stating that AMCOM has a policy and practice of negotiating fair and reasonable prices in accordance with FAR requirements and other applicable regulatory guidance. Additionally, the Deputy Assistant Secretary of the Army (Policy and Procurement) stated that some form of cost analysis was performed that supported price reasonableness when information other than cost and pricing data was used in most instances of AMCOM requirements and that contracting officer "judgment" was applied with regard to the prices reflected in contract awards.

Audit Response. The Army comments are not responsive. Although the contracting officers followed procedures, their "judgment" to accept data the OEM supplied without testing the validity of the data resulted in the Army's paying prices too high for spare parts. Based on the results of the audit, the Army needs to perform some data tests that ensure contractors are supplying accurate information other than cost and pricing data. We request that the Army reconsider its position on the recommendation and provide additional comments in response to the final report.

3. Document and escalate negotiations when an original equipment manufacturer's behavior is either unreasonable or uncooperative. This unreasonable and uncooperative behavior includes refusing to quote an item and requiring DoD contracting officers to procure the item from an exclusive distributor that provides limited value to DoD or refusing to provide information other than cost or pricing data (to include uncertified cost or pricing data) as required by the Federal Acquisition Regulation.

Defense Logistics Agency Comments. The Director of Logistics Operations partially concurred, stating that an OEM decision concerning whether to sell products directly or through any alternative means is not subject to any statutory or regulatory peacetime constraints. The Director of Logistics Operations concurred that when major adverse situations of this nature occur, the matter should be escalated within Government and OEM management channels for resolution or remediation.

Audit Response. We consider the DLA comments responsive.

Army Comments. The Deputy Assistant Secretary of the Army (Policy and Procurement) did not concur, stating that all AMCOM contracts for the four NSNs reviewed contained determinations that prices were fair and reasonable. Further, elevating negotiations is merely one technique that contracting officers should consider.

Audit Response. The Army comments are not responsive. Even though contracting officers determined that prices were fair and reasonable, the prices

were too high because the validity of the data used to support prices was not tested. Although FAR 15.404-3, "Subcontract Pricing Considerations" does place primary responsibility on the prime contractor to evaluate subcontractor proposals, the contracting officer has ultimate responsibility for determination of the price reasonableness for the prime contract, including subcontracting costs. The Defense Federal Acquisition Regulation Supplement 215.404-3, "Subcontract Pricing Considerations," also emphasizes situations where the contracting officer should request audit or field pricing assistance to analyze and evaluate the proposal of a subcontractor. Two such instances--if a business relationship between the contractor and the subcontractor is not conducive to independence and the contractor is a sole-source supplier with the subcontract costs representing a substantial part of the contract cost--apply here. We believe that contracting officers should use all of the tools available to obtain fair and reasonable prices, including elevating negotiations when necessary to obtain sufficient data to ensure prices are truly fair and reasonable. We request that the Army reconsider its position on the recommendation and provide additional comments in response to the final report.

4. In conjunction with the Air Force, initiate action to implement a new Strategic Supplier Alliance with either AAR Defense Systems or Hamilton Sundstrand.

Defense Logistics Agency Comments. The Director of Logistics Operations concurred, stating that DLA is in the very early stages of formulating an SSA with Hamilton Sundstrand by identifying and obtaining confirmation from additional potential stakeholders, including the Army and Air Force. The Director of Logistics Operations did not concur with implementing an SSA with AAR at this time because current SSA efforts and resources for DLA are aimed at engaging OEMs of sole-source spare parts.

Audit Response. We consider the DLA comments responsive.

Army Comments. The Deputy Assistant Secretary of the Army (Policy and Procurement) did not concur, stating that AMCOM contracting officers initiated action for procuring spare parts directly from Hamilton Sundstrand with a goal for contract award in March 2004 months before receiving the IG DoD draft audit report.

Audit Response. The Army comments are not responsive. We believe that an SSA with Hamilton Sundstrand that involves all the potential stakeholders, including DLA, the Army, and the Air Force, has a much greater chance for success. We request that the Army reconsider its position on the recommendation and provide additional comments in response to the final report.

Appendix A. Scope and Methodology

We visited or contacted individuals and organizations within DoD, AAR Defense Systems, and Hamilton Sundstrand. We reviewed 35 orders (29 contracts) for 11 different Hamilton Sundstrand sole-source spare parts (NSNs) procured between March 1999 and August 2002 from AAR Defense Systems with a total value of $16.8 million. The Haystack Online for Windows showed 566 parts ordered from AAR Defense Systems from March 1999 to August 2002 valued at $64.1 million. Of the 566 parts, 89 made up $57.6 million or 90 percent of the $64.1 million. During the period reviewed, DoD awarded 311 orders for the 89 parts. Our verification showed that Hamilton Sundstrand was the OEM for 87 of the 89 spare parts. We selected 11 of the 87 spare parts that were high dollar items for our review.

We reviewed information other than cost or pricing data from AAR Defense Systems that included the price charged by the OEM, Hamilton Sundstrand, and additional pass-through costs charged to DoD. We obtained standard manufacturing cost data for 2000, 2001, and 2002 from Hamilton Sundstrand. We also reviewed Hamilton Sundstrand commercial sales data from January 2000 through June 2002.

We reviewed delivery orders, contract awards, price negotiation memorandums, and correspondence within the contract files and Haystack Online for Windows database to determine whether DoD Components were receiving fair and reasonable prices and whether AAR Defense Systems was providing added value to DoD by acting as a distributor for Hamilton Sundstrand.

We performed this audit from November 2001 through March 2003 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We relied on computer-processed data from the Haystack Online for Windows database to determine the contracting activities to visit and to determine audit sample selection. Although we did not perform a formal reliability assessment of the computer-processed data from the Haystack Online for Windows database, we determined that the contract numbers, award dates, and contractors on the contracts reviewed generally agreed with the information in the computer-processed data. We did not find errors that would preclude use of the computer-processed data to meet the audit objectives or that would change the conclusions in this report.

We also relied on Hamilton Sundstrand's cost estimating system for standard manufacturing cost data to determine fair and reasonable prices for spare parts. We did not validate the data; however, DCAA performed audits in 1997 and 1999 on Sundstrand Aerospace Corporation's costs estimating system and stated that internal controls and procedures of the cost estimating system were adequate. Sundstrand Aerospace Corporation has undergone changes in their corporate structure since DCAA performed the audits. DCAA is performing an audit on Hamilton Sundstrand's cost estimating systems and expects to issue a draft report of that audit in October 2003.

General Accounting Office High-Risk Area. The General Accounting Office (GAO) has identified several high-risk areas in DoD. This report provides coverage of the DoD Contract Management and Inventory Management high-risk areas.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.50, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed DSCR, DSCC, and AMCOM's adequacy of management controls of contract management. Specifically, we reviewed management controls over price reasonableness determinations. We also reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified management control weaknesses for AMCOM, DSCC, and DSCR as DoD Instruction 5010.40 defines. AMCOM, DSCC, and DSCR controls for contract management were insufficient to make sure that price reasonableness determinations resulted in DoD receiving a fair and reasonable price for the 11 spare parts reviewed. Recommendations 1., 2., and 3., if implemented, will improve contract management procedures and could result in potential monetary benefits. DLA conducted a Procurement Management Review in June 2001 on the pricing of first-time buys that identified management control weaknesses. Although DLA identified the management control weaknesses, problems still exist in determining fair and reasonable prices. A copy of the final report will be sent to the senior official in charge of management controls for DLA and AMCOM.

Adequacy of Management's Self-Evaluation. In the FY 2001 Annual Statement of Assurance, DLA identified the pricing of first-time buys as an assessable unit and reported that as a management concern for DSCR and DSCC. In addition, DSCR and DSCC provided price reasonableness determination training in FY 2002 for all contracting officers and buyers. AMCOM did not identify contract management as an assessable unit in its FY 2001 Annual Statement of Assurance and, therefore, did not identify price reasonableness determinations as a management concern or material weakness.

Appendix B. Prior Coverage

During the last 5 years, GAO and the IG DoD have issued 21 reports discussing spare parts and price reasonableness determinations. Unrestricted GAO reports can be accessed over the Internet at http://www.gao.gov. Unrestricted IG DoD reports can be accessed at http://www.dodig.osd.mil/audit/reports.

GAO

GAO, Report No. GAO-02-502, "DoD Needs Better Guidance on Granting Waivers for Certified Cost or Pricing Data," April 22, 2002

GAO, Report No. GAO-01-772, "Army Inventory: Parts Shortages Are Impacting Operations and Maintenance Effectiveness," July 31, 2001

GAO, Report No. GAO-01-587, "Air Force Inventory: Parts Shortages Are Impacting Operations and Maintenance Effectiveness," June 27, 2001

GAO, Report No. GAO-01-22, "Defense Acquisitions: Price Trends for the Defense Logistics Agency's Weapon Systems Parts," November 3, 2000

GAO, Report No. GAO/NSIAD-00-30, "Defense Inventory: Opportunities Exist to Expand the Use of Defense Logistics Agency Best Practices," January 26, 2000

GAO, Report No. GAO/NSIAD-00-22, "Contract Management: A Comparison of DoD and Commercial Airline Purchasing Practices," November 29, 1999

GAO, Report No. GAO/NSIAD-00-21, "Defense Inventory: Management of Repair Parts Common to More than one Military Service can be Improved," October 20, 1999

GAO, Report No. GAO/NSIAD-99-90, "Contract Management: DoD Pricing of Commercial Items Needs Continued Emphasis," June 24, 1999

IG DoD

IG DoD Report No. D-2002-112, "Industrial Prime Vendor Program at the Air Force Air Logistics Centers," June 20, 2002

IG DoD Report No. D-2002-059, "Results of the Defense Logistics Agency Strategic Supplier Alliance with Honeywell International, Incorporated," March 13, 2002

IG DoD Report No. D-2001-171, "Industrial Prime Vendor Program at the Naval Aviation Depot – Cherry Point," August 6, 2001

IG DoD Report No. D-2001-129, "Contracting Officer Determinations of Price Reasonableness When Cost or Pricing Data Were Not Obtained," May 30, 2001

IG DoD Report No. D-2001-072, "Industrial Prime Vendor Program at the Naval Aviation Depot – North Island," March 5, 2001

IG DoD Report No. D-2000-99, "Procurement of the Propeller Blade Heaters for the C-130 and P-3 Aircraft," June 12, 2000

IG DoD Report No. D-2000-98, "Spare Parts and Logistics Support Procured on a Virtual Prime Vendor Contract," June 14, 2000

IG DoD Report No. 99-218, "Sole-Source Noncommercial Spare Part Orders on a Basic Ordering Agreement," October 12, 1999

IG DoD Report No. 99-217, "Sole-Source Commercial Spare Parts Procured on a Requirements Type Contract, " August 16, 1999

IG DoD Report No. 99-101, "Logistics Response Time for the Direct Vendor Delivery Process, Defense Supply Center, Columbus," March 4, 1999

IG DoD Report No. 99-026, "Commercial Spare Parts Purchased on a Corporate Contract," January 13, 1999

IG DoD Report No. 98-088, "Sole-Source Prices for Commercial Catalog and Noncommercial Spare Parts," October 13, 1998

IG DoD Report No. 98-064, "Commercial and Noncommercial Sole-Source Items Procured on Contract N000383-93-G-M111," February 6, 1998

Appendix C. Comparison of DoD Prices with Fair and Reasonable Prices

			DoD Prices			Fair and Reasonable Prices			Difference	
NSN	Contract/Order	Date	Quantity	Unit	Total	Year[16]	Unit	Total	Amount	Percent
AMCOM										
2835-01-106-9153[17]	DAAH2300P0066	Nov 99	30	2,372.00	71,160	2000	[18]	[18]	[18]	[18]
2835-01-106-9153	DAAH2300C0390	Sep 00	100	2,491.76	249,176	2000	[18]	[18]	[18]	[18]
2835-01-106-9153[19]	*1.035303862*	*2002*		*2,579.73*		*2002*	*[18]*			*[18]*
2835-01-106-9156	DAAH2300P1175	Sep 00	90	4,815.84	433,426	2000	[18]	[18]	[18]	[18]
2835-01-106-9156	DAAH2300P1175	May 01	90	4,936.24	444,262	2001	[18]	[18]	[18]	[18]
2835-01-106-9156	DAAH2302C0080	Jan 02	228	4,936.24	1,125,463	2002	[18]	[18]	[18]	[18]
2835-01-419-2118	DAAH2300C0194	Jun 00	75	8,468.98	635,174	2000	[18]	[18]	[18]	[18]
2835-01-419-2118	DAAH2302C0085	Dec 01	75	8,666.22	649,967	2001	[18]	[18]	[18]	[18]
2835-01-419-2118[19]	*1.016983627*	*2002*		*8,813.40*		*2002*	*[18]*			*[18]*
2835-00-176-8867	DAAH2300C0364	Sep 00	60	3,540.00	212,400	2000	[18]	[18]	[18]	[18]
2835-00-176-8867[19]	*1.035303862*	*2002*		*3,664.98*		*2002*	*[18]*			*[18]*
AMCOM Subtotal					**3,821,026**			**[18]**	**[18]**	**[18]**

[16]We did not obtain standard data from Hamilton Sundstrand for 1999.

[17]NSN 2835-01-106-9153 will be replaced by NSN 2835-01-208-7789 in the future.

[18]This figure was calculated using contractor proprietary data and has been deleted.

[19]We used Navy Inflation Indices of 1.035 to calculate prices from 2000 to 2002 and 1.017 to calculate prices from 2001 to 2002.

			DoD Prices			Fair and Reasonable Prices			Difference	
NSN	Contract/Order	Date	Quantity	Unit	Total	Year[16]	Unit	Total	Amount	Percent
DSCC										
2520-00-153-2652	SP074099C2425	May 99	40	4,885.00	195,400	2000	18	18	18	18
2520-00-153-2652	SP075000C3755	Dec 99	75	4,261.00	319,575	2000	18	18	18	18
2520-00-153-2652	SP075000C3794	April 00	80	4,261.12	340,890	2000	18	18	18	18
2520-00-153-2652	SP075000C3814	Jul 00	60	4,261.00	255,660	2000	18	18	18	18
2520-00-153-2652	SP075000C3711	Sep 00	61	4,261.12	259,928	2000	18	18	18	18
2520-00-153-2652[19]	*1.035303862*	*2002*		*4,411.55*		*2002*	*18*			*18*
DSCC Subtotal					**1,371,453**			**18**	**18**	**18**
DSCP										
3895-01-446-8522	SP056000ML044	May 00	2	14,584.00	29,168	2000	18	18	18	18
3895-01-446-8522	SP056000C0066	Sep 00	25	14,584.00	364,600	2000	18	18	18	18
3895-01-446-8522	SP056002C0200	Nov 01	90	15,313.00	1,378,170	2001	18	18	18	18
3895-01-446-8522[19]	*1.016983627*	*2002*		*15,573.07*		*2002*	*18*			*18*
DSCP Subtotal					**1,771,938**			**18**	**18**	**18**

NSN	Contract/Order	Date	DoD Prices Quantity	DoD Prices Unit	DoD Prices Total	Fair and Reasonable Prices Year[16]	Fair and Reasonable Prices Unit	Fair and Reasonable Prices Total	Difference Amount	Difference Percent
DSCR										
2835-00-015-8599	SP041199MEC01	Mar 99	1	7,269.00	7,269	2000	18	18	18	18
2835-00-015-8599	SP041199C5452	May 99	25	7,269.00	181,725	2000	18	18	18	18
2835-00-015-8599	SP048099D05640001	Sep 99	200	7,269.12	1,453,824	2000	18	18	18	18
2835-00-015-8599	SP048099D05640002	Aug 00	40	8,146.95	325,878	2000	18	18	18	18
2835-00-015-8599	SP048099D05640003	Feb 01	160	8,146.95	1,303,512	2001	18	18	18	18
2835-00-015-8599[19]	*1.016983627*	*2002*		*8,285.31*		*2002*	*18*			*18*
2835-01-462-3375	SP048000C5228	Dec 99	130	3,592.96	467,085	2000	18	18	18	18
2835-01-462-3375	SP048000G0001TY91	Aug 01	42	3,932.50	165,165	2001	18	18	18	18
2835-01-462-3375	SP048000G0001TY95	Nov 01	380	3,900.00	1,482,000	2001	18	18	18	18
2835-01-462-3375	SP048000G0001TY95	Nov 01	380	4,097.00	1,556,860	2001	18	18	18	18
2835-01-462-3375[19]	*1.016983627*	*2002*		*4,166.58*		*2002*	*18*			*18*
2835-00-104-7376	SP048000G0001TY67	Mar 01	36	3,692.94	132,946	2001	18	18	18	18
2835-00-104-7376	SP048000G0001TY2W	Jun 02	223	3,813.16	850,335	2002	18	18	18	18
2835-00-962-5838	SP048000G0001TY66	Apr 01	39	4,567.75	178,142	2001	18	18	18	18
2835-00-962-5838	SP048000G0001TY66	May 01	39	4,796.15	187,050	2001	18	18	18	18
2835-00-962-5838	SP048000G0001TY1X	Dec 01	79	5,019.04	396,504	2001	18	18	18	18
2835-00-962-5838	SP048000G0001TY1X	May 02	79	5,269.99	416,329	2002	18	18	18	18
2835-00-963-1393	SP048000MA259	Dec 99	45	1,021.00	45,945	2000	18	18	18	18
2835-00-963-1393	SP048000G0001TY04	April 00	97	1,075.00	104,275	2000	18	18	18	18
2835-00-963-1393	SP048000G0001TY65	May 01	418	1,089.00	455,202	2001	18	18	18	18
2835-00-963-1393	SP048000G0001TY3T	Aug 02	79	1,184.20	93,552	2002	18	18	18	18
DSCR Subtotal					**9,803,598**			**18**	**18**	**18**
Total					**16,768,014**			**18**	**18**	**18**

Appendix D. Management Comments on the Finding and Audit Response

DLA Comments on the Finding

Limited Data Available to DLA Contracting Officers. The Director of Logistics Operations commented that based on the limited data available, DLA contracting officers determined that the prices were not fair and reasonable for two contracting actions and reported that the prices could not be determined fair and reasonable in seven other instances. The Director of Logistics Operations also commented that DLA contracting officers were unable to obtain the cost data later provided by Hamilton Sundstrand to the IG DoD.

Audit Response. Based on comments received from DLA and discussions with the Army, the IG DoD revised the finding paragraph to acknowledge that the cost data Hamilton Sundstrand provided to the IG DoD was not made available to the contracting officers. We agree that without the cost data IG DoD obtained, contracting officers would not have been able to determine that prices were too high for the contracting actions.

Methodology for Calculating Fair and Reasonable Prices. The Director of Logistics Operations commented that neither the IG DoD methodology for calculating prices deemed fair and reasonable for the Government to pay for Hamilton Sundstrand parts was explained nor were the actual calculations of the IG DoD provided in the draft.

Audit Response. The IG DoD briefed and provided data to representatives from the DSCR cost and pricing group on the IG DoD calculations of fair and reasonable prices. The data were also provided to DLA headquarters representatives. In addition, the IG DoD audit team has extensive experience pricing spare parts procured from various contractors including Hamilton Sundstrand and the calculations were also briefed to Hamilton Sundstrand representatives (see Appendix B, Prior Coverage, IG DoD). Our calculations and methodology are always available to DLA personnel.

Recognizing a Reasonable Profit Margin for AAR Defense Systems. The Director of Logistics Operations commented that it is reasonable to allow contractor markups and profit commensurate with the value of services provided. The Director also commented that DLA contracting officers had no alternative but to buy Hamilton Sundstrand sole-source parts from AAR Defense Systems and to recognize AAR Defense Systems costs and a reasonable profit margin, regardless of the existence and extent of any value-added services AAR Defense Systems would provide.

Audit Response. Statements appear to be contradictory. However, the actions DLA took to procure items directly from Hamilton Sundstrand should resolve this issue.

Army Comments on the Finding

Failing to Negotiate Fair and Reasonable Prices. The Deputy Assistant Secretary of the Army (Policy and Procurement) commented that the AMCOM practice is to comply with all regulatory and statutory requirements when negotiating fair and reasonable prices.

Audit Response. Based on comments received from the Army, the IG DoD revised the finding paragraph to acknowledge that AMCOM and DLA contracting officers followed established procedures and with available information generally determined prices fair and reasonable for sole-source spare parts procured from AAR Defense Systems--an exclusive distributor for Hamilton Sundstrand.

Commerciality of Hamilton Sundstrand Spare Parts. The Deputy Assistant Secretary of the Army (Policy and Procurement) commented that the FAR does not base the determination of commerciality of parts on comparison of military to commercial sales. In addition, the Army commented that AMCOM has commercial pricing for the four AMCOM NSNs and that two of the NSNs (specifically, NSN 2835-01-106-9153 and NSN 2835-00-176-8867) are not commercial "of a type."

Audit Response. The FAR definition of a commercial item specifically states that a commercial item is customarily used by the public or by non-Governmental entities for purposes other than Governmental purposes. Therefore, military sales do not support commerciality. Further, the IG DoD obtained sales history information from Hamilton Sundstrand. The information referenced 148 sales for part numbers identical or "of a type" for NSN 2835-01-106-9153. Our review of the information identified 100 of the sales were to AAR Defense Systems (Hamilton Sundstrand's distributor for military sales). The other 48 sales were to foreign governments or companies performing work for both commercial and Government entities where the end-user could not be identified. Therefore, we characterized those sales as commercial. The IG DoD used Hamilton Sundstrand's sales history data to characterize parts as commercial "of a type." Contracting officers must verify whether sales histories provided as support of commerciality are in fact sales to the government. If so, the sales clearly do not qualify as commercial sales.

Methodology for Calculating Fair and Reasonable Pricing. The Deputy Assistant Secretary of the Army (Policy and Procurement) commented that although the Army could not determine exactly how the IG DoD calculated the fair and reasonable prices, the Army believes the prices are significantly understated. The Army also commented, "Although we requested the 'cost data' utilized by the DODIG in their evaluation, the DODIG did not provide the cost data for our review." Additionally, the Army commented that it believes that the IG DoD used questionable methods to calculate fair and reasonable prices, such as not considering quantities as a factor.

Audit Response. The IG DoD has extensive experience in calculating fair and reasonable prices using cost data. We have performed similar audits at Boeing, Hamilton Sundstrand, Honeywell, Bell Helicopter, and BF Goodrich (see Appendix B, Prior Coverage, IG DoD). Audit team members have also supported

the DLA/Honeywell SSA and provided guidance and support using cost data to price thousands of individual spare parts. In addition, the calculations were briefed to Army headquarters representatives and also to Hamilton Sundstrand representatives. As previously stated, explanations of the calculations, methodology, and data were and are always available to Army personnel. In regard to the quantities issue, Hamilton Sundstrand uses a standard cost estimating system to price spare parts. Prices in standard cost estimating systems generally do not vary based on different quantities. In addition, Hamilton Sundstrand did not identify any policy relating to different quantities that would affect its standard costs, we used the appropriate standard for each year, and we found only minimal differences in the standards for the same parts from year to year regardless of the quantities ordered.

Obtaining Information Other than Cost or Pricing Data. The Deputy Assistant Secretary of the Army (Policy and Procurement) commented that AMCOM contracting officers requested and received information other than cost or pricing data to support the fair and reasonable price determinations made for three of the four AMCOM NSNs.

Audit Response. The IG DoD recognizes that AMCOM contracting officers did request, receive, and rely on information other than cost or pricing data to support the fair and reasonable price determinations made for three of the four AMCOM NSNs. Unfortunately, this information was inaccurate and misleading. Consequently, we believe AMCOM contracting officers need to test in the future the validity of the data.

Quoted Lead Times as a Measure of Added Value. The Deputy Assistant Secretary of the Army (Policy and Procurement) commented that quoted lead times may not be an accurate judge of determining added value and that AAR was able to expedite orders to add value.

Audit Response. Because AAR Defense Systems was not stocking the Hamilton Sundstrand parts, the Army should have been just as successful as improving delivery times from Hamilton Sundstrand. Therefore, any improvement on the quoted lead-time would not be an added value that the Army could not also have obtained.

Appendix E. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, Army Materiel Command
  Commander, Army Aviation and Missile Command

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

Director, Defense Logistics Agency
  Commander, Defense Supply Center Columbus
  Commander, Defense Supply Center Philadelphia
  Commander, Defense Supply Center Richmond

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

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

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FORT BELVOIR, VIRGINIA 22060-6221

JUN 1 0 2003

IN REPLY REFER TO J-3

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Sole-Source Spare Parts Procured From an Exclusive Distributor, March 20, 2003, Project No. D2002CH-0029.000

The Defense Logistics Agency's comments on the finding and recommendations of the subject draft report are attached.

We appreciate the opportunity to comment on the draft report. The point of contact for this is Mr. Jerry Gilbart, Procurement Integrity and Pricing Branch, 703-767-1350 or Ms. Annell Williams, Internal Review Office, 703-767-6274.

HAWTHORNE L. PROCTOR
Major General, USA
Director
Logistics Operations

Attachment

Federal Recycling Program Printed on Recycled Paper

Final Report Reference

Subject: Draft of a Proposed Report on Sole-Source Spare Parts Procured From an Exclusive Distributor, Project No. D2002CH-0029.000

Finding: AMCOM and DLA contracting officers failed to negotiate fair and reasonable prices for sole-source (commercial or noncommercial) spare parts procured from AAR Defense Systems, an exclusive distributor for Hamilton Sundstrand. Fair and reasonable prices were not negotiated because contracting officers:

Were directed by the OEM, Hamilton Sundstrand (which declined to give a quote) to procure spare parts through its exclusive distributor, AAR Defense Systems, even though the distributor provided limited value to DoD;

- Relied on inaccurate and misleading "information other than cost or pricing data" provided by AAR Defense Systems that originated from Hamilton Sundstrand and failed to perform cost analysis of OEM prices to determine price reasonableness; and

- Failed to sufficiently document and escalate negotiations in cases where the behavior of the OEM was either unreasonable or uncooperative.

Darkened areas of this page represent contractor proprietary data that has been deleted.

AMCOM and DLA had also not established a strategic supplier alliance with either AAR Defense Systems or Hamilton Sundstrand. As a result, AMCOM and DLA paid $16.9 million instead of $[redacted] million, or [redacted] percent ($[redacted] million) more than fair and reasonable prices on 36 orders (30 contracts) for 11 sole-source Hamilton Sundstrand spare parts procured from AAR Defense Systems from March 1999 through August 2002. Based on annual demand and the most recent prices paid, we calculate that DoD will pay about $22.3 million, or [redacted] percent more than fair and reasonable prices for the same items in FYs 2004 through 2009, if the problems are not corrected. The AAR Defense Systems average pass-through costs ([redacted] percent) represent $[redacted] million of the $22.3 million.

DLA Comments: Partially concur.

Revised Pages i, 3, and 7

The Defense Logistics Agency (DLA) partially concurs in the first sentence of the Department of Defense (DoD) Inspector General (IG) audit finding, i.e., that DLA contracting officers failed to negotiate fair and reasonable prices for the procurements in question. Based on the limited data that was available to DLA contracting officers for the 27 DLA contracting actions covered by the audit, the contracting officers determined that the prices were not fair and reasonable for two contracting actions; and in seven additional instances, contracting officers reported that the prices could not be determined to be fair and reasonable. DLA contracting officers were unable to obtain the cost data later provided by Hamilton Sundstrand (HS) to the IG, which the IG used to calculate differences averaging [redacted] percent above prices they deem "fair and reasonable" for the 27 DLA contracting actions they reviewed.

Final Report Reference

Darkened areas of this page represent contractor proprietary data that has been deleted.

The concept of fair and reasonable pricing for commercial items is often not discernable via any objective standards; rather, varying interpretations of the facts of each individual procurement situation often result in honest differences of view as to whether a price was fair and reasonable in the circumstances. The draft report acknowledges that Government contracting officers were obliged to buy the parts from AAR because HS would not submit quotes to enable the Government to directly purchase these sole source parts. The finding states "AAR Defense Systems' average pass-through costs ([redacted] percent) represent $[redacted] million of the $22.3 million" the IG deemed "in excess." In our view, it is reasonable to allow contractors markups and profit commensurate with the value of services provided.

Apart from this issue, neither the IG's methodology for calculating prices it deemed "fair and reasonable" for the Government to pay (HS) for these parts was explained, nor their actual calculations provided in the draft. Based on our understanding of the audit approach, we agree it should produce reasonable results, although we note that 77.1 percent of the dollar value of DLA buys the IG deemed excessive were awarded after 1999. And, as explained on page 18 of the draft, "We [the IG] did not validate the data..." The draft reported that "...DCAA performed audits on Sundstrand Aerospace Corporation's cost estimating system in 1997 and 1999 and stated the internal controls and procedures of the cost estimating system were adequate." The draft goes on to state that "Sundstrand Aerospace Corporation has undergone changes in their corporate structure since DCAA performed these audits...." and a subsequent review by DCAA has not been completed. Therefore, it is appropriate to qualify our concurrence with the audit conclusion.

DLA also partially concurs in the second sentence of the audit finding, i.e., that fair and reasonable prices were not achieved. We concur concerning the two buys DLA contracting officers deemed to have been awarded at prices they viewed as "unfair and unreasonable." Regarding the balance, as stated above, there are not objective standards for determining fair and reasonable prices for commercial items when contracting officers have been unable to obtain cost data to validate price increases.

DLA's position regarding each of the three reasons stated for this audit conclusion follows:

(1) The first IG-reported reason is that DLA "...contracting officers...Were directed by the OEM, Hamilton Sundstrand (which declined to give a quote) to procure spare parts through its exclusive distributor, AAR Defense Systems, even though the distributor provided limited value to DoD." This left DLA contracting officers with no alternative but to buy its sole source parts from AAR, and to recognize AAR's costs and a reasonable profit margin, regardless of the existence and extent of any value-added services AAR would provide.

(2) The second IG-reported reason is that DLA "...contracting officers...Relied on

inaccurate and misleading 'information other than cost or pricing data' provided by AAR Defense Systems that originated from Hamilton Sundstrand and failed to perform cost analysis of OEM prices to determine price reasonableness." All but five of the DLA awards were below the Truth in Negotiations Act (TINA) threshold, and four of those five were coded commercial. Since TINA restricts the Government in these circumstances, contracting officers were limited in the depth and nature of data obtainable, to seeking "information other than cost or pricing data."

DLA contracting officers have historically had difficulty obtaining "information other than cost or pricing data" in the form of uncertified cost data to support fair and reasonable prices as obtained by the IG. Further, without such HS cost data, DLA contracting officers were often unable to verify statements made by HS to support price increases. In addition, since contracts were with AAR, not HS, and commercial pricing restrictions and practices applied, breakdowns of costs from HS's estimating system were even more difficult to obtain and requests usually were denied. Accordingly, the DLA awards were, by necessity, primarily based on price analysis, considering the relevance of information our contracting officers were able to obtain from AAR. In only one of the 27 DLA contracting actions reviewed by the IG was it noted (page 13 of the draft) that some irrelevant information on HS forward pricing rates was found in the contract file and relied on in determining price reasonableness. We view this as an exceptional incident not indicative of a deficiency. Nonetheless, we will note the incident in a request to our Hardware Centers to remind contracting personnel of the need for assuring relevance of data in similar circumstances.

(3) The third IG-reported cause is that our "...contracting officers...Failed to sufficiently document and escalate negotiations in cases where the behavior of the OEM was either unreasonable or uncooperative." Unfortunately, the OEM was not a party to negotiations. DLA contracting officers made every effort to procure directly from OEMs when practical, as this enables DLA to provide the best value for customers.

DLA concurs in the statement-of-fact in the first sentence of the final paragraph of the finding, i.e., "AMCOM and DLA had also not established a strategic supplier alliance with either AAR Defense Systems or Hamilton Sundstrand,." We agree that such alliances can be beneficial and we continue to pursue one with HS. Background information on strategic alliances is provided at pages 15-16 of the draft, and the status of our efforts with HS is included in our comments to Recommendation No. 4 below. However, since the absence of such an alliance with HS is not listed in the draft as a fourth cause of the purported "overpricing," this sentence should be moved elsewhere in the IG finding or deleted. Its present placement is confusing since the following sentence, beginning with "As a result..." implies the absence of an alliance is a fourth cause of higher prices.

DLA concurs that we paid more than fair and reasonable prices on the DLA actions, as listed in Appendix C of the draft. However, DLA contracting officers did not have access to the cost data used by the IG in calculating the amounts they deemed "fair and reasonable."

We agree with the audit conclusion that higher contract costs will continue to result over the next five fiscal years for any future requirements for these items if the problems pointed out in the draft are not corrected. However, for the aforementioned reasons, any increased amount will depend on the ability of DLA contracting officers to obtain access to HS cost data similar to that obtained by the IG.

Recommendation No. 1: Commander, U.S. Army Aviation and Missile Command and the Director, Defense Logistics Agency require that contracting officers initiate action to procure sole-source Hamilton Sundstrand spare parts directly from the original equipment manufacturer or develop a business case that supports the use of an exclusive distributor to provide inventory stockage and material distribution requirements.

DLA Comments: Concur. The Defense Supply Center Richmond (DSCR) Integrated Supplier Team (IST) for HS has had several discussions with HS managers on this recommendation and advise that the company is willing to provide pricing information for approximately 50 - 70 sole-source National Stock Numbers (NSNs) for stock support and agrees to pursue a long-term corporate contract. A solicitation is expected to be issued by mid-June 2003. It will have provisions for adding more sole-source HS spare parts managed by DSCR and our other hardware supply centers (Defense Supply Center Columbus (DSCC) and the Defense Supply Center Philadelphia (DSCP)), and possibly the Services.

Disposition: Action is ongoing. ECD: May 28, 2004.

Recommendation No. 2: Commander, U.S. Army Aviation and Missile Command and the Director, Defense Logistics Agency require that contracting officers obtain information that is adequate to evaluate reasonableness of price in accordance with Federal Acquisition Regulation requirements. This information, "information other than cost or pricing data," includes uncertified cost or pricing data from the original equipment manufacturer that can be used to perform cost analysis to support price reasonableness determinations.

DLA Comments: Partially Concur. Although contracting officers have a responsibility for determining price reasonableness, they individually have little leverage in obtaining uncertified cost data from other than the suppliers with whom they contract. The course of action addressed in our response to Recommendation No. 4 should enhance our ability to obtain such information.

Disposition: Action is considered complete.

Recommendation No. 3: Commander, U.S. Army Aviation and Missile Command and the Director, Defense Logistics Agency require that contracting officers document and escalate negotiations when an original equipment manufacturer's behavior is either unreasonable or uncooperative. This unreasonable and uncooperative behavior includes

refusing to quote an item and requiring DoD contracting officers to procure the item from an exclusive distributor that provides limited value to DoD or refusing to provide "information other than cost or pricing data" (to include uncertified cost or pricing data) as required by the Federal Acquisition Regulation.

DLA Comments: Partially Concur. Generally speaking, an OEM's decision as to whether to sell products directly or through any alternative means is not subject to any statutory or regulatory peacetime constraints. We agree, however, such decisions can have a deleterious effect on efforts to optimize support of our military's needs. DLA concurs that when major adverse situations of this nature occur, the matter should be escalated within Government and OEM management channels for resolution or remediation. DLA has taken the initial steps in an effort to secure a satisfactory resolution. Action is ongoing under Recommendation No. 4 below, as explained in our response thereto.

Disposition: Action is considered complete.

Recommendation No. 4: Commander, U.S. Army Aviation and Missile Command and the Director, Defense Logistics Agency require that contracting officers in conjunction with the Air Force, initiate action to implement a new Strategic Supplier Alliance with either AAR Defense Systems or Hamilton Sundstrand.

DLA Comments: Concur. DLA is in the very early stages of formulating a Strategic Supplier Alliance (SSA) directly with HS by identifying and obtaining confirmation from additional potential stakeholders, i.e., the Army (AMCOM), and the Air Force (Headquarters, Air Force Materiel Command or Oklahoma City Air Logistics Center). If the Services are not in a position to participate at this time, DLA will continue to work directly with HS and then with the Services at a later date. DLA does not concur in initiating action to implement a new SSA with AAR at this time. DLA's current SSA efforts and resources are aimed at engaging OEMs of sole-source spare parts.

DLA was the first federal agency to put a SSA in place---with Honeywell Inc. (then AlliedSignal)---winning the David Packard Excellence in Acquisition Award for that effort. Now, DLA is looking at having as many as 16 of these partnerships in place by the end of FY 2003. DLA continues to pursue efforts that further enhance our ability to partner with industry. We are holding Senior Executive Partnership Round Tables to work top level issues and stress the need and benefit of additional alliances with our industry partners. The first of these round tables was held at the DSCR in December 2002. This particular event included executives from more than a dozen companies, including HS, representatives from the three DLA hardware supply centers and representatives from the Naval Inventory Control Point. Round Table attendees were briefed on the logistics transformation throughout the DoD and efforts to establish formal partnerships among DoD, other Federal customers, and industry. The first Round Table was a resounding success for DLA and the attendees, and it set the stage for similar combined events to be held in the future. The second Senior Executive Round Table was

hosted by Lockheed Martin at their Greenville, South Carolina facility, May 12-13, 2003, and Hamilton Sundstrand was represented.

Disposition: Action is ongoing. ECD: May 28, 2004.

Department of the Army Comments

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

12 AUG 2003

REPLY TO
ATTENTION OF

SAAL-PS

MEMORANDUM FOR U.S. ARMY AUDIT AGENCY, AUDIT COORDINATION & FOLLOWUP OFFICE (MR. BRIAN C.SMITH), PENTAGON, ROOM 2B139, WASHINGTON, DC 20310

SUBJECT: DODIG Draft Report Project No. D2002CH-0029.000, Sole-Source Spare Parts Procured from an Exclusive Distributor

I have reviewed the enclosed comments prepared by the Army Material Command (AMC) and the U.S. Army Aviation and Missile Command (AMCOM) and concur with their findings. I also agree with the AMC caveat that although the command response states that AMCOM non-concurs with the auditors' recommendations, the actions delineated in the reply meets the intent of the recommended action.

Point of contact for this response is Mr. Kenneth Tedeschi, commercial (703) 604-7003, DSN: 664-7003, or e-mail address kenneth.tedeschi@saalt.army.mil.

Esther Morse
for E. Ballard
Deputy Assistant Secretary of the Army
(Policy and Procurement)

Enclosure

Printed on Recycled Paper

DEPARTMENT OF THE ARMY
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND
5001 EISENHOWER AVENUE, ALEXANDRIA VA 22333-0001

AMCIR-A (36-5c) 06 JUN 2003

MEMORANDUM FOR MS BETH CASARIO, CHIEF, THE ARMY AUDIT LIAISON OFFICE, U.S. ARMY AUDIT AGENCY, 3101 PARK CENTER DRIVE, ALEXANDRIA, VA 22302-1596

SUBJECT: DODIG Draft Report Project No. D2002CH-0029.000, Sole-Source Spare Parts Procured from an Exclusive Distributor (AMC No. D0210)

1. We are enclosing the US Army Materiel Command position on subject report IAW AR 36-2.

2. Our headquarters concurs with the comments prepared by the U.S. Army Aviation and Missile Command (AMCOM). Although the command response states that AMCOM nonconcurs with the auditors' recommendations, the actions delineated in the reply meets the intent of the recommended action.

3. Point of contact for this audit is Mr. David Robinson, commercial (703) 617-9024, DSN: 767-9024, or e-mail address david.m.robinson@us.army.mil.

FOR THE COMMANDER:

Encl
as

ARCHIE B. FORD
Chief, Internal Review and
Audit Compliance Office

DEPARTMENT OF THE ARMY
UNITED STATES ARMY AVIATION AND MISSILE COMMAND
REDSTONE ARSENAL, ALABAMA 35898-5000

REPLY TO
ATTENTION OF

AMSAM-IR (36-2b) 9 May 03

MEMORANDUM FOR Internal Review and Audit Compliance Office (AMCIR-A), U.S. Army Materiel Command, 5001 Eisenhower Avenue, Alexandria, VA 22333-0001

SUBJECT: DODIG Draft Report Project No. D2002CH-0029.000, Sole-Source Spare Parts Procured From an Exclusive Distributor (AMC No. D0210)

1. Reference memorandum, HQ AMC, AMCIR-A, 9 Apr 03, subject as above.

2. The U.S. Army Aviation and Missile Command (AMCOM) comments to the subject draft report are enclosed.

3. The point of contact is Mr. Keith Jones, AMSAM-IR, commercial (256) 313-1785 or DSN 897-1785 or email at keith.jones@redstone.army.mil.

Encl

Keith Jones
for ELLIS L. COX
Chief, Internal Review and
Audit Compliance Office

AN EQUAL OPPORTUNITY EMPLOYER

DEPARTMENT OF THE ARMY
UNITED STATES ARMY AVIATION AND MISSILE COMMAND
REDSTONE ARSENAL, ALABAMA 35898-5000

REPLY TO
ATTENTION OF

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Encl

JAMES L. FLINN III
Deputy to the Commanding General

AN EQUAL OPPORTUNITY EMPLOYER

Final Report Reference

U.S. ARMY AVIATION AND MISSILE COMMAND COMMENTS
DODIG Draft Report
Sole-Source Spare Parts Procured From an Exclusive Distributor
(DODIG Project No. D2002CH-0029.000)
(AMC No. D0210)
(AMCOM Project No. 03-0202-067)

FINDING: Spare Parts Prices

SUMMARY: AMCOM and DLA contracting officers failed to negotiate fair and reasonable prices for sole-source (commercial or noncommercial) spare parts procured from AAR Defense Systems, an exclusive distributor for Hamilton Sundstrand. Fair and reasonable prices were not negotiated because contracting officers:

- were directed by the OEM, Hamilton Sundstrand (which declined to give a quote) to procure spare parts through its exclusive distributor, AAR Defense Systems, even though the distributor provided limited value to DOD;
- relied on inaccurate and misleading "information other than cost or pricing data" provided by AAR Defense Systems that originated from Hamilton Sundstrand and failed to perform cost analysis of OEM prices to determine price reasonableness; and
- failed to sufficiently document and escalate negotiations in cases where the behavior of the OEM was either unreasonable or uncooperative.

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AMCOM and DLA had also not established a strategic supplier alliance with either AAR Defense Systems or Hamilton Sundstrand. As a result, AMCOM and DLA paid $16.9 million instead of $[redacted] million, or [redacted] percent ($[redacted] million) more than fair and reasonable prices on 36 orders (30 contracts) for 11 sole-source Hamilton Sundstrand spare parts procured from AAR Defense Systems from March 1999 through August 2002. Based on annual demand and the most recent prices paid, we calculate that DOD will pay about $22.3 million, or 87.9 percent more than fair and reasonable prices for the same items in FYs 2004 through 2009, if the problems are not corrected. The AAR Defense Systems average pass-through costs ([redacted] percent) represent $[redacted] million of the $22.3 million.

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GENERAL COMMENTS:

Overall, we nonconcur with the DODIG draft report, specifically that Aviation and Missile Command (AMCOM) contracting officers failed to negotiate fair and reasonable prices. It is AMCOM practice to comply with all regulatory and statutory requirements in negotiating fair and reasonable prices. The actions in question were accomplished within these guidelines. While disagreements may occur over pricing of individual national stock numbers (NSN), contracting officers followed regulations and statutes in making a "fair and reasonable" price determination. Acquisition reform initiatives have discouraged contracting professionals from obtaining cost and pricing data unless this practice can be justified in accordance with the Federal Acquisition Regulation (FAR). Thus, this initiative has served to empower some contractors in refusing to provide cost or data for contracts when requested by contracting officers. However, contracting officers requested and received "information other than cost and pricing data" from the prime contractor, with little or no problem, when determining price reasonableness as required by FAR part 15.

Revised Pages i, 3, and 7

The following comments are applicable to the four AMCOM NSNs referenced in the DODIG draft report.

Commerciality

We disagree with the DODIG draft report statement that " ... commerciality of the parts is questionable based on guidance because the commercial market is clearly insufficient to support any price reasonableness determination". Clearly, looking at "Figure 1. Comparison of Military to Commercial Sales" in the DODIG draft report, sales for 2 (Item 1 - NSN 2835-01-106-9153 and Item 4 - NSN 2835-00-176-8867) of the 4 AMCOM NSNs are comparable.

However, the FAR doesn't base the determination of commerciality of parts on comparison of military to commercial sales. Specifically, FAR 2.101(1) states that a commercial item is "Any item, other than real property, that is of a type customarily used by the public or by non-governmental entities for purposes other than government purposes, and (1) has been sold, leased, or licensed to the general public; or (ii) has been offered for sale, lease, or license to the general public; ...". For the four AMCOM NSNs:

- NSN 2835-01-106-9153. AMCOM has commercial pricing for this item, which is not an "of a type" commercial item as referenced in the DODIG draft report. This item has evolved to a new NSN (2835-01-208-7789), stock number (4503191), and part number (10334-100) for current buys. Also, AMCOM has Hamilton Sundstrand's commercial sales history which reflects approximately 101 commercial sales of this item which we

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believe is sufficient commercial history for use as one data point for determining price reasonableness.

- NSN 2835-01-108-9156. AMCOM has commercial pricing history for this item, which we believe is adequate to support this item as being sold in the commercial market place.

- NSN 2835-01-419-2118. AMCOM has commercial pricing history for this item, which we believe is adequate to support this item as being sold in the commercial market place.

- NSN 2835-00-176-8867. AMCOM has commercial pricing history, which is not an "of a type" commercial item as referenced in the DODIG draft report.

In general, Hamilton Sundstrand considers itself as primarily a commercial supplier, with more commercial airline industry customers than military customers. Hamilton Sundstrand establishes its commercial prices for a 2 to 3 year period and publishes them in its Commercial Catalog. Included in its 2002 Commercial Catalog, are all four AMCOM NSNs referenced in the DODIG draft report, which are offered for sale to the general public [FAR 2.101(1)(ii)].

Furthermore, FAR 15.403-3(c) states that, "At a minimum, the contracting officer must use price analysis to determine whether the price is fair and reasonable whenever the contracting officer acquires a commercial item. The fact that a price is included in a catalog does not, in and of itself, make it fair and reasonable." As a result, contracting officers, in addition to using price analysis, requested and received "information other than cost or pricing data". We discuss this in more detail below.

DODIG Estimates of Fair and Reasonable Prices

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We could not determine exactly how DODIG calculated its prices, but believe that they are significantly understated. For example, the DODIG estimated 2002 price for NSN 2835-01-106-9153 was $[redacted], which was lower than the Army historical price paid in 1992 ($613.81). Overall, we believe that DODIG used questionable methods to estimate its fair and reasonable prices, such as not considering quantities as a factor in estimating its prices.

As stated in the DODIG draft report, "Hamilton Sundstrand did not make the cost data available to either AAR Defense Systems or the DOD contracting officers". Although we requested the "cost data" utilized by the DODIG in their evaluation, the DODIG did not provide the cost data for our review. To agree with the DODIG estimates for its prices, which we believe are estimated, hypothetical and for which we have no support, would be to countermand

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contracting officer responsibilities for ensuring price reasonableness, especially since we have support for the awarded contract prices.

The statement that DODIG " ... obtained 2000, 2001 and 2002 cost standards (total manufacturing costs) from Hamilton Sundstrand for the 11 spare parts reviewed and calculated fair and reasonable prices from the OEM by adding approved military general and administrative rates along with a profit margin (cost build-up price)" does not give any quantitative data that we could validate or refute.

However, AMCOM does have support for how contracting officers determined that prices were fair and reasonable. Specifically, some of the actions that contracting officers used to determine fair and reasonable prices included:

- NSN 2835-01-106-9153.
  - Contract DAAH23-00-C-0390, awarded 22 Sep 00 for $249,176. In addition to a price analysis, determination that the item was a commercial item and negotiation of prices, contracting officers received "information other than cost and pricing data" from AAR Defense Systems. This information included the Forward Pricing Rate Agreement (FPRA) for Hamilton Sundstrand, dated 24 Mar 00, and showed [redacted]
  - Contract DAAH23-00-P-0066, awarded 19 Nov 99 for $71,160. This procurement was designated an urgent requirement by the requiring element because of zero-balance high-priority back orders which would have a negative impact (estimated at about $5.9 million) on the repair program for UH-60 Auxiliary Power Units (APU) if parts were not supplied to complete the APU repairs. Contracting officers received "information other than cost and pricing data", which showed a change in the business unit method reflected in a revised Material Acquisition rate to include factory direct labor and overhead costs as a more appropriate method of allocating manufacturing costs. The production manufacturing direct labor and overhead rates were eliminated as a result of this simplification initiative. Therefore, there are no separately identified direct labor or manufacturing overhead costs applied to procurement hardware. The material Acquisition Rate, as well as the cost of the rates utilized in the proposal had been negotiated

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and agreed to between the Rockford DCMO and Defense Contract Audit Agency (DCAA) offices of the U.S. Government and Hamilton Sundstrand for use in developing and negotiating proposals.

- NSN 2835-01-106-9156.
  - Contract DAAH23-00-P-1175, awarded 21 Sep 00. An AMCOM engineering review determined that the item was commercial. For purposes of price reasonableness determination, the contracting officers received and utilized "information other than cost and pricing data". In addition to receiving the current FPRA in effect at the time for Hamilton Sundstrand, contracting officers requested and received DCMA assistance in the pricing review. Contracting officers also used historical pricing, dating back to 1982 with Hamilton Sundstrand, as additional support for price reasonableness.
  - Contract DAAH23-02-C-0080, awarded Jan 02. For this negotiated commercial award, contracting officers used various price analysis methods. For example, contracting officers compared historical commercial sales prices, applied a learning curve analysis, and verified the AAR Defense Systems rates with DCMA.

Revised Pages i, 2, 3, 16, 20, 24, and 26

- NSN 2835-02-429-2118. Contract DAAH23-02-C-0085, awarded 13 Dec 01. In addition to performing a price analysis (e.g. reviewed historical pricing and legacy sales history), contracting officers received "information other than cost and pricing data". DODIG failed to identify that the unit price includes the container cost of $271.70; therefore, actual unit price awarded for base year is $8,666.22 for comparison purposes.
- NSN 2835-00-176-8867. Contract DAAH23-00-C-0364, awarded 15 Sep 00. Contracting officers did a price analysis, comparison of commercial pricing history, and negotiated price. This item was critical and failure to acquire part was estimated to have potentially cost the Government about $2,131.80 a day.

Lead-Times

We question the conclusion that comparing quoted lead-times is an accurate judge of added value. DODIG failed to include the actual delivery time in its determination of added value. Specifically, the following are examples of deliverables actually achieved and reflect an effort by AAR Defense Systems to expedite and/or stock parts in order to add value:

- NSN 2835-01-106-9153. The quoted lead-time was 6 months, but actual first delivery was 3.9 months (118 days) with total quantity shipped complete within 172 days.

- NSN 2835-01-106-9156. For contract DAAH23-00-P-1175, the quoted lead-time was 9 months, but actual first delivery was within 3.4 months (101 days) and total shipped complete within 5.8 months. For contract DAAH23-02-C-0080, an initial quantity shipped in less than 30 days from award.

- NSN 2835-01-419-2118. For contract DAAH23-02-C-0085, the quoted lead-time was 9 months, but an initial quantity shipped within 49 days.

RECOMMENDATIONS AND COMMAND COMMENTS:

Recommendation 1: DODIG recommended that the Commander, U.S. Army Aviation and Missile Command require that contracting officers initiate action to procure sole-source Hamilton Sundstrand spare parts directly from the original equipment manufacturer or develop a business case that supports the use of an exclusive distributor to provide inventory stockage and materiel distribution requirements.

Command Comments and Action Taken: Nonconcur. AMCOM contracting officers initiated action to procure spare parts directly from Hamilton Sundstrand months before receiving the DODIG draft audit report. On 3 Jun 02, AMCOM contracting and Hamilton Sundstrand representatives held a kick-off meeting to initiate the process toward executing a long-term contract with Hamilton Sundstrand in support of AMCOM spare parts requirements. The consensus of the meeting was that this was a good plan for supporting AMCOM spares requirements and that Hamilton Sundstrand was willing to participate in this type of contract action.

On 25 Feb 03, a followup meeting was held at AMCOM with the following results:

- Hamilton Sundstrand agreed to an alpha type contract – a contract in which the government and the contractor work in concert as a team upon identification of the requirements, to price, evaluate, negotiate and award one contract action. The Government evaluates each portion of the contractor's proposal as submitted and does not require a completed proposal for

each element of the request before the pricing/technical evaluation is initiated.

- Contract term would reflect a minimum of 5 years for period of performance.

- All segments of Hamilton Sundstrand will be reflected in one contract, i.e. the San Diego facility (cage 55820) and the Windsor Locks, CT facility (cage 73030), and AAR Defense Systems would be included as a subcontractor when their services are required.

- A set of "guiding business principles" was agreed to by Kenneth D. Martin, Director, Contracts and Counsel, Hamilton Sundstrand and Ms. L. Marlene Cruze, Executive Director, Acquisition Center, U.S. Army Aviation and Missile Command on 4 Mar 03. These principles will govern the methodology employed for both parties in the execution of this long-term contract.

- A listing of potential items for this contract effort was provided to Hamilton Sundstrand who is currently reviewing it, while the AMCOM requiring element, Integrated Material Management Center (IMMC) is also reviewing it to determine the quantities and types of items which should be included in this contract effort.

- The draft Integrated Product Team Charter is currently at Hamilton Sundstrand for review.

The goal for award of this requirement is currently Mar 04.

Recommendation 2: DODIG recommended that the Commander, U.S. Army Aviation and Missile Command require that contracting officers obtain information that is adequate to evaluate reasonableness of price in accordance with Federal Acquisition Regulation requirements. This information, "information other than cost or pricing data", includes uncertified cost or pricing data from the original equipment manufacturer that can be used to perform cost analysis to support price reasonableness determinations.

Command Comments and Action Taken: Nonconcur. It is AMCOM policy and practice to negotiate fair and reasonable prices in accordance with FAR requirements and other applicable regulatory guidance, such as the Office of the Secretary of Defense Acquisition, Technology, and

Logistics (Acquisition Initiatives) Commercial Item Handbook (Version 1.0), dated Nov 01.

While the DODIG may disagree with fair and reasonable prices and commerciality of the four AMCOM National Stock Numbers that DODIG reviewed, contracting officers followed regulations and statutes in making a "fair and reasonable" price determination. The FAR is very specific in the guidance relative to the issue of obtaining more information than is necessary to determine price reasonableness. Specifically, FAR 15.403-3(a)(1) states that, "The contracting officer is responsible for obtaining information that is adequate for evaluating the reasonableness of the price or determining cost realism, but the contracting officer should not obtain more information than is necessary."

In addition, FAR 15.403-3(c)(2)(ii) states that, "The contracting officer must, to the maximum extent practicable, limit the scope of the request for information relating to commercial items to include only information that is in the form regularly maintained by the offeror as part of its commercial operations."

Additionally, some form of cost analysis was performed to support price reasonableness determinations when "information other than cost and pricing data" was utilized in most instances of AMCOM requirements. Please note the specific language regarding cost analysis in FAR 15.404-1(c)(1) which states "... the application of judgment to determine how well the proposed costs represent what the cost of the contract should be ... ". It is the assertion of this Command that contracting officer judgment was applied to these actions in regard to all prices reflected in contract awards.

Also, FAR 15.404-1(a)(1) states, "the complexity and circumstances of each acquisition should determine the level of detail of the analysis required". As a large portion of the AMCOM actions were awarded as commercial contracts, these actions were considered to be adequately evaluated based upon complexity and circumstances.

Recommendation 3: DODIG recommended that the Commander, U.S. Army Aviation and Missile Command require that contracting officers document and escalate negotiations when an original equipment manufacturer's behavior is either unreasonable or uncooperative. This unreasonable and uncooperative behavior includes refusing to quote an item and requiring DOD contracting officers to procure the item from an exclusive distributor that provides limited value to DOD or refusing to provide "information other than cost or pricing data" (to include uncertified cost or pricing data) as required by the Federal Acquisition Regulation.

Command Comments and Action Taken: Nonconcur. The DODIG draft report implies that contracting officers had difficulty achieving price reasonableness compared to the DODIG estimated prices based on data acquired after the award. For all AMCOM contracts for the four AMCOM National Stock Numbers that DODIG reviewed, the contract file contained contracting officers' determinations that prices were fair and reasonable and adequate documentation to support these determinations. In addition to using various price analysis methodologies, contracting officers' also based their determinations on "information other than cost and pricing data".

Further, Appendix O of the Office of the Secretary of Defense Acquisition, Technology, and Logistics (Acquisition Initiatives) Commercial Item Handbook (Version 1.0), dated Nov 01, lists the action of elevating negotiations as only one technique that contracting officers should consider. Other techniques include buying minimum quantities, which AMCOM did. Lastly, Appendix O specifically states that, "Requiring activities should adapt to and leverage the commercial marketplace, rather than expecting the commercial marketplace to adapt to the DOD environment. Suppliers striving to preserve their commercial practices should not be considered unreasonable solely on that basis."

Recommendation 4: DODIG recommended that the Commander, U.S. Army Aviation and Missile Command require that contracting officers in conjunction with the Air Force, initiate action to implement a new Strategic Supplier Alliance with either AAR Defense Systems or Hamilton Sundstrand.

Command Comments and Action Taken: Nonconcur. See comments for recommendation 1.

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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