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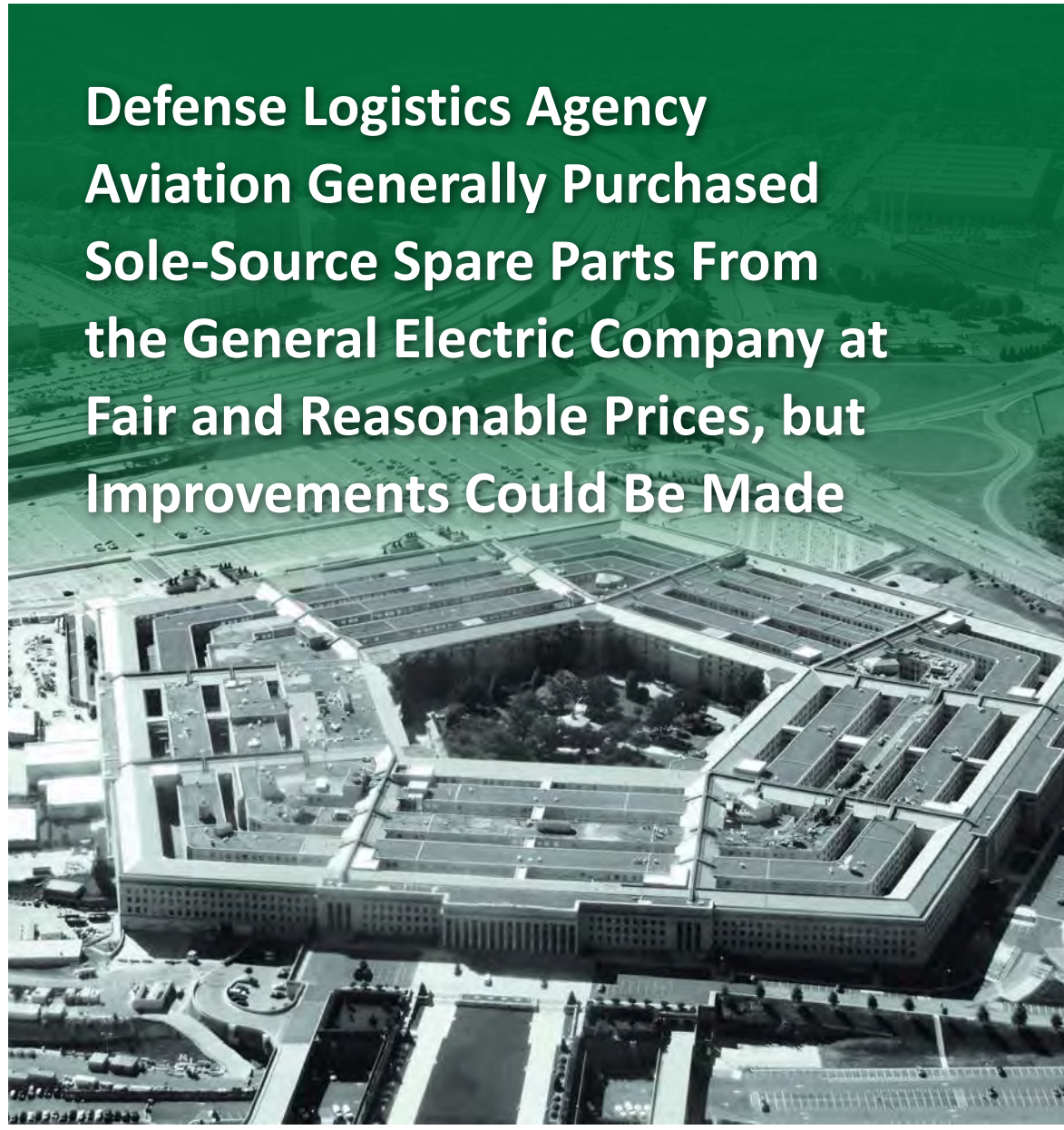
INSPECTOR GENERAL

U.S. Department of Defense

JULY 24, 2015



Defense Logistics Agency Aviation Generally Purchased Sole-Source Spare Parts From the General Electric Company at Fair and Reasonable Prices, but Improvements Could Be Made



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Results in Brief

*Defense Logistics Agency Aviation Generally Purchased
Sole-Source Spare Parts From the General Electric Company at
Fair and Reasonable Prices, but Improvements Could Be Made*

July 24, 2015

Objective

Our audit objective was to determine whether the Defense Logistics Agency (DLA) Aviation was purchasing sole-source spare parts at fair and reasonable prices from the General Electric Company (GE).

Finding

The DLA Aviation contracting officer generally purchased sole-source spare parts from GE at fair and reasonable prices for the nonstatistical sample of sole-source spare parts reviewed, valued at \$23 million of the \$104 million sole-source spare parts purchased. However, the contracting officer did not adequately support the commercial item determinations for sole-source spare parts procured from GE. This occurred because the contracting officer did not:

- validate the prior commercial item determinations; and
- maintain the documentation for the prior determinations.

As a result, the contracting officer may not obtain the appropriate cost or pricing data required to develop an effective bargaining position during future negotiations.

Recommendations

The Director, DLA, should require DLA Aviation contracting officers to perform market research to validate that prior commercial item determinations are appropriate before they award future contracts. The Director should also require contracting officers to retain documentation of the market research and rationale in the contract file that support commercial item determinations.

Management Comments and Our Response

Comments from the Director, DLA Acquisition, responding for the Director, DLA, addressed all specifics of the recommendations, and no further comments are required. Please see the Recommendations Table on the next page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Logistics Agency		1.a and 1.b



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500**

July 24, 2015

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Defense Logistics Agency Aviation Generally Purchased Sole-Source Spare Parts From the General Electric Company at Fair and Reasonable Prices, but Improvements Could Be Made (Report No. DODIG-2015-153)

We are providing this report for your information and use. The Defense Logistics Agency Aviation generally purchased sole-source spare parts from the General Electric Company at fair and reasonable prices for the sole-source spare parts reviewed, valued at \$23 million. However, improvements are needed for the commercial item determinations to maintain fair and reasonable prices in the future. We conducted this audit in accordance with generally accepted government auditing standards.

We considered management comments on a draft of this report when preparing the final report. Comments from the Director, Defense Logistics Agency Acquisition, responding for the Director, Defense Logistics Agency, addressed all specifics of the recommendations and conformed to the requirements of DoD Instruction 7650.03; therefore, we do not require additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-9077 (DSN 664-9077).

Jacqueline L. Wicecarver
Jacqueline L. Wicecarver
Assistant Inspector General
Acquisition, Parts, and Inventory

Contents

Introduction

Objective	1
Background	1
Review of Internal Controls	3

Finding. Commercial Item Determinations on GE Procurements Not Supported

Fair and Reasonable Prices Generally Received	4
Potential Pricing Risks	8
No Support for the Commercial Item Determinations	9
Conclusion	11
Recommendations, Management Comments, and Our Response	12

Appendixes

Appendix A. Scope and Methodology	13
Review of Price Reasonableness Determinations	14
Cost Analysis	14
Review of Commercial Item Determinations	15
Use of Computer-Processed Data	15
Use of Technical Assistance	15
Appendix B. Prior Coverage	16
Appendix C. Sampling Methodology	18

Management Comments

Defense Logistics Agency	20
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Acronyms and Abbreviations

Introduction

Objective

Our audit objective was to determine whether the Defense Logistics Agency (DLA) Aviation was purchasing sole-source spare parts at fair and reasonable prices from the General Electric Company (GE). See Appendix A for a discussion of the scope and methodology and Appendix B for prior audit coverage related to the objective.

Background

DLA is headquartered in Fort Belvoir, Virginia. According to DLA, it is DoD's largest logistics combat-support agency and supplies over 85 percent of the Military Services' spare parts. DLA Aviation, headquartered in Richmond, Virginia, is the materiel manager for over 1.1 million repair parts. It manages spare parts for engines on fighters, bombers, and helicopters; all airframe and landing-gear parts; flight safety equipment; and propeller systems.

General Electric Company

According to GE, it provides consumers with products such as appliances, consumer electronics, lighting, software, and aviation systems. GE Aviation, located in Evendale, Ohio, is a world leading provider of jet and turboprop engines, components, and integrated systems for commercial, military, business, and general aviation aircraft. GE Aviation also supports over 1,800 commercial and military aircraft.

Defense Contract Management Agency

The Defense Contract Management Agency (DCMA) works directly with Defense suppliers to help ensure that DoD supplies and services are delivered on time, at projected cost, and meet all performance requirements. Before contract award, DCMA provides advice and information to help construct effective solicitations, identify potential risks, select the most capable contractors, and write contracts that meet the needs of DoD customers. After contract award, DCMA monitors the contractors' performance and management systems to ensure that cost, product performance, and delivery schedules comply with the contract terms and conditions. DCMA professionals serve as in-plant representatives for military buying agencies throughout the contract.

Defense Procurement and Acquisition Policy Office

The Defense Procurement and Acquisition Policy Office (DPAP) is part of the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics). DPAP is responsible for all contracting and procurement policies in DoD. According to DPAP, it enables components to effectively deliver equipment and services that meet the needs of the warfighter by providing policy, guidance, and oversight.

In September 2008, the Office of the Under Secretary of Defense (Acquisition, Technology, and Logistics) issued a memorandum that required DPAP to perform preaward peer reviews on all contracts with an estimated dollar value of \$1 billion or more. The objectives of the peer reviews were to ensure that contracting officers across DoD consistently and appropriately implemented policy and regulations; continuously improved the quality of contracting processes; and facilitated sharing best practices and lessons learned. From April through August 2011, DPAP officials performed a peer review during the preaward phase to assist the DLA Aviation contracting officer with price negotiations with GE.

General Electric Company Contract

On August 31, 2012, DLA Aviation awarded a fixed-price contract¹ to GE for sole-source spare parts associated with GE aircraft engines. The base period was for 5 years with one option period of 4 years and a maximum estimated dollar value of \$7 billion. The contract includes a clause that allows the contracting officer to re-evaluate GE's prices every 3 years. The DLA Aviation contracting officer is scheduled to re-evaluate prices in August 2015.

Audit Sample of General Electric Sole-Source Spare Parts

As of November 12, 2014, DLA Aviation contracting officers purchased 342 sole-source spare parts on the contract valued at \$104 million. We selected a statistical sample of 58 sole-source spare parts, valued at \$78 million, and reviewed the documentation DLA Aviation used to justify the price reasonableness determinations. We nonstatistically sampled 8 of the 58 sole-source spare parts that consisted of 27 subcomponents, valued at \$23 million, to perform cost analysis and review the commercial item² determinations. See Appendix C for a detailed discussion of the statistical sampling methodology.

¹ Contract SPM4AX-12-D-9422.

² Federal Acquisition Regulation (FAR) Subpart 2.101, "Definitions," January 29, 2013, defines a commercial item, in part, as any item that is of a type used by the general public or by non-governmental entities for other than governmental purposes and has been sold or offered for sale to the general public.

Review of Internal Controls

DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified an internal control weakness related to the commercial item determinations. We will provide a copy of the report to the senior official responsible for internal controls at DLA Aviation.

Finding

Commercial Item Determinations on GE Procurements Not Supported

The DLA Aviation contracting officer generally purchased sole-source spare parts from GE at fair and reasonable prices for the nonstatistical sample of sole-source spare parts reviewed, valued at \$23 million of the \$104 million sole-source spare parts purchased. However, the contracting officer did not adequately support the commercial item determinations for sole-source spare parts procured from GE.

This occurred because the contracting officer did not:

- validate the prior commercial item determinations; and
- maintain the documentation for the prior determinations.

As a result, the contracting officer may not obtain the appropriate cost or pricing data required to develop an effective bargaining position during future negotiations.

Fair and Reasonable Prices Generally Received

The contracting officer generally purchased sole-source spare parts at fair and reasonable prices from GE for the parts reviewed...

The contracting officer generally purchased sole-source spare parts at fair and reasonable prices from GE for the parts reviewed, valued at \$23 million of the \$104 million sole-source spare parts purchased. The FAR³ states that contracting officers must purchase supplies at fair and reasonable prices. According to DLA Aviation officials, before negotiating the prices with GE representatives, the contracting officer:

- performed price analysis;⁴
- requested a cost analysis; and
- implemented DPAP peer review recommendations.

³ FAR 15.402, "Pricing Policy."

⁴ FAR 15.404, "Proposal Analysis," and related provisions in the Defense Federal Acquisition Regulation Supplement (DFARS) and Procedures, Guidance and Information (PGI), provide guidance on price and cost analysis.

We performed a price reasonableness analysis on a nonstatistical sample of eight sole-source spare parts, valued at \$23 million, and determined that the prices DLA Aviation paid for these parts were generally fair and reasonable.

Price Analysis Performed Prior to Contract Award

According to DLA Aviation officials, the contracting officer performed a price analysis on all sole-source spare parts to determine a fair and reasonable price. The audit team verified that the contracting officer performed the appropriate price analysis for a statistical sample of 58 sole-source spare parts on the contract. DFARS⁵ requires contracting officers to analyze the contractor's line item pricing proposals and identify when the proposed price exceeds 25 percent of the lowest price the Government recently paid. To meet this requirement, the contracting officer obtained several previous contract prices and validated the rationale for the previous fair and reasonable price determinations. In addition, the contracting officer adjusted prices on the previous contracts for quantity and inflation to calculate a comparable price. The contracting officer then calculated the dollar value difference between the comparable price and GE's proposed price. If the dollar value price difference was outside an acceptable percentage range of the comparable price and the estimated annual demand dollars for the part were over a specified dollar threshold, the price would require additional analysis. However, the contracting officer was not required to accept the GE proposed price as fair and reasonable if it was in an acceptable range of the comparable price and could request additional documentation as necessary to support the price reasonableness determinations. See Table 1 for the range of acceptable differences (in percent) between GE's proposed price and the contracting officer's comparison price for determining if additional analysis was required on a part.

(FOUO) Table 1. Acceptable Range of Differences Between GE's Proposed Price and the Contracting Officer's Price

(FOUO) Estimated Annual Demand in Total Dollars Per Part	Acceptable Range of Price Difference (Percent)
Greater than \$ [REDACTED]	Less than or equal to [REDACTED]
\$ [REDACTED] - \$ [REDACTED]	Less than or equal to [REDACTED]
\$ [REDACTED] - \$ [REDACTED]	Less than or equal to [REDACTED]
\$ [REDACTED] - \$ [REDACTED]	Less than or equal to [REDACTED]
\$ [REDACTED] - \$ [REDACTED]	Less than or equal to [REDACTED]

(FOUO)

⁵ DFARS 215.404-1, "Proposal Analysis Techniques," revised May 18, 2011.

Cost Analysis Completed During Price Negotiations

The contracting officer requested a cost analysis on select sole-source commercial spare parts to determine a fair and reasonable price. DFARS PGI⁶ states that a



The contracting officer requested that GE provide other-than-certified cost or pricing data...

part designated as commercial does not prohibit the contracting officer from requiring other-than-certified cost or pricing data. The contracting officer requested that GE provide other-than-certified cost or pricing data (such as supplier quotes, supplier agreements, catalogs, GE estimates, and cost elements), for all 338 sole-source commercial spare parts purchased on the contract as of November 12, 2014. The four remaining sole-source spare parts purchased required certified cost or pricing data because they were noncommercial.

DFARS PGI⁷ also states that a cost analysis is required if the contracting officer cannot obtain sufficient data to perform a price analysis. Therefore, according to the contracting officer, DCMA price analysts were requested to provide additional assistance for the sole-source spare parts with the highest estimated annual demand and for other parts with lower estimated annual demand that fell outside the acceptable ranges in Table 1 above. The analysts stated that they provided the contracting officer pricing recommendations after performing a cost analysis that included comparing material prices on GE's proposals to GE's supplier agreements and validating cost elements, such as labor, general and administrative, and profit. The analysts provided supporting documentation for their reviews on 20 of the 58 sole-source spare parts in our statistical sample.

We performed a detailed cost analysis on eight sole-source spare parts, valued at \$23 million, to determine if DLA Aviation received a fair and reasonable price. We obtained GE's cost for material and applied its cost elements to calculate a fair and reasonable price in each year of the pricing period.⁸ We compared our calculated price to the contract price and determined that the prices for the eight sole-source spare parts were generally fair and reasonable. See Table 2 for the dollar value and percentage differences between the IG fair and reasonable price and the contract price for each year of the 3-year pricing period for the eight sole-source spare parts reviewed.

⁶ DFARS PGI, 215.403-1, "Prohibition on obtaining certified cost or pricing data," revised May 28, 2014.

⁷ DFARS PGI, 215.404-1, "Proposal analysis techniques," May 28, 2014.

⁸ A pricing period consists of 36 months. The first pricing period for this contract was from August 31, 2012 through August 30, 2015.

~~(FOUO)~~ Table 2. Calculated Differences Between Our Fair and Reasonable Price and Contract Price

(FOUO) National Stock Numbers	2013 Price Difference		2014 Price Difference		2015 Price Difference	
	Value ¹	Percentage	Value	Percentage	Value	Percentage
2840011987361	\$12.97	■	\$10.51	■	\$10.48	■
2840012010562	N/A ²	N/A	-\$32.90	■	-\$4.51	■
2840014503755	-\$64.19	■	\$257.81	■	\$42.91	■
2840015161911	-\$24.40	■	-\$26.91	■	-\$11.18	■
2840015244332	-\$0.91	■	\$8.38	■	\$14.40	■
2840015975067	N/A	N/A	N/A	N/A	\$16.34	■
2840015986053	\$245.92	■	\$247.04	■	\$198.06	■
6620015481506	N/A	N/A	-\$94.31	■	-\$19.68	■

¹ The value represents the difference between our fair and reasonable price and the contract price agreed to by the contracting officer. Negative values (indicated with a minus sign) represent the contract price was less than the fair and reasonable price that we calculated.

² Part was not included in contract during pricing year; therefore, prices would not have been available until the pricing year the part was added.

~~(FOUO)~~

Defense Procurement and Acquisition Policy Office Peer Review Recommendations Implemented

The contracting officer implemented recommendations provided during DPAP officials' 2011 peer review. During the contract proposal peer review, DPAP officials identified four areas of concern. Specifically, DPAP officials questioned:

- the negotiations approach;
- the length of pricing periods;
- GE's allocated costs; and
- GE's proposed profit rate.

The contracting officer considered each of these areas during the proposal price negotiations. For example, DPAP officials were concerned that having a 3-year pricing period allowed GE to earn unintended profits when its cost for a part decreased during the pricing period. To address the DPAP concern, the contracting officer added a clause in the contract requiring periodic reviews of GE's cost data and shared cost savings.

Potential Pricing Risks

Although the contracting officer generally received fair and reasonable prices for the eight sole-source spare parts reviewed, we identified potential risks with the escalation rates and the availability of subcontractor pricing information that may prevent DLA Aviation from obtaining fair and reasonable prices in future pricing periods.



...we identified potential risks... that may prevent DLA Aviation from obtaining fair and reasonable prices...

Escalation Rates

For this contract, the contracting officer agreed to escalate material costs when GE's supplier agreements expired in 2013 or 2014, thereby reducing the effect of future material cost increases on GE. According to the DLA Acquisition Directive,⁹ contracting officers can escalate a current proposed price by applying an appropriate price index to estimate a future price. For example, if a supplier agreement expired in 2014, GE would estimate the 2015 material costs by escalating its previous supplier's material costs by an established percentage. GE would then use the escalated material costs when calculating the proposed prices for the DLA Aviation contract. Using an appropriate price index, the contracting officer could allow GE to escalate its material costs. Under this approach, however, the contracting officer risks not benefiting from future decreases to GE's material costs.

(FOUO) To ensure DoD benefited from decreases in future material costs, the contracting officer required GE to re-evaluate prices for the sole-source spare parts with the highest estimated annual total cost during the second year of each pricing period. In August 2014, GE re-evaluated prices for 70 of the 342 sole-source spare parts purchased by DLA Aviation. Based on this review, the contracting officer and GE decreased prices for 15 of the 70 sole-source spare parts. However, we identified an instance where GE negotiated lower material costs for a sole-source spare part that was not part of its review. For example, GE had a supplier agreement in April 2012 for a coupling at a cost of \$[REDACTED] through December 31, 2014. During the price negotiations in October 2012, GE escalated DLA's 2015 price for the coupling to \$[REDACTED], although in April 2012, GE's supplier offered to extend the cost of \$[REDACTED] through 2016. In December 2013, GE negotiated a lower cost of \$[REDACTED] with the supplier until 2018. However, the contracting officer was not aware that GE's material cost had decreased and will not benefit from the cost savings.

⁹ DLA Acquisition Directive Subpart 15.404, "Proposal Analysis," October 2014.

As a result of our audit, the contracting officer stated that she requested that DCMA review the GE material costs for all sole-source spare parts that did not have a supplier agreement from August 31, 2015, through August 30, 2018. Additionally, GE agreed to request that its suppliers extend material costs through the pricing period to limit escalation. Furthermore, when material costs decline, GE agreed to review those parts rather than automatically applying an escalation rate.

Bromont Parts

The contracting officer purchased sole-source spare parts, valued at \$7.2 million,¹⁰ from GE that were manufactured by Bromont, GE's subsidiary located in Quebec, Canada. According to GE, Bromont was required to provide its estimated costs for sole-source spare parts to GE twice a year. GE used these estimates to propose prices to the contracting officer; however, DoD has not validated Bromont's estimated costs. According to DCMA officials, it was difficult to obtain the necessary supporting documentation in the past since the U.S. Government did not have audit authority over Canadian companies. Although DLA Aviation only purchased \$7.2 million in sole-source spare parts on this contract for Bromont parts, DCMA officials stated that Bromont provided parts on multiple Government contracts where the same risk may exist.

During the course of our audit, DCMA officials stated they began a review of GE's proposal process for sole-source spare parts manufactured by Bromont. The review began in March 2015 and included Bromont's cost-estimating manual, memorandum of understanding between Bromont and GE, historical rates, and supporting documentation for material costs. According to DCMA officials, they intend to recommend that GE provide documentation to support Bromont's future costs.

No Support for the Commercial Item Determinations

Although the contracting officer generally obtained fair and reasonable prices, the contracting officer did not adequately support the commercial item determinations for sole-source spare parts procured from GE. Specifically, the contracting officer could not provide the market research and rationale to support commercial item determinations for the sole-source spare parts we reviewed. This occurred because the contracting officer did not validate the prior commercial item determinations and did not maintain documentation for the prior determinations.

¹⁰ Represented 6.9 percent of the total value of the parts procured on the contract.

Commercial Item Determinations Not Validated

The contracting officer did not validate the prior commercial item determinations. The DLA Acquisition Directive¹¹ states that previous commercial item determinations should be considered as a potential indicator of commerciality, and the preference is to accept a prior determination of commerciality unless there is a reason not to. The Directive also states that prior determinations do not relieve the contracting officer from performing market research,¹² to the extent appropriate to the circumstances, to determine if a prior commerciality designation is relevant to the current buy. However, according to the contracting officer, she relied solely on the prior determinations and did not perform market research or analysis to validate whether the determinations were still appropriate for all sole-source spare parts on the contract.

Because of the lack of market research, we requested commercial sales¹³ data from GE for eight sole-source spare parts that the contracting officer designated as commercial-off-the-shelf (COTS) items. The FAR¹⁴ defines a COTS item as a commercial item that is sold in substantial quantities in the commercial market and is offered to the Government without any modifications. However, GE was unable to provide adequate commercial sales data to substantiate the contracting officer's COTS determinations for the eight sole-source spare parts. DLA Aviation contracting officers should perform market research to validate that prior commercial item determinations are appropriate before future contracts are awarded.

As a result of our audit, the contracting officer conducted a commercial item determination review, dated May 19, 2015, for the sole-source spare parts included on the GE contract. Specifically, the contracting officer conducted market research to identify commercial sales for the spare parts. To support the market research, GE provided the contracting officer commercial sales data, including total sales to both the government and commercial market; descriptions of the commercial variants for the spare parts on the GE contract; and commercial invoices that

¹¹ DLA Acquisition Directive Subpart 12.1, "Acquisition of Commercial Items-General," November 2014.

¹² FAR Part 10, "Market Research," May 29, 2014, states that market research includes techniques such as publishing formal requests for information in technical or scientific journals or business publications; querying the Government-wide database of contracts and commercial databases for information; and reviewing catalogs and other publications available on-line.

¹³ For purposes of this report, commercial sales are any sales to the general public or non-governmental entities for purposes other than governmental purposes.

¹⁴ FAR Subpart 2.101, "Definitions," January 29, 2013.

included descriptions of spare parts that were bought and used in the commercial market. As a result, the contracting officer determined that the sole-source spare parts currently on the GE contract were commercial-of-a-type.¹⁵

Commercial Item Determinations Support Not Maintained

The contracting officer did not maintain documentation for the prior commercial item determinations. The DFARS PGI¹⁶ requires contracting officers to fully and adequately document in the contract files the market research and rationale to support a commercial item determination. According to the contracting officer, she could not identify when the commercial item determinations were made, only that the sole-source spare parts were determined to be COTS items. The contracting officer further stated that although the DLA Aviation system¹⁷ identified the eight sole-source spare parts as COTS items, it did not contain any market research or analysis to support the determinations. DLA Aviation contracting officers should document the market research and rationale used to support commercial item determinations in the contract file.

Conclusion

By not validating and documenting the commercial item determinations, the contracting officer may not obtain the appropriate cost or pricing data required to develop an effective bargaining position. In this instance, the contracting officer obtained other-than-certified cost or pricing data to determine the price reasonableness on this contract. However, there is no assurance that GE will continue providing data for sole-source commercial spare parts in the future, which places DoD at a disadvantage during contract negotiations. Therefore, contracting officers must exercise caution when making commercial item determinations so they continue to receive the appropriate data.

¹⁵ Commercial-of-a-type is defined as a commercial item with minor modifications of a type not customarily available in the commercial market made to meet Federal Government requirements.

¹⁶ DFARS PGI 212.1, "Acquisition of Commercial Items-General," January 24, 2008.

¹⁷ The DLA Aviation system is EProcurement. EProcurement is a part of DLA's Enterprise Business System that includes contract management functions such as the electronic contract folder.

Recommendations, Management Comments, and Our Response

Recommendation 1

We recommend that the Director, Defense Logistics Agency, require Defense Logistics Agency Aviation contracting officers to:

- a. Perform market research, to the extent appropriate to the circumstances, to validate that prior commercial item determinations are appropriate before future contracts are awarded, as required by Defense Logistics Agency Acquisition Directive Subpart 12.1.**
- b. Retain documentation of the market research and rationale that support commercial item determinations in the contract file, as required by Defense Federal Acquisition Regulation Supplement Procedures, Guidance and Information 212.1.**

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, responding for the Director, Defense Logistics Agency, agreed, stating that he would provide guidance implementing the existing policy requiring contracting officers to perform market research to validate that prior commercial item determinations are appropriate. The guidance will also implement existing policy that requires contracting officers to retain the market research documentation and rationale supporting the commercial item determinations in the contract file. The Director stated he would provide the guidance within 30 days of the issuance of this report.

Our Response

Comments from the Director addressed the specifics of the recommendations, and no further comments are required.

Appendix A

Scope and Methodology

We conducted this performance audit from November 2014 through June 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

DLA Aviation initially awarded the GE contract as contract number SPM4AX-12-D-9422. In September 2012, DLA Aviation transitioned to a new business software that required separate contract numbers for each of the contractor's manufacturing locations. Therefore, DLA Aviation modified the initial base contract into five separate contracts for ordering purposes:

- SPE4AX-12-D-9422;
- SPE4AX-12-D-9400;
- SPE4AX-12-D-9401;
- SPE4AX-12-D-9402; and
- SPE4AX-12-D-9403.

As of November 12, 2014, DLA Aviation had only purchased sole-source spare parts on contract numbers SPE4AX-12-D-9422, SPE4AX-12-D-9400, and SPE4AX-12-D-9401. Therefore, we included only these contracts in our review.

To determine whether DLA Aviation purchased sole-source spare parts at fair and reasonable prices, we reviewed DLA Aviation purchases for contract numbers SPE4AX-12-D-9422, SPE4AX-12-D-9400, and SPE4AX-12-D-9401. From August 31, 2012, through November 12, 2014, DLA Aviation purchased 342 sole-source spare parts, valued at \$104 million, on these contracts.

We statistically sampled 58 of the 342 sole-source spare parts, valued at \$78.3 million, purchased on the contracts to review the price reasonableness determinations by the DLA Aviation contracting officer. We nonstatistically sampled 8 of the 58 sole-source spare parts, valued at \$23 million, to perform cost analysis and review the commercial item determinations.

In addition, we interviewed personnel from DLA Aviation, DCMA, Defense Contract Audit Agency, and GE to identify their roles and responsibilities related to pricing the GE contract. We also reviewed applicable regulations and guidance on contract pricing, including:

- FAR Subpart 2.1, “Definitions;”
- FAR Part 10, “Market Research;”
- DFARS Subpart 215.4, “Contract Pricing;”
- DFARS PGI 212.1, “Acquisition of Commercial Items-General;”
- DFARS PGI 215.4, “Contract Pricing;”
- DLA Acquisition Directive Subpart 12.1, “Acquisition of Commercial Items-General;” and
- DLA Acquisition Directive Subpart 15.4, “Contracting Pricing.”

Review of Price Reasonableness Determinations

We reviewed DLA Aviation’s contract files for a sample of 58 sole-source spare parts to determine whether the contracting officer obtained sufficient documentation for determining fair and reasonable prices. Specifically, we reviewed the contracting officer’s price analysis worksheet, the price negotiation worksheet, and the GE proposal for these sole-source spare parts. GE’s proposal included supplier quotes and its method to determine the price to charge DLA Aviation. We compared the costs from the supplier quotes to GE’s pricing method. Then we compared GE’s proposed prices to the contract price on the price negotiation spreadsheet.

Cost Analysis

We performed a cost analysis on a nonstatistical sample of 8 of the 58 sampled, sole-source spare parts. We obtained GE’s actual material costs from the supplier invoice history in its Improve Materials Productivity to Achieve Cost Targets (IMPACT) purchasing system for all subcomponents with a supplier agreement and a total cost over \$100. For the remaining subcomponents, we relied on the estimated costs from GE’s pricing proposal. In addition, we obtained GE’s cost factors; including labor, general and administrative, and profit; from its pricing proposal and applied those rates to GE’s material costs to calculate a fair and reasonable price. Finally, we compared our calculated fair and reasonable price to the contract price.

Review of Commercial Item Determinations

We reviewed DLA Aviation's contract files and interviewed the DLA Aviation contracting officer to determine the support for the commercial item determinations on a nonstatistical sample of 8 of the 58 sole-source spare parts sampled. Because the contracting officer did not have documentation to support the determinations, we requested commercial sales data from GE to verify if the item was COTS.

Use of Computer-Processed Data

We used computer-processed data from the GE IMPACT purchasing system. IMPACT included information such as GE suppliers, price history, and part numbers. We compared the IMPACT vendor history and invoice data to the actual supplier agreements from GE's hard copy supplier agreement files and determined the data were sufficiently reliable for the purposes of our audit.

Use of Technical Assistance

The DoD OIG Quantitative Methods Division (QMD) assisted us during the audit. Specifically, QMD provided a statistical sample of 58 sole-source spare parts from contract numbers SPE4AX-12-D-9422, SPE4AX-12-D-9400, and SPE4AX-12-D-9401 that DLA Aviation purchased from August 31, 2012, through November 12, 2014. See Appendix C for a detailed discussion of the statistical sampling methodology.

Appendix B

Prior Coverage

During the last 5 years, the DoD OIG issued 14 reports discussing spare parts pricing issues. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

DoD IG

DODIG-2015-137, "Improvements Needed on DoD Procurements from Robertson Fuel Systems," June 25, 2015

DODIG-2015-120, "Defense Logistics Agency Did Not Obtain Fair and Reasonable Prices From Meggitt Aircraft Braking Systems for Sole-Source Commercial Spare Parts," May 8, 2015

DODIG-2015-103, "Summary of DoD Office of Inspector General Spare Parts Pricing Audits: Additional Guidance is Needed," March 31, 2015

DODIG-2015-058, "U.S. Air Force May Be Paying Too Much for F117 Engine Sustainment," December 22, 2014

DODIG-2015-053, "Naval Supply Systems Command Needs to Improve Cost Effectiveness of Purchases for the Phalanx Close-In Weapon System," December 19, 2014

DODIG-2014-110, "Ontic Engineering and Manufacturing Overcharged the Defense Logistics Agency for Sole-Source Spare Parts," September 15, 2014

DODIG-2014-088, "Defense Logistics Agency Aviation Potentially Overpaid Bell Helicopter for Sole-Source Commercial Spare Parts," July 7, 2014

DODIG-2014-054, "Defense Logistics Agency Land and Maritime Paid Too Much for High Mobility Multipurpose Wheeled Vehicle Repair Parts," April 4, 2014

DODIG-2014-038, "Air Force Life Cycle Management Center Could Not Identify Actual Cost of F119 Engine Spare Parts Purchased from Pratt and Whitney," February 10, 2014

DODIG-2014-020, "U.S. Army Contracting Command Did Not Obtain Fair and Reasonable Prices for Communications Equipment," December 5, 2013

DODIG-2013-090, "Improved Guidance Needed to Obtain Fair and Reasonable Prices for Sole-Source Spare Parts Procured By the Defense Logistics Agency From the Boeing Company," June 7, 2013

D-2011-104, "Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract with Sikorsky to Support the Corpus Christi Army Depot," September 8, 2011

D-2011-061, "Excess Inventory and Contract Pricing Problems Jeopardize the Army Contract with Boeing to Support the Corpus Christi Army Depot," May 3, 2011

D-2011-042, "Lean Six Sigma Project – Defense Logistics Agency/Honeywell Long-Term Contract Model Using One-Pass Pricing for Sole-Source Spare Parts," February 18, 2011

Appendix C

Sampling Methodology

Sampling Objective

We initially selected a statistical sample of sole-source spare parts from the population, as described below, for review to determine whether the prices negotiated for those parts were fair and reasonable. From the statistical sample, we selected a nonstatistical sample to perform cost analysis and to review the commercial item determinations.

Sample Population

We obtained a list of DLA Aviation purchases for contract numbers SPE4AX-12-D-9422, SPE4AX-12-D-9400, and SPE4AX-12-D-9401 from August 31, 2012, through November 12, 2014, which included 342 sole-source spare parts, valued at approximately \$104 million. We included only DLA Aviation purchases that exceeded \$50,000, which totaled 156 sole-source spare parts, valued at \$101.4 million. We considered the 156 sole-source spare parts as our population.

Sample Design

QMD designed a stratified sampling plan by dividing the population into seven strata (sections) based on contract number and value of the sole-source spare parts. Because there were only four sole-source spare parts on contract number SPE4AX-12-D-9422, QMD included all of those parts in the sample. QMD used the total purchase prices on contract numbers SPE4AX-12-D-9400 and SPE4AX-12-D-9401 to stratify the sole-source spare parts into six categories. Next, QMD used Microsoft Excel's random function tool to randomize within each stratum and selected the sample items. See Table C for the number of sole-source spare parts in the statistical sample and population in each stratum.

Table C. Strata Used to Select Statistical Sample of Sole-Source Spare Parts

Stratum		Stratum Sample Size (Parts)	Sample Total Value	Stratum Population Size (Parts)	Population Total Value
SPE4AX-12-D-9422		4	\$4,311,298	4	\$4,311,298
SPE4AX-12-D-9400	Greater than \$1 million	10	16,080,151	10	16,080,151
	Greater than or equal to \$250,000 and less than \$1 million	7	3,561,251	22	10,933,343
	Greater than or equal to \$50,000 and less than \$250,000	5	443,534	40	4,777,637
SPE4AX-12-D-9401	Greater than \$2 million	9	39,038,777	9	39,038,777
	Greater than or equal to \$300,000 and less than \$2 million	17	14,238,046	24	19,784,572
	Greater than or equal to \$50,000 and less than \$300,000	6	644,931	47	6,434,490
Total		58	\$78,317,988	156	\$101,360,268

Sample Projections

We performed a review of the contract documentation for the 58 sole-source spare parts in the statistical sample to determine whether the contracting officer obtained sufficient documentation for determining fair and reasonable prices. We then selected a nonstatistical sample of eight sole-source spare parts to perform a cost analysis for price reasonableness and to determine the adequacy of the commercial item determinations. Because we used a nonstatistical sample from the statistical sample to determine price reasonableness, we could not project across the universe whether the contracting officer obtained sufficient documentation to determine price reasonableness.

Management Comments

Defense Logistics Agency



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
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JUL 15 2015

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Response to DoD IG Draft Report "DLA Generally Purchased Sole-Source Spare Parts From the General Electric Company at Fair and Reasonable Prices, but Improvements Could be Made" (Project No. D2015-D000AT-0064.000)

Attached is the DLA's response to the subject Draft Report. Thank you for the opportunity to review the Report and comment on the finding and recommendations.

The point of contact for this audit is [REDACTED] DLA Office of the Inspector General, [REDACTED]


MATTHEW R. BEEBE
Director, DLA Acquisition

Attachment:
As stated

Defense Logistics Agency (cont'd)

The Department of Defense Inspector General recommends that the Director, Defense Logistics Agency (DLA), require DLA Aviation contracting officers to:

Recommendation 1.a: Perform market research to the extent appropriate to the circumstances, to validate that prior commercial item determinations are appropriate before future contracts are awarded, as required by DLA Directive Subpart 12.1.

Recommendation 1.b: Retain documentation of the market research and rationale that support commercial item determinations in the contract file, as required by Defense Federal Acquisition Regulation Supplement Procedures, Guidance and Information (DFARS PGI) 212.1.

DLA Response to Recommendations 1.a and 1.b: Concur. The DLA Director, Acquisition will provide an exhortatory Procurement Letter (PROCLTR) to require contracting officers to perform market research to the extent appropriate to the circumstances, to validate that prior commercial item determinations are appropriate before future contracts are awarded, as required by DLA Directive Subpart 12.1. The PROCLTR will also require contracting officers to retain documentation of the market research and rationale that support commercial item determinations in the contract file, as required by DFARS PGI 212.1. The Memorandum will be issued no later than 30 days after the DoD IG final report is issued.

DODIG PROJECT NO. D2015-D000AT-0064.000

Acronyms and Abbreviations

COTS	Commercial-Off-the-Shelf
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DLA	Defense Logistics Agency
DPAP	Defense Procurement and Acquisition Policy Office
FAR	Federal Acquisition Regulation
GE	General Electric Company
IMPACT	Improve Materials Productivity to Achieve Cost Targets
PGI	Procedures, Guidance and Information
QMD	Quantitative Methods Division

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