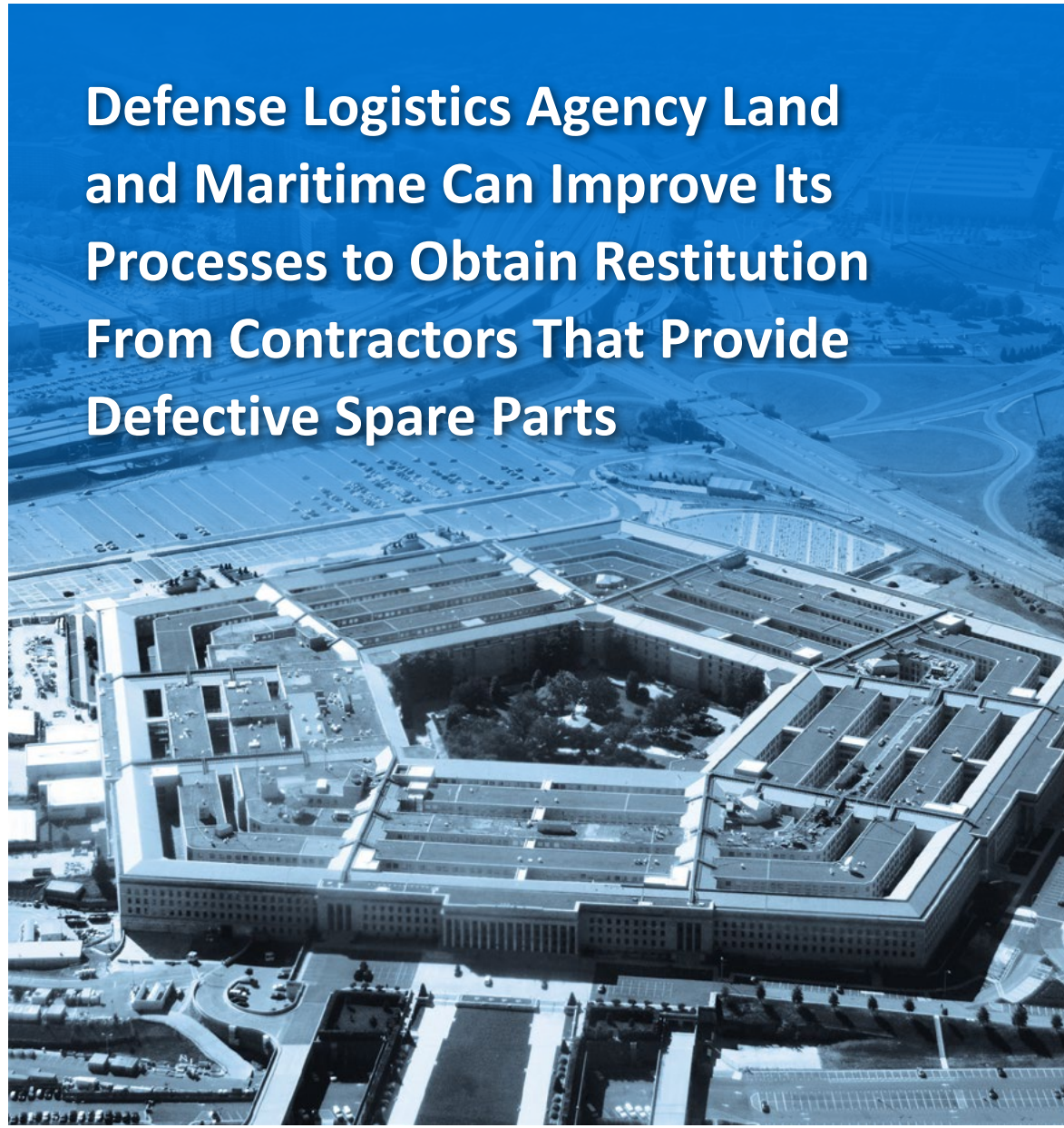




INSPECTOR GENERAL

U.S. Department of Defense

FEBRUARY 23, 2017



Defense Logistics Agency Land and Maritime Can Improve Its Processes to Obtain Restitution From Contractors That Provide Defective Spare Parts

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Results in Brief

Defense Logistics Agency Land and Maritime Can Improve Its Processes to Obtain Restitution From Contractors That Provide Defective Spare Parts

February 23, 2017

Objective

We determined whether Defense Logistics Agency (DLA) Land and Maritime personnel adequately processed product quality deficiency reports and obtained appropriate restitution (reimbursement) from contractors that provided defective spare parts. This is the third in a series of audits on product quality deficiency reports processed by the DLA.

We statistically sampled 64 of 354 contracts cited on product quality deficiency reports that DLA Land and Maritime closed between July 2014 and June 2015. In addition, we nonstatistically sampled 4 of 11 contracts for items coded as critical safety items.

Finding

DLA Land and Maritime did not adequately process product quality deficiency reports or pursue appropriate restitution for a projected 267 contracts for which contractors provided defective parts. This occurred because DLA Land and Maritime lacked oversight and controls to ensure that its logistics operations and acquisition personnel:

- coordinated and requested restitution from responsible contractors;
- adequately searched the DoD inventory to identify and remove defective parts;
- returned defective parts to the responsible contractors for replacement; and
- tracked the status of parts returned to the responsible contractors for replacement.

Finding (cont'd)

We project that as a result of DLA Land and Maritime's lack of oversight and controls, it did not obtain \$3.4 million in restitution.¹ In addition, DLA did not account for defective parts in the DoD supply chain, including all parts on a nonstatistically sampled contract for a critical safety item for which DoD customers submitted product quality deficiency reports. Defective parts in the DoD supply chain create a potential risk for warfighter readiness and safety.

DLA Headquarters and DLA Land and Maritime initiated several corrective actions during the audit to improve product quality deficiency report processing. These actions address obtaining restitution for defective parts and the removal of defective parts from the DoD supply chain. However, additional actions are needed.

Recommendations

We recommend that the Director, DLA, develop a plan of action with milestones to improve the agency's processes to identify defective spare parts in the DoD inventory and pursue restitution from contractors that provide the defective parts. The plan should address the findings in this report, establish controls and oversight, and provide sufficient training to ensure DLA Land and Maritime logistics operations and acquisition personnel:

- coordinate and request restitution from contractors that provide defective parts;
- adequately search the DoD inventory to identify and remove defective parts;
- return defective parts to responsible contractors for replacement;
- track the status of defective parts shipped back to contractors and ensure that appropriate restitution is provided in the form of replacement parts or other means; and

¹ See Appendix B for details on the statistical projections.



Results in Brief

Defense Logistics Agency Land and Maritime Can Improve Its Processes to Obtain Restitution From Contractors That Provide Defective Spare Parts

Recommendations (cont'd)

- until corrective actions are fully implemented, continue to review all contracts with associated product quality deficiency reports where DLA's investigation concluded that the contractor provided defective parts, take prompt action to pursue and obtain appropriate restitution for these parts, and remove all defective parts from the DoD supply chain.

Management Comments and Our Response

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA, agreed with the finding and addressed all specifics of the recommendations.

The Deputy Director stated that DLA had completed several actions to address concerns with restitution for defective parts. The Deputy Director stated that a Directive Type Memorandum was developed and published in December 2016, which provides high-level enterprise-wide guidance for pursuing restitution. The Deputy Director stated that DLA Land and Maritime developed a control sheet to document key decisions throughout the product quality deficiency report process and conducted training for all Product Specialists and Post Award Acquisition Specialists in January 2017.

The Deputy Director provided details on completed updates to the Enterprise product quality deficiency report Deskbook, Job Aids, and the DLA Acquisition Directive. The Deputy Director provided additional details on the comprehensive review of product quality deficiency reports DLA Land and Maritime completed in October 2016.

The Deputy Director stated that DLA Land and Maritime will conduct a monthly review of all completed product quality deficiency reports where the discrepancy was attributed to contractor noncompliance, and will provide monthly data on restitution status to DLA Acquisition. The Deputy Director stated that a product quality deficiency report Continuous Process Improvement Event is underway to identify gaps in the Agency's restitution process with a target completion date of December 2017. In addition, the Deputy Director stated that DLA will develop and issue a manual that captures both the high level requirements in DLA's December 2016 Directive Type Memorandum and the detailed execution steps at the DLA Primary Level Field Activities. The target completion date for the manual is June 30, 2017.

We will close these recommendations once we verify that the proposed actions have been implemented. Please see the Recommendations Table on the next page for the status of recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Director, Defense Logistics Agency	None	1.a, 1.b, 1.c, 1.d, 2	None

The following categories are used to describe agency management's comments to individual recommendations:

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.





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

February 23, 2017

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,
TECHNOLOGY, AND LOGISTICS
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Defense Logistics Agency Land and Maritime Can Improve Its Processes to Obtain
Restitution From Contractors That Provide Defective Spare Parts
(Report No. DODIG-2017-059)

We are providing this report for your information and use. The Defense Logistics Agency Land and Maritime did not adequately process product quality deficiency reports or pursue appropriate restitution from contractors that supplied defective parts for a projected 267 contracts, and did not obtain a projected \$3.4 million in restitution. In addition, the Defense Logistics Agency Land and Maritime did not account for defective parts in the DoD supply chain, which creates a potential risk for warfighter readiness and safety. Defense Logistics Agency Headquarters and Land and Maritime initiated several corrective actions to improve product quality deficiency report processing; however, additional actions are needed. This is the third in a series of audits. 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 Deputy Director, Defense Logistics Agency Logistical Operations, responding for the Director, Defense Logistics Agency, addressed all specifics of the recommendations and conformed to the requirements of DoD Instruction 7650.03.

We appreciate the courtesies extended to the staff. Please direct questions to Mr. Patrick Nix at (703) 604-9332 (DSN 664-9332).

A handwritten signature in black ink, reading "Troy M. Meyer".

Troy M. Meyer
Principal Assistant Inspector General
for Audit

Contents

Introduction

Objective	1
Background	1
Review of Internal Controls	3

Finding. DLA L&M Did Not Adequately Process PQDRs or Pursue Appropriate Restitution From Contractors That Supplied Defective Parts

4

Inadequate Processing of PQDRs Hindered Ability to Pursue and Obtain Restitution	5
Coordination With Acquisition Personnel to Pursue Restitution Was Inconsistent	6
Identification of Defective Parts Could Be Better	10
Process to Return Defective Parts to Contractors for Replacement Was Not Effective	14
Status of Returned Parts Was Not Tracked	17
DLA L&M Missed Opportunities to Obtain Restitution and Defective Parts Create a Potential Risk for Warfighter Readiness and Safety	19
DLA Corrective Actions	20
Conclusion	22
Recommendations, Management Comments, and Our Response	22

Appendixes

Appendix A. Scope and Methodology	25
Use of Computer-Processed Data	27
Use of Technical Assistance	27
Prior Coverage	27
Appendix B. Statistical Sampling Methodology and Analysis	29
Appendix C. Federal Acquisition Regulation Clause 52.246-2	31

Management Comments

Defense Logistics Agency	34
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Acronyms and Abbreviations

38

Introduction

Objective

We determined whether Defense Logistics Agency (DLA) Land and Maritime (L&M) personnel adequately processed product quality deficiency reports (PQDRs) and obtained appropriate restitution² (reimbursement) from contractors that provided defective spare parts. This is the third in a series of audits on DLA PQDR processing. The first two audits determined whether DLA Aviation personnel adequately processed PQDRs. For scope and methodology and prior audit coverage, see Appendix A.

Background

Defense Logistics Agency

The DLA, headquartered at Fort Belvoir, Virginia, provides the Army, Marine Corps, Navy, Air Force, and combined allied forces with a full spectrum of logistics, acquisition, and technical services. The DLA also provides more than 90 percent of the military's spare parts.

DLA L&M, headquartered in Columbus, Ohio, is the U.S. military's integrated materiel manager for more than 1.9 million spare parts and operating supply items in support of land, maritime, and missile weapons systems.

DLA L&M purchases spare parts from contractors, stores the parts in DLA distribution depots, and sells and issues parts to DoD customers.³ In addition to DLA L&M, the DLA has several other supply chains that process PQDRs.

Product Quality Deficiency Reporting

PQDRs are the primary tool for customer feedback on the quality of spare parts issued through the DoD supply chain. Customers submit PQDRs when they determine that new or newly reworked Government-owned spare parts do not fulfill their expected purpose, operation, or service. DLA Regulation 4155.24⁴ implements DoD policy for reporting product quality deficiency data. In addition, the DLA published a PQDR Deskbook⁵ that provides details on PQDR

² For this report, "restitution" refers to the value of parts that the PQDR investigation determined to be defective as a result of contractor noncompliance. Restitution can be in the form of repaired or replacement parts, refunds, or voluntary consideration. For instances where DLA L&M pursued restitution for our sample items, the restitution was generally in the form of repaired or replacement parts.

³ DoD customers include various Military Department maintenance organizations and units.

⁴ DLA Regulation 4155.24, "Product Quality Deficiency Report Program," July 20, 1993.

⁵ DLA Deskbook Appendix B35, "Quality Notifications, Product Quality Deficiency Reports (PQDR)," December 12, 2014.

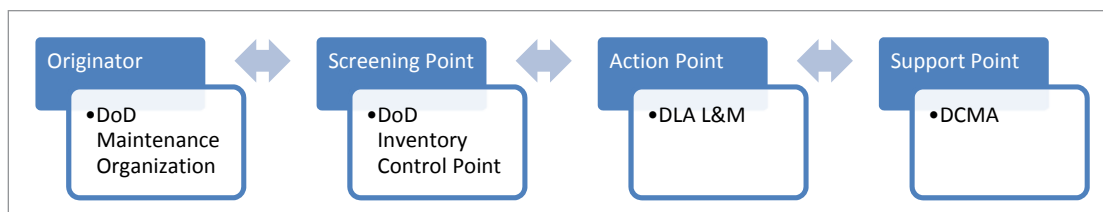
processing. DoD organizations use PQDRs to report product defects that result from deficiencies in design, workmanship, specifications, material, or other nonconforming conditions, such as improper packaging.

The DLA Regulation establishes a system for feedback on product quality and provides for the initial reporting, cause correction, and status accounting of individual product quality deficiencies. The process primarily focuses on the following roles.

- **Originator**—a user (customer) that discovers the defective part and initiates the PQDR and, in some cases, provides the deficient part (an exhibit) for Government or contractor testing.
- **Screening Point**—a designated group identified within each DoD organization that reviews the PQDR for validity, accuracy, and completeness of required information and identifies and transmits the PQDR to the proper action point within or outside the DoD organization.
- **Action Point**—the organization that leads and manages the PQDR investigation, which determines the validity of the reported defect, the cause, and the appropriate corrective actions. For DLA-managed items, this responsibility is assigned to a DLA quality assurance specialist.
- **Support Point**—the organization that assists the action point in the investigation upon request. The Defense Contract Management Agency (DCMA) generally fulfills this role.

Figure 1 identifies the DoD organizations that fulfilled the roles above for the PQDRs reviewed during this audit.

Figure 1. Organizations Involved in Processing DLA L&M PQDRs



Source: DoD Office of Inspector General.

DoD organizations document PQDR processing, tracking, and resolution in the U.S. Navy-hosted Product Data Reporting and Evaluation Program (PDREP) information system. PDREP interfaces with other DoD systems, such as the DLA Enterprise Business System (EBS), during the PQDR reporting process. Specifically, DLA personnel process PQDRs in the DLA EBS, the DLA's core financial system of record. The DLA EBS also interfaces with the DLA Distribution Standard System, which DLA distribution depots use to manage the DLA's spare part inventory at

DLA storage facilities. This interface primarily occurs when DLA L&M personnel search the DLA distribution depot inventory for defective spare parts and direct depot personnel to return defective spare parts to the responsible contractor.

DoD Guidance to Obtain Contractor Restitution

DoD acquisition guidance⁶ states that if nonconforming parts are discovered after acceptance, the defect appears to be the fault of the contractor, any warranty has expired, and there are no other contractual remedies, that the contracting officer:

- shall notify the contractor in writing of the nonconforming parts;
- shall request that the contractor repair or replace the parts; and
- may accept consideration (payment) if offered.

Review of Internal Controls

DoD Instruction 5010.40⁷ 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 where DLA L&M personnel did not adequately process PQDRs, adequately search the DoD inventory to identify and remove defective parts, or pursue and obtain appropriate restitution from contractors that provided defective parts. We will provide a copy of the report to the senior DLA official responsible for internal controls.

⁶ Defense Federal Acquisition Regulation Supplement Part 246, "Quality Assurance," Subpart 246.4, "Government Contract Quality Assurance," Clause 246.407, "Nonconforming Supplies or Services."

⁷ DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013.

Finding

DLA L&M Did Not Adequately Process PQDRs or Pursue Appropriate Restitution From Contractors That Supplied Defective Parts

DLA L&M did not adequately process PQDRs or pursue appropriate restitution from contractors that supplied defective parts. Specifically, we project that DLA L&M did not pursue appropriate restitution for 267 contracts⁸ for which contractors provided defective parts. This occurred because DLA L&M lacked oversight and controls to ensure that its logistics operations and acquisition personnel:

- coordinated with each other to request restitution from responsible contractors;
- adequately searched the DoD inventory to identify and remove defective parts;
- returned defective parts to the responsible contractors for replacement; and
- tracked the status of parts returned to the responsible contractors for replacement.

We project that as a result of DLA L&M's lack of oversight and controls, it did not obtain \$3.4 million⁹ in restitution for defective parts. In addition, DLA L&M did not account for defective parts in the DoD supply chain, including all parts on a nonstatistically sampled contract for a critical safety item for which DoD customers submitted PQDRs. Defective parts in the DoD supply chain create a potential risk for warfighter readiness and safety.

DLA Headquarters and DLA L&M initiated several corrective actions during the audit to improve PQDR processing. These actions address obtaining restitution for defective parts and the removal of defective parts from the DoD supply chain. However, additional actions are needed.

⁸ These contracts were for national stock numbers—13-digit stock numbers used to identify inventory items in the DoD supply chain (see Appendix B for details on the statistical projections).

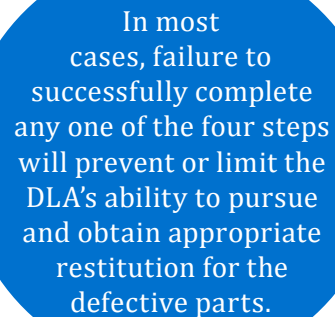
⁹ The \$3.4 million represents the projected value of the defective parts that were not replaced or refunded (see Appendix B for details on the statistical projections).

Inadequate Processing of PQDRs Hindered Ability to Pursue and Obtain Restitution

DLA L&M did not adequately process PQDRs, and did not pursue or obtain appropriate restitution from contractors that supplied defective parts. To pursue and obtain appropriate contractor restitution, DLA L&M logistics operations and acquisition personnel¹⁰ need to complete the following four steps to process PQDRs either independently or with assistance from other designated personnel as specified by DLA guidance.¹¹

1. Contact the responsible contractor, request restitution, and determine the type of restitution.
2. Search DLA distribution depots for additional defective spare parts provided by the responsible contractor and notify DoD customers that purchased the defective parts and have them search their on-hand inventory for the defective parts.¹²
3. Take action to ensure all defective spare parts identified in PQDRs and through additional searches are removed from the DoD supply chain and are either disposed of (if the contractor does not require the parts to be returned for repair or replacement) or shipped to the responsible contractor for inspection and repair or replacement.
4. Track and maintain oversight of defective spare parts shipped to the responsible contractor and ensure that the responsible contractor provides appropriate restitution.

In most cases, failure to successfully complete any one of the four steps will prevent or limit the DLA's ability to pursue and obtain appropriate restitution for the defective parts. DLA quality assurance specialists wrote a closing report for each PQDR investigation to explain and document the cause of the deficiency, whether contractor or Government action caused the deficiency, the actions taken to correct the deficiency, and the disposition of the defective product.



In most cases, failure to successfully complete any one of the four steps will prevent or limit the DLA's ability to pursue and obtain appropriate restitution for the defective parts.

¹⁰ These personnel include quality assurance specialists, resolution specialists, and contracting officers.

¹¹ This includes DLAR 4155.24, the DLA PQDR Deskbook, and a DLA EBS Job Aid, "DLA L&M Post Awards Quality Notification Team Return to Contractor Process," September 2014.

¹² The DLA refers to its search of DLA distribution depot inventory as "stock screening" and the search of the DoD inventory and notification of customers as "alert notification."

The PQDR investigations DLA L&M closed between July 2014 and June 2015 identified 354 contracts where contractor noncompliance caused the defective parts. We reviewed a stratified statistical sample of 64 contracts. We evaluated how DLA L&M personnel completed the four steps described earlier and whether they obtained appropriate restitution from contractors that provided defective parts.

Our evaluation identified that DLA L&M’s limited execution of the four steps hindered its ability to pursue and obtain appropriate restitution and left defective parts unaccounted for in the DoD supply chain. Table 1 lists the shortcomings we identified and the number of occurrences for the statistical sample of 64 contracts we reviewed.

Table 1. Number of Missing Restitution Steps in Statistical Sample of 64 Contracts

Restitution Step	No. of Occurrences*
1. Did not coordinate with acquisition personnel	35
2. Did not identify and remove defective parts from DoD inventory	33
3. Did not return defective parts to contractor	35
4. Did not track defective parts returned to contractor	18

* The number of occurrences is more than 64 because for some of the 64 contracts, DLA L&M personnel did not perform more than one step.

Coordination With Acquisition Personnel to Pursue Restitution Was Inconsistent

DLA L&M quality assurance specialists did not always coordinate with acquisition personnel to contact responsible contractors and pursue restitution for defective spare parts. This occurred for 35 of the 64 contracts we reviewed.

DLA Regulation 4155.24 requires DLA quality assurance specialists to take the following actions when the PQDR investigation determines that a contractor is responsible for providing defective parts.

- If the item was inspected at the shipping source, request that the quality assurance element at the Contract Administration Office¹³ investigate the deficiency with the contractor and provide a corrective action response.
- If the item was not inspected at the shipping source, request that the contracting office responsible for the contract have the contractor investigate the deficiency and provide a corrective action response.

¹³ DLA L&M personnel stated that the Contract Administrative Office would be DCMA because a source inspection would have been performed by DCMA at the contractor’s facility before shipment.

The Regulation also requires DLA personnel to pursue cost-free repair, replacement, or reimbursement for the defective material. However, DLA L&M did not have the oversight and controls needed to make sure that its quality assurance personnel consistently completed these required actions. When DLA L&M acquisition personnel are notified that a contractor provided defective parts, they must review the applicable contract warranty and inspection terms and the circumstances to determine contractual rights and the appropriate course of action, such as pursuing a contract modification with the contractor, if warranted. However, ineffective contract warranty terms and DLA L&M's inconsistent application of contract inspection clauses limited its ability to pursue restitution.



Ineffective contract warranty terms and DLA L&M's inconsistent application of contract inspection clauses limited its ability to pursue restitution.

Contract Warranty Terms Not Effective

DLA L&M generally included a 12-month warranty clause in its contracts.¹⁴ However, DLA L&M acquisition personnel informed us that the warranty clause can be ineffective. Contractors generally deliver material to a DLA distribution depot, where it is stored until ordered and shipped to DoD customers. Ordering and shipping sometimes occur more than 12 months after contractors deliver the material to the depot. Nevertheless, the DLA PQDR Deskbook requires DLA personnel to investigate out-of-warranty nonconforming parts to the fullest extent, including contacting the contractor or support point to pursue restitution.

DLA L&M quality assurance personnel did not always pursue restitution from contractors that provided defective parts after the warranty period expired. Specifically, the PQDR investigations associated with two of the contracts we reviewed noted that the parts were out of warranty and there was no evidence of coordination with DLA L&M acquisition personnel to pursue restitution. For these two contracts, DLA L&M destroyed \$52,796 worth of defective parts without restitution.

¹⁴ DLA L&M included Defense Logistics Acquisition Directive 52.246-9054, "Warranty – Acceptance of Supplies (Sep 2008)," or similar warranty clauses in 53 of the 64 contracts in our stratified statistical sample.

Contract Inspection Terms Not Consistently Applied

DLA L&M acquisition personnel informed us that their contracts include an inspection clause,¹⁵ which gives them the authority to revoke acceptance of supplies when it is determined the supplies do not conform¹⁶ to contract requirements. The clause permits DLA L&M to revoke acceptance for latent defects, fraud, gross mistakes amounting to fraud, or as otherwise provided in the contract. This inspection clause allows DLA L&M acquisition personnel to revoke acceptance of supplies but requires them to notify the contractor within a reasonable time¹⁷ after discovering defective parts. DLA L&M acquisition officials explained that as a general rule they consider a maximum of 6 months as a reasonable amount of time for contacting the contractor for restitution after identification of defective parts.

DLA Regulation 4155.24 requires DLA personnel to pursue cost-free repair, replacement, or reimbursement for the defective material. Therefore, DLA L&M personnel should pursue restitution at any point after identifying defects. For example, we found an instance where DLA L&M requested and received restitution for an item a contractor had delivered 9 years before the customer submitted a PQDR identifying it as defective.

Contract Modifications for Restitution Were Not Consistently Established

When DLA L&M quality assurance personnel notify DLA L&M acquisition personnel that a contractor provided defective parts, DLA L&M acquisition personnel should notify the contractor in writing of the nonconforming parts and request that the contractor repair or replace the parts. If the contractor agrees, then DLA L&M should establish a bilateral contract modification¹⁸ with the responsible contractor. A bilateral contract modification requires the contractor to either provide replacement parts by a specified date or refund the Government for the cost of the parts. However, DLA L&M limited its ability to obtain restitution because quality assurance personnel did not consistently coordinate with acquisition personnel to have them determine DLA's contractual rights and establish bilateral contract modifications with contractors when warranted.

¹⁵ DLA L&M included Federal Acquisition Regulation Part 52, "Solicitation Provisions and Contract Clauses," Subpart 52.2, "Text of Provisions and Clauses," Clause 52.246-2, "Inspection of Supplies—Fixed Price," as an inspection clause in 60 of the 64 contracts in our stratified sample. See Appendix C for Federal Acquisition Regulation 52.246-2 in its entirety.

¹⁶ Supplies are nonconforming when they are defective in material or workmanship or are otherwise not in conformity with contract requirements.

¹⁷ This requirement was established by court decision interpreting the inspection clause. See *Perkin-Elmer Corp. v. United States*, 47 Fed. Cl. 672 (2000).

¹⁸ Bilateral means that DLA L&M and contractor representatives must both sign the modification.

For example, we reviewed a contract for 16 defective torsion suspension bars, valued at \$2,640 each, used on the M-88 recovery vehicle (see Figure 2).



Figure 2. Torsion Suspension Bar
Source: PDREP.

An Army customer submitted a PQDR identifying 15 defective torsion suspension bars. DLA L&M had the defective parts shipped to the DLA Product Testing Center and the lab confirmed the defect. Instead of coordinating with DLA L&M acquisition specialists to establish a bilateral contract modification, the quality assurance specialist coordinated directly with the contractor. DLA L&M shipped the defective parts to the contractor in October 2014, and at the time the contractor agreed to repair and return the parts to DLA. In response to our inquiries in April 2016, the DLA L&M quality assurance specialist determined that the 15 defective parts were still at the contractor's facility and referred the case to the DLA L&M contract litigation office. A DLA L&M contract litigation attorney stated that because the quality assurance specialist did not coordinate with DLA L&M acquisition personnel within a reasonable time after identifying the parts as defective, DLA L&M was no longer able to obtain restitution. In addition, DLA L&M did not account for the one remaining torsion suspension bar from the total contract quantity of 16. As

a result, DLA L&M missed the opportunity to obtain restitution for the \$42,240 it paid the contractor for the defective parts and the defective part remaining in the DoD supply chain creates a potential risk to the warfighter.

The DLA should establish controls and oversight to make sure DLA L&M quality assurance personnel coordinate with acquisition personnel in a timely manner to pursue restitution from contractors that provide defective parts.

Identification of Defective Parts Could Be Better

For 33 of the 64 contracts we reviewed, DLA L&M quality assurance specialists did not adequately search the DoD inventory to identify and remove defective spare parts. DLA quality assurance specialists usually performed searches of the DLA's distribution depot inventory for defective parts, but infrequently notified DoD customers and requested that they search their inventories for the defective parts they purchased.

DLA Regulation 4155.24 and the DLA PQDR Deskbook require DLA L&M quality assurance specialists to take action during a PQDR investigation to identify and remove defective parts from the DoD supply chain. Specifically, DLA L&M quality assurance specialists are required to:

- determine if additional defective parts exist beyond those reported in PQDRs;
- conduct a stock screening and search the DLA inventory by notifying DLA distribution depots that store the parts and have the depots search their inventories for defective spare parts; and
- if all items on the contract in question have not been accounted for, issue an alert notification to DoD customers that purchased the parts and have them search their inventories for additional defective parts.

In addition, the DLA PQDR Deskbook requires the PQDR approving official to make sure that DLA L&M quality assurance specialists properly execute these steps and account for all affected material.

Stock Screenings at DLA Depots and Alert Notifications to DoD Customers

Stock Screenings

If DLA L&M quality assurance specialists determine that the contract quantity is greater than the reported PQDR quantity, the quality assurance specialists need to initiate a stock screening to notify DLA distribution depots that received the spare parts and have them search their inventories for defective spare parts. The purpose of the stock screening is to suspend defective spare parts at DLA depots and preclude shipment of additional defective spare parts to DoD customers. DLA L&M quality assurance specialists process stock screenings in EBS and enter the stock number, the type of stock screening, a description of any specific screening requirements, the contract number and contractor, the specific DLA distribution depots that are required to screen their on-hand inventories, and a priority level for a response time. The DLA distribution depots report the results of the stock screenings and DLA L&M logistics operations personnel provide the DLA distribution depots disposition instructions for any defective spare parts identified as a result of the search.

Alert Notifications

If not all the spare parts on the contract in question are accounted for through stock screenings, DLA quality assurance specialists also need to issue alert notifications to DoD customers that purchased the spare parts. Alert notifications include information on the spare part, contract, and responsible contractor, and provide a summary of the investigation. The alert notifications request that the affected military service or DoD customer search their inventories for additional defective



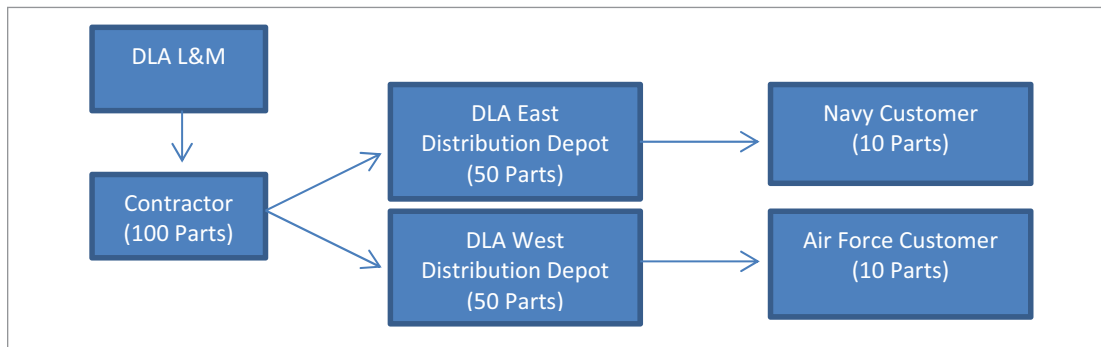
DLA L&M officials stated that once DLA issues an alert notification, DLA has no control over the affected military service's actions to track down additional defective parts.

spare parts. The alert notifications generally instruct DoD customers to report to the DLA any additional defective parts discovered using PQDRs within a specified timeframe. DLA L&M officials stated that once DLA issues an alert notification, DLA has no control over the affected military service's actions to track down additional defective parts. If the military service does not take action to identify and report back additional defective parts, DLA's ability to obtain restitution is limited.

Process to Identify and Remove Defective Parts From the Supply Chain

We created an example to show the DLA's process of identifying and removing defective parts from the supply chain (Figure 3). In the flowchart, the DLA awards a contract to a contractor for 100 parts. The contractor ships 50 parts to each of the DLA's east and west distribution depots. A Navy customer orders 10 parts from the east distribution depot and an Air Force customer orders 10 parts from the west distribution depot.

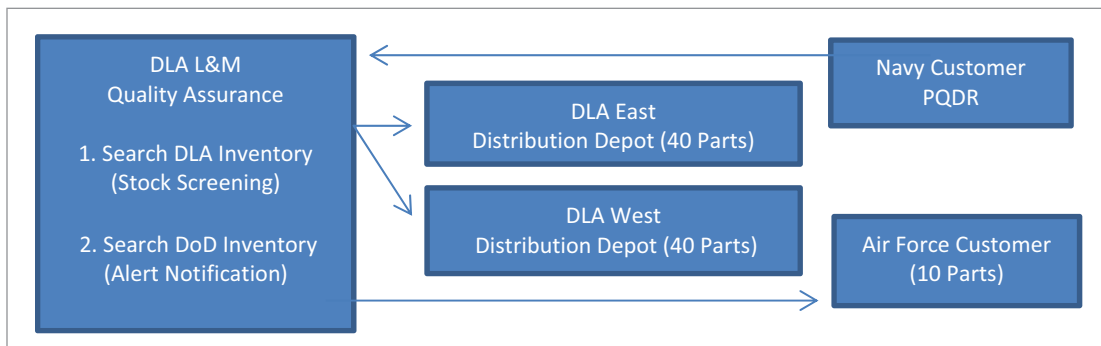
Figure 3. Example of DLA Contract for 100 Parts and Associated Shipments



Source: DoD Office of Inspector General.

The Navy customer then submits a PQDR to notify the DLA of 10 defective parts. The PQDR investigation determines that the contractor incorrectly manufactured all 100 parts and the contractor agreed to replace them if returned. To properly account for all 100 defective parts in accordance with DLA policy, the DLA quality assurance specialist should initially determine that the PQDR identified only 10 of the 100 defective parts, leaving 90 defective parts unaccounted for in the DoD supply chain. As illustrated in Figure 4, the DLA quality assurance specialist should then search DLA and DoD inventories to account for the remaining 90 defective parts.

Figure 4. Example of Searching DLA and DoD Inventories for 90 Defective Parts



Source: DoD Office of Inspector General.

Quality Assurance Personnel Did Not Consistently Account for All Defective Spare Parts in the DoD Inventory

DLA L&M lacked oversight and controls to ensure that its quality assurance personnel consistently completed the required actions. Specifically, DLA L&M quality assurance personnel did not consistently account for all defective spare parts in the DoD inventory. In addition, DLA L&M quality supervisory personnel did not provide adequate oversight of PQDR investigations. Defective spare parts that are unaccounted for in the DoD inventory can potentially impact warfighter readiness and safety and also limit the DLA's ability to obtain appropriate restitution.

Defective spare parts that are unaccounted for in the DoD inventory can potentially impact warfighter readiness and safety and also limit the DLA's ability to obtain appropriate restitution.

For example, we reviewed a contract for 50 power distribution panels, valued at \$1,764 each, used on the family of light and medium tactical vehicles (see Figure 5).



Figure 5. Power Distribution Panel
Source: PDREP.

An overseas military depot and a DoD contractor submitted PQDRs citing multiple deficiencies with the power distribution panels. The DLA L&M quality assurance specialist initiated a stock screening but did not properly execute it. In response to the stock screening, DLA distribution depot personnel identified and suspended (placed a hold on) 29 power distribution panels. The stock suspension was cancelled without justification and allowed DLA distribution depot personnel to use defective power distribution panels to fill a DoD customer's order. Upon receiving the defective spare parts, the DoD customer submitted additional PQDRs. The contractor replaced the defective power distribution panels, but many of the replacement parts were also defective.

In addition, the DLA L&M quality assurance specialist did not issue an alert notification to account for the remaining 21 power distribution panels purchased under the contract. The DLA L&M quality assurance specialist stated that he did not issue an alert notification to the customers that purchased those parts because he thought it would cause confusion and all customers would think that they had one of the defective power distribution panels. In response to our audit, DLA L&M issued an alert notification to DoD customers and a letter to the contractor requesting a monetary refund of \$31,207.

The DLA should establish controls and oversight to make sure DLA L&M quality assurance personnel adequately search the DoD inventory to identify and remove defective parts.

Process to Return Defective Parts to Contractors for Replacement Was Not Effective

For 35 of the 64 contracts we reviewed, DLA L&M logistics operations personnel did not ensure that defective parts identified through stock screenings or PQDRs were returned to responsible contractors to receive restitution. When DLA L&M personnel confirm that a contractor is responsible for the defective parts, the contractor may provide restitution in the form of replacement parts. In some cases, the contractor requests that the defective parts be shipped to its facility so it can replace them. In other cases, the contractor agrees to replace the parts without requiring the return of the defective parts. To get the defective parts to the contractor, DLA L&M must provide timely and accurate disposition instructions to DoD customers or DLA depots holding the parts.

DLA L&M Process for Providing Disposition Instructions to DoD Customers Holding Defective Parts

For the defective parts identified in PQDRs, the DLA Deskbook specifies that DLA L&M logistics operations personnel must provide the customer that initiated the PQDR with disposition instructions for the defective parts. Generally, DLA L&M instructed customers to take one of the following actions regarding the defective parts:

- dispose of the parts and remove them from the DoD supply chain (if the contractor does not require the parts to be returned for repair or replacement);
- ship the parts directly to the responsible contractor; or
- ship the parts to a specific DLA distribution depot for consolidation with other defective parts from the contract, if applicable, and shipment to the responsible contractor.

DLA L&M personnel informed us that when a customer ships defective parts directly to the contractor, DLA L&M cannot track the parts in the DLA EBS. Therefore, DLA L&M does not have full assurance that all defective parts are shipped back to the contractor or that the contractor has shipped the replacement parts back to the customer. In addition, DLA L&M personnel informed us that if a customer ships defective parts to a specific DLA distribution depot without DLA L&M logistics operation personnel first establishing a due-in record¹⁹ for the parts, the DLA distribution depot may process the receipt as an unauthorized return and the parts may be destroyed. As a result, the Government may miss out on receiving appropriate restitution.

DLA L&M personnel informed us that when a customer ships defective parts directly to the contractor, DLA L&M cannot track the parts in the DLA EBS.

DLA L&M Process for Providing Disposition Instructions to DLA Depots Holding Defective Parts

For the defective parts identified through stock screenings, the DLA Deskbook specifies that DLA L&M logistics operations personnel must provide the DLA distribution depots with disposition instructions. Generally, DLA L&M instructed the DLA distribution depots to take one of the following actions for the defective parts:

- dispose of the parts and remove them from the DoD supply chain (if the contractor does not require the parts to be returned for repair or replacement); or

¹⁹ A system record showing the quantity of parts and associated contract identification number that are due in to arrive at the DLA distribution depot at a specified date.

- code the parts to reflect a litigation status²⁰ and suspend (hold) the parts until the pending litigation with the contractor is resolved, then ship the defective parts to the responsible contractor for repair or replacement or destroy them (if the contractor does not require the parts to be returned for repair or replacement).

DLA L&M Did Not Always Provide or Ensure Proper Execution of Disposition Instructions

DLA L&M did not establish controls and oversight that make sure defective parts were returned to the responsible contractors, and DLA L&M logistics operations personnel did not always provide adequate disposition instructions to DoD customers or DLA distribution depots holding defective parts. In addition, DLA L&M personnel did not ensure that personnel properly executed their disposition instructions.

For example, we reviewed a contract for 243 linear actuating cylinders, valued at \$1,050 each, used on the M1 tank (see Figure 6).



²⁰ This legal action to resolve a dispute is initiated by assigning a supply condition code of "L" to indicate a litigation status.

An Army customer submitted a PQDR identifying 101 defective linear actuating cylinders. At DLA L&M's direction, the customer shipped the 101 defective parts to the contractor, which repaired and returned the parts to the DLA. As part of the PQDR investigation, DLA logistics operational personnel identified 137 additional linear actuating cylinders from the contract at a DLA distribution depot. In response to our inquiries about the status of those additional parts, the DLA L&M quality assurance specialist informed us that the parts had been mistakenly destroyed instead of being returned to the contractor for repair. As a result, DLA L&M will not obtain restitution for the \$143,850 it paid the contractor for the defective linear actuating cylinders.²¹

The DLA should establish controls and oversight to make sure DLA L&M logistics operations personnel return defective parts to responsible contractors for replacement.

Status of Returned Parts Was Not Tracked

For 18 of the 64 contracts we reviewed, DLA L&M acquisition and logistics operations personnel did not properly track defective parts returned to contractors to ensure that the contractors provided appropriate restitution in the form of replacement parts. Although DLA L&M returned the defective parts for 18 contracts, the contractors:

- did not provide any replacement parts for 13 contracts, and
- replaced only a portion of the parts returned for 5 contracts.

DLA L&M lacked controls and oversight needed to adequately track parts returned to contractors for replacement. Specifically, DLA L&M personnel explained that they must properly complete the process of establishing a bilateral contract modification for resupply to enable DLA L&M to track the due-in status of replacement parts in EBS. As part of this process, DLA L&M establishes a tracking record in EBS that identifies the number of replacement parts the contractor agreed to provide and a date the parts are due in. This tracking record should be identified as a new contract line item number linked in EBS to the original contract that provided the defective parts. Linking the tracking record to the original contract creates a due-in record in EBS for tracking purposes and also creates a due-in record that the DLA distribution depot uses to process the receipt of the replacement parts upon arrival at the depot.

²¹ In addition, DLA L&M did not account for the 5 remaining parts from the total contract quantity of 243.

However, as mentioned, DLA L&M logistics operations personnel did not consistently coordinate with DLA L&M acquisition personnel to create contract modifications. Therefore, there was no assurance that DLA L&M personnel created the necessary tracking orders in EBS. In addition, there was no assurance that acquisition personnel adequately monitored and provided sufficient oversight over the exchange of defective parts for good ones.²²

For example, we reviewed a contract for 117 vehicle operation panels, valued at \$610 each, used on the M997 ambulance. An Army customer submitted a PQDR identifying 45 defective vehicle operation panels. At DLA L&M's direction, the customer shipped the 45 defective parts to the contractor for repair in August 2014. However, DLA L&M did not establish a bilateral contract modification with the contractor or a tracking record in EBS. In response to inquiries we made in April 2016, the DLA L&M quality assurance specialist informed us that he had lost track of the 45 defective parts sent to the contractor. A stock screening identified that an additional 42 defective vehicle operation panels were being stored at a DLA distribution depot. DLA EBS data showed that

Although for this PDQR investigation, DLA L&M was able to account for all 117 defective parts purchased on the contract, DLA L&M did not obtain any restitution for the \$71,370 paid for the defective parts.

those 42 defective vehicle operation panels were still at the depot and had been there since May 2014. The DLA L&M quality assurance specialist also informed us that another customer had purchased the remaining 30 defective vehicle operation panels supplied by the contractor and had to repair the panels. Although for this PDQR investigation, DLA L&M was able to account for all 117 defective parts purchased on the contract, DLA L&M did not obtain any restitution for the \$71,370 paid for the defective parts.

The DLA should require DLA L&M to establish controls and oversight to track the status of defective parts shipped back to contractors and ensure that appropriate restitution is provided in the form of replacement parts.

²² DLA L&M developed a report using EBS data to monitor the status of replacement parts due-in from contractors and was refining the report based on concerns raised during the audit.

DLA L&M Missed Opportunities to Obtain Restitution and Defective Parts Create a Potential Risk for Warfighter Readiness and Safety

Missed Opportunities to Obtain Restitution

When DLA L&M determined that contractors provided defective parts, it did not take the necessary actions to make sure the DoD obtained appropriate restitution. By not completing the necessary actions, DLA L&M missed opportunities to hold poor-performing contractors accountable and for the DoD to obtain the appropriate restitution. We project²³ that DLA L&M did not obtain \$3.4 million in restitution for 267 contracts.

Defective Parts Create a Potential Risk for Warfighter Readiness and Safety

DLA L&M did not adequately search the DoD inventory for defective parts. As a result, DLA L&M did not account for defective spare parts in the DoD supply chain. These defective parts create a potential risk for warfighter readiness and safety. For example, we reviewed a contract for 170 solid rubber wheels used on the MHU munitions transporter. A Navy customer submitted a PQDR for 80 defective wheels, stating that a ridge on the inside of the wheel rubbed on the brake shoes, causing premature wearing on the shoes. The customer noted on the PQDR that the lack of serviceable wheels delayed completion of a depot overhaul program.

In addition to our statistical sample of 64 contracts, we also reviewed 4 of 11 nonstatistically selected contracts with associated PQDRs for items categorized as critical safety items.²⁴ We did not identify problems with three contracts. However, one of the four was a contract for 320,000 O-rings used on multiple aircraft, helicopter, and missile platforms.

Navy and DoD contractor customers generated PQDRs for 3,950 O-rings and noted that the contractor improperly packaged the O-rings in clear bags instead of using either a specialized paper or polyethylene film with an ultraviolet resistant coating (see Figure 7). The improper packaging may decrease the useful life of the O-ring, creating a potential risk to warfighter safety and readiness. The DLA L&M PQDR investigation found that the contract had been improperly awarded to a contractor that was not an approved manufacturer for the O-rings.

²³ See Appendix B for details on the statistical projections.

²⁴ A part, assembly, or support equipment whose failure could cause loss of life, permanent disability or major injury, loss of a system, or significant equipment damage.



Figure 7. Improperly Packaged O-Ring
Source: PDREP.

As part of the PQDR investigation, the DLA L&M quality assurance specialist conducted stock screening and identified 86,283 additional O-rings from the contract in question, leaving 229,767 unaccounted for in the DoD supply chain. However, the DLA L&M quality assurance specialist determined that an alert notification was not necessary. Based on our inquiries in July 2016, DLA L&M conducted an additional stock screening and issued an alert notification. As a result, DLA personnel identified 4 additional O-rings at DLA depots, and as of September 2016, DoD customers had reported 55 additional O-rings as defective on 3 PQDRs.²⁵

DLA Corrective Actions

DLA Headquarters and DLA L&M initiated several corrective actions to improve PQDR processing and to obtain restitution from contractors that provided defective parts. These corrective actions included PQDR policy updates, alert notifications for 18 contracts that were part of our sample,²⁶ and a comprehensive review of PQDRs.

²⁵ This still left 229,708 O-rings unaccounted for in the DoD supply chain.

²⁶ The 18 contracts include 17 contracts from our statistical sample and 1 contract from our nonstatistical sample.

PQDR Policy Updates

DLA L&M officials briefed us on several ongoing initiatives to improve PQDR processing. One initiative involves policy updates and process changes to require early involvement of acquisition personnel in the restitution process. The quality assurance specialist will provide acquisition post-award personnel with the preliminary investigation results, disposition instructions, and restitution recommendations at the start of the PQDR investigation, allowing acquisition personnel to research the records to determine contractual rights and to start the restitution process much earlier than the current process allows.

A second initiative involves policy updates and process changes to require customers to return all deficient parts to specified DLA depots. The current process permits the customer to return defective material directly to the contractor, causing the DLA to lose control of the assets. The new process will require DoD customers to ship all parts identified on the PQDR to a DLA depot. The process will also provide DCMA with instructions for any parts in its control. This initiative will allow a due-in tracking record to be established in the DLA EBS and allow the DLA to maintain control of the material until it arrives at the DLA distribution depot. Both initiatives are scheduled for DLA-wide implementation when complete. DLA issued the standard operating procedure associated with the second initiative in October 2016.

Alert Notifications for Audit Sample Items

DLA L&M issued alert notifications to DoD customers for 18 contracts for which we identified that the quality assurance specialist did not account for all defective parts in the DoD supply chain during the PQDR investigation.

Comprehensive Review of PQDRs

In March 2016, the DLA Director of Logistics Operations directed all DLA primary field-level activities to perform a comprehensive PQDR review. The Director cited the results of our second audit in this series on DLA PQDR processing²⁷ and stated that the purpose of the review was to enhance warfighter support through analyzing existing processes, procedures, and policy for completeness and adherence. The memorandum also directed a review of all PQDRs from January 2014 through March 2016.

DLA L&M quality assurance officials informed us in October 2016 that they reviewed 2,739 contractor noncompliance PQDRs from January 2014 through April 2016 and issued 501 follow-on screening actions, 1,149 follow-on alert notifications, and turned 2,739 PQDRs over to DLA L&M acquisition personnel

²⁷ DODIG-2016-052, "Defense Logistics Agency Aviation Can Improve its Processes to Obtain Restitution From Contractors That Provide Defective Spare Parts," February 23, 2016.

to pursue restitution. In addition, DLA L&M acquisition officials informed us that they had obtained \$3.2 million in restitution. DLA L&M quality assurance officials informed us that they also reviewed 339 PQDRs from May 2016 through August 2016 and issued 38 follow-on screening actions and 86 follow-on alert notifications and turned 187 PQDRs over to DLA L&M acquisition personnel to pursue restitution.²⁸

Conclusion

We identified several deficiencies in DLA L&M's processes for obtaining restitution from contractors that provide defective spare parts. Our projections show that DLA L&M did not obtain \$3.4 million in restitution from contractors that supplied defective parts for 267 contracts. In addition, DLA L&M allowed defective parts to remain in the DoD supply chain. However, if DLA L&M addresses our findings, it can improve its ability to recover funds and to remove defective parts from the DoD supply chain and improve warfighter readiness and safety.

DLA L&M performed a comprehensive review of all PQDRs from January 2014 through August 2016 and is updating its policies and controls over PQDR processing in response to our last audit. However, at the conclusion of this audit, the DLA had not fully implemented those policies and controls. Therefore, until it has fully implemented all corrective actions, DLA L&M should continue to review all contracts with associated PQDRs, for which its PQDR investigations concluded that the contractor provided defective parts. DLA L&M should focus on high-value and mission-critical items, and ensure that prompt action is taken to pursue and obtain appropriate restitution and remove all defective parts from the DoD supply chain.

Recommendations, Management Comments, and Our Response

Recommendation 1

We recommend that the Director, Defense Logistics Agency, develop a plan of action with milestones to improve the agency's process of identifying defective parts, requesting repair and replacement of defective parts, and accepting consideration. The plan should establish controls and oversight and provide sufficient training to ensure Defense Logistics Agency Land and Maritime logistics operations and acquisition personnel:

- a. coordinate in a timely manner to request restitution from contractors that provide defective parts;**

²⁸ DLA L&M provided this information at the end of our audit field work and we did not validate these corrective actions.

- b. adequately search the DoD inventory to identify and remove defective parts;**
- c. return defective parts to responsible contractors for repair or replacement; and**
- d. track the status of defective parts shipped back to contractors and ensure that appropriate restitution is provided in the form of repaired or replaced parts or other means.**

Defense Logistics Agency Comments

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA, agreed, stating that DLA has completed several actions to address concerns with restitution for defective parts. The Deputy Director stated that a Directive Type Memorandum was developed and published in December 2016, which provides high-level enterprise-wide guidance for pursuing restitution. The Deputy Director stated that to meet the intent of the Directive Type Memorandum, DLA L&M developed a cross-process Standard Operating Procedure that provides a structured approach for PQDR investigation with continued engagement throughout the investigation, and provides management and oversight of the process. The Deputy Director stated that DLA L&M developed a control sheet to document key decisions throughout the PQDR process and conducted PQDR training for all Product Specialists and Post Award Acquisition Specialists in January 2017. The Deputy Director also provided details on completed updates to the Enterprise PQDR Deskbook, the Enterprise PQDR Job Aid, the Stock Screening and Alert Job Aids, and the DLA Acquisition Directive. The Deputy Director also provided additional details on the comprehensive review of PQDRs DLA L&M completed in October 2016.

Our Response

Comments from the Deputy Director addressed all specifics of the recommendations; therefore, this recommendation is resolved. We will close this recommendation once we obtain the new and updated guidance and verify that the identified actions have been implemented.

Recommendation 2

We recommend that until corrective actions to improve product quality deficiency report processing are fully implemented, the Director, Defense Logistics Agency, require the Defense Logistics Agency Land and Maritime to continue to review all contracts with associated product quality deficiency reports for which the report investigations concluded that the contractor provided defective parts. The review should focus on high-value and mission-critical items, ensure that prompt action is taken to pursue appropriate restitution, and remove all defective parts from the DoD supply chain.

Defense Logistics Agency Comments

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA, agreed, stating that DLA is reviewing all contracts with associated PQDRs for which the report of investigation concluded that the contractor provided defective parts. DLA Land and Maritime will conduct a monthly review of all completed PQDRs where the discrepancy was attributed to contractor noncompliance, and will provide monthly data on restitution status to DLA Acquisition. The Deputy Director also stated that a PQDR Continuous Process Improvement Event is underway to identify gaps in the Agency's restitution process with a target completion date of December 2017. In addition, the Deputy Director stated that DLA will develop and issue a manual that captures both the high level requirements in DLA's December 2016 Directive Type Memorandum and the detailed execution steps at the DLA Primary Level Field Activities. The target completion date for the manual is June 30, 2017.

Our Response

Comments from the Deputy Director addressed all specifics of the recommendation; therefore, this recommendation is resolved. We will close this recommendation once we obtain details on the monthly reviews of completed PQDRs, the manual scheduled for completion in June 2017, and the results of the gap analysis scheduled for completion in December 2017, and verify that the identified actions have been implemented.

Appendix A

Scope and Methodology

We conducted this performance audit from January 2016 through December 2016 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.

We reviewed the following:

- Federal Acquisition Regulation Part 52, “Solicitation Provisions and Contract Clauses,” Subpart 52.2, “Text of Provisions and Clauses,” Clause 52.246-2, “Inspection of Supplies—Fixed Price”
- Defense Federal Acquisition Regulation Supplement Part 246, “Quality Assurance,” Subpart 246.4, “Government Contract Quality Assurance,” Clause 246.407, “Nonconforming Supplies or Services”
- DLA Regulation 4155.24 / Army Regulation 702-7 / Secretary of the Navy Instruction 4855.5A / Air Force Regulation 74-6, “Product Quality Deficiency Report Program,” July 20, 1993
- DLA Deskbook Appendix B35, “Quality Notifications (QN), Product Quality Deficiency Reports (PQDR),” December 12, 2014
- DLA EBS Job Aid, “DLA Land and Maritime Post Awards Quality Notification (QN) Team Return to Contractor (RTC) Process,” September 2014

We contacted personnel from:

- DLA Headquarters, Fort Belvoir;
- DLA Land and Maritime, Columbus, Ohio; and
- DCMA (headquarters and multiple field offices).

We obtained a population of PQDRs and associated contracts from PDREP for which DLA L&M was the action point. Specifically, we obtained a population of 3,299 PQDRs, which DLA L&M closed from July 1, 2014, through June 30, 2015. These PQDRs were associated with 2,802 contracts. We reviewed deficiency cause codes²⁹ with other deficiency indicators, and concluded that for 421 contracts, the 610 associated PQDRs indicated that the contractor was at fault for the deficiency.

²⁹ A one-digit code that the DLA quality assurance specialist uses to identify the cause of the defective parts, such as contractor noncompliance, Government technical data package, or design error.

We stratified the population of contracts based on a calculated “minimum deficiency value.” PDREP contained the PQDRs and number of defective parts customers reported for our population of contracts. We calculated the minimum deficiency value by multiplying the number of defective items identified in PQDRs for each contract by the item’s sales value. We removed 67 contracts that had a minimum deficiency value less than \$100, which resulted in a sample population of 354 contracts and 534 associated PQDRs.

The DoD Office of Inspector General (DoD OIG) Quantitative Methods Division designed a stratified sample of 64 of the 354 contracts for review.³⁰ The 64 contracts had at least 97 PQDRs because originators sometimes submitted multiple PQDRs for the same deficiency, and the DLA generally combined investigations. In some cases, we also looked at other PQDRs associated with the same contract and stock number.

We reviewed each contract to determine whether DLA L&M personnel adequately processed the associated PQDRs and obtained appropriate restitution from contractors that provided defective parts. We interviewed DLA L&M quality assurance personnel, resolution specialists, acquisition personnel, and other personnel. Specifically, we reviewed associated evidence to determine if DLA L&M personnel took reasonable action to:

- convince the contractor to agree to provide restitution for the defective parts;
- search the DLA and DoD inventories for related defective parts;
- return defective parts to the contractor (if applicable); and
- track parts returned to the contractor to ensure appropriate restitution was obtained.

In addition to our statistical sample of 64 contracts, we also used nonstatistical methods to select 4 contracts for items categorized as critical safety items. Specifically, we obtained a population of 3,299 PQDRs, which DLA L&M closed from July 1, 2014, through June 30, 2015. These PQDRs were associated with 2,802 contracts. We reviewed the population and identified 11 contracts with 17 associated PQDRs for items coded as critical safety items for which DLA L&M verified the defect during the PQDR investigation. We analyzed the PQDR investigations for the 11 contracts for items categorized as critical safety items and identified 4 that warranted further review because DLA L&M may not have accounted for all defective parts in the DoD inventory.

³⁰ See Appendix B for details.

Use of Computer-Processed Data

We used computer-processed data from the U.S. Navy-hosted PDREP and the DLA EBS.

We obtained data from PDREP in the form of contracts with associated PQDRs closed from July 2014 through June 2015. We focused on PQDRs where DLA L&M was the action point for the investigation. To test the reliability of the PDREP data, we reviewed PQDR investigation results and coding to determine if a contractor was responsible for defective parts. We interviewed DLA L&M quality assurance specialists and other responsible DLA L&M personnel and reviewed additional support in the DLA EBS that supported the PQDR investigation results. In addition, we obtained the contracts DoD customers cited on the PQDRs in PDREP and verified the accuracy of the cited contract information for our sample items.

We obtained data from the DLA EBS in the form of stock screening results and inventory receipts, issues, and balance information. To test the reliability of the data, we interviewed DLA L&M quality assurance specialists and other responsible DLA L&M personnel. We determined that the computer-processed data were sufficiently reliable for our purposes.

Use of Technical Assistance

The DoD OIG Quantitative Methods Division designed the stratified statistical sample and projected the results. See Appendix B for detailed information about the work the Quantitative Methods Division performed.

Prior Coverage

During the last 5 years, the DoD OIG issued two reports discussing DLA PQDR processing. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

DoD OIG

Report No. DODIG-2016-052, “Defense Logistics Agency Aviation Can Improve Its Processes to Obtain Restitution From Contractors That Provide Defective Spare Parts,” February 23, 2016

DLA Aviation did not pursue and obtain appropriate restitution from contractors that supplied defective parts. We projected that DLA Aviation did not obtain appropriate restitution for 269 national stock numbers for which contractors provided defective parts. As a result, we projected that DLA

Aviation has not recovered at least \$12.3 million in restitution. In addition, because DLA Aviation personnel did not follow the required steps to pursue and obtain restitution, defective parts were unaccounted for in the DoD supply system, negatively impacting warfighter readiness and safety.

Report No. DODIG-2015-140, "Defense Logistics Agency Can Improve Its Product Quality Deficiency Report Processing," July 1, 2015

DLA Aviation quality assurance personnel conducted adequate investigations for 49 of the 52 PQDR investigations we nonstatistically selected. However, personnel did not select the right code to properly identify the root causes of the deficiencies determined by their investigations for 21 of the 52 PQDR investigations. In addition, the cause codes assigned in EBS and PDREP differed for 17 of the 52 PQDR investigations in our sample and for a total of 1,921 of the 9,347 PQDRs that DLA supply chains closed between August 2013 and August 2014.

Inaccurate data on the results of PQDR investigations limits the effectiveness of the DoD PQDR Program and prevents meaningful analysis of the primary causes of spare part quality deficiencies. In addition, inaccurate data weakens the DLA's ability to hold contractors responsible for providing nonconforming parts because contractor evaluation tools such as PPIRS contain incomplete data. Ultimately, this increases the risk of DoD procuring nonconforming spare parts from contractors, which impacts warfighter readiness and safety.

Appendix B

Statistical Sampling Methodology and Analysis

Population

We obtained a population of 3,299 PQDRs, for which DLA L&M was the action point, and which were closed from July 1, 2014, through June 30, 2015. These PQDRs were associated with 2,802 contracts. We reviewed deficiency cause codes with other deficiency indicators, and concluded that for 421 contracts, the 610 associated PQDRs indicated that the contractor was at fault for the deficiency. In addition, because it was not cost-effective to review them, we removed all contracts from the population that had a minimum deficiency value of less than \$100, which reduced the population to 354 contracts and 534 associated PQDRs.

Measures and Parameters

For the 64 contracts reviewed, we determined whether DLA L&M reported the contractor at fault for the deficiency and if DLA L&M obtained appropriate restitution. We used a 90-percent confidence interval.

Sample Plan

The DoD OIG Quantitative Methods Division designed a stratified sampling plan for this project. We stratified the population into four groups and selected the sample shown in Table 2.

Table 2. Stratified Population and Sample

Stratum and Description	Sample	Population
I. Minimum Deficiency > = \$20,000	30	30
II. Minimum Deficiency > = \$10,000 < \$20,000	9	23
III. Minimum Deficiency > = \$1,000 < \$10,000	15	147
IV. Minimum Deficiency > = \$100 < \$1,000	10	154
Total	64	354

Statistical Analysis and Interpretation

Based on the audit results for the 64 contracts we reviewed from the population that we provided to DoD OIG Quantitative Methods Division analysts, we calculated the following statistical projections for the number of contracts where the contractor was at fault for the defective parts and where DLA L&M did not obtain appropriate restitution as shown in Table 3.

Table 3. Statistical Projections for 64 Contracts Reviewed

Type of Projection	Lower Bound	Point Estimate	Upper Bound
Number of Contracts	221	267	312
Value of Restitution Not Obtained	\$3,034,293	\$3,437,589	\$3,840,885

Note: Projections are based on a 90-percent confidence level.

We are 90-percent confident that the number of contracts for which the contractor was at fault for the defective parts and for which DLA L&M did not obtain appropriate restitution is between 221 and 312 with a point estimate of 267. We are also 90-percent confident that the dollar amount of restitution that DLA L&M did not obtain is between \$3,034,293 and \$3,840,885 with a point estimate of \$3,437,589.

Appendix C

Federal Acquisition Regulation Clause 52.246-2

Inspection of Supplies—Fixed-Price (Aug 1996)

(a) Definition. “Supplies,” as used in this clause, includes but is not limited to raw materials, components, intermediate assemblies, end products, and lots of supplies.

(b) The Contractor shall provide and maintain an inspection system acceptable to the Government covering supplies under this contract and shall tender to the Government for acceptance only supplies that have been inspected in accordance with the inspection system and have been found by the Contractor to be in conformity with contract requirements. As part of the system, the Contractor shall prepare records evidencing all inspections made under the system and the outcome. These records shall be kept complete and made available to the Government during contract performance and for as long afterwards as the contract requires. The Government may perform reviews and evaluations as reasonably necessary to ascertain compliance with this paragraph. These reviews and evaluations shall be conducted in a manner that will not unduly delay the contract work. The right of review, whether exercised or not, does not relieve the Contractor of the obligations under the contract.

(c) The Government has the right to inspect and test all supplies called for by the contract, to the extent practicable, at all places and times, including the period of manufacture, and in any event before acceptance. The Government shall perform inspections and tests in a manner that will not unduly delay the work. The Government assumes no contractual obligation to perform any inspection and test for the benefit of the Contractor unless specifically set forth elsewhere in this contract.

(d) If the Government performs inspection or test on the premises of the Contractor or a subcontractor, the Contractor shall furnish, and shall require subcontractors to furnish, at no increase in contract price, all reasonable facilities and assistance for the safe and convenient performance of these duties. Except as otherwise provided in the contract, the Government shall bear the expense of Government inspections or tests made at other than the Contractor’s or subcontractor’s premises; provided, that in case of rejection, the Government shall not be liable for any reduction in the value of inspection or test samples.

(e)

(1) When supplies are not ready at the time specified by the Contractor for inspection or test, the Contracting Officer may charge to the Contractor the additional cost of inspection or test.

(2) The Contracting Officer may also charge the Contractor for any additional cost of inspection or test when prior rejection makes reinspection or retest necessary.

(f) The Government has the right either to reject or to require correction of nonconforming supplies. Supplies are nonconforming when they are defective in material or workmanship or are otherwise not in conformity with contract requirements. The Government may reject nonconforming supplies with or without disposition instructions.

(g) The Contractor shall remove supplies rejected or required to be corrected. However, the Contracting Officer may require or permit correction in place, promptly after notice, by and at the expense of the Contractor. The Contractor shall not tender for acceptance corrected or rejected supplies without disclosing the former rejection or requirement for correction, and, when required, shall disclose the corrective action taken.

(h) If the Contractor fails to promptly remove, replace, or correct rejected supplies that are required to be removed or to be replaced or corrected, the Government may either

(1) by contract or otherwise, remove, replace, or correct the supplies and charge the cost to the Contractor; or

(2) terminate the contract for default. Unless the Contractor corrects or replaces the supplies within the delivery schedule, the Contracting Officer may require their delivery and make an equitable price reduction. Failure to agree to a price reduction shall be a dispute.

(i)

(1) If this contract provides for the performance of Government quality assurance at source, and if requested by the Government, the Contractor shall furnish advance notification of the time –

(i) When Contractor inspection or tests will be performed in accordance with the terms and conditions of the contract; and

(ii) When the supplies will be ready for Government inspection.

(2) The Government's request shall specify the period and method of the advance notification and the Government representative to whom it shall be furnished. Requests shall not require more than 2 workdays of advance notification if the Government representative is in residence in the Contractor's plant, nor more than 7 workdays in other instances.

(j) The Government shall accept or reject supplies as promptly as practicable after delivery, unless otherwise provided in the contract. Government failure to inspect and accept or reject the supplies shall not relieve the Contractor from responsibility, nor impose liability on the Government, for nonconforming supplies.

(k) Inspections and tests by the Government do not relieve the Contractor of responsibility for defects or other failures to meet contract requirements discovered before acceptance. Acceptance shall be conclusive, except for latent defects, fraud, gross mistakes amounting to fraud, or as otherwise provided in the contract.

(l) If acceptance is not conclusive for any of the reasons in paragraph (k) hereof, the Government, in addition to any other rights and remedies provided by law, or under other provisions of this contract, shall have the right to require the Contractor

(1) at no increase in contract price, to correct or replace the defective or nonconforming supplies at the original point of delivery or at the Contractor's plant at the Contracting Officer's election, and in accordance with a reasonable delivery schedule as may be agreed upon between the Contractor and the Contracting Officer; provided, that the Contracting Officer may require a reduction in contract price if the Contractor fails to meet such delivery schedule; or

(2) within a reasonable time after receipt by the Contractor of notice of defects or nonconformance, to repay such portion of the contract as is equitable under the circumstances if the Contracting Officer elects not to require correction or replacement. When supplies are returned to the Contractor, the Contractor shall bear the transportation cost from the original point of delivery to the Contractor's plant and return to the original point when that point is not the Contractor's plant. If the Contractor fails to perform or act as required in (1) or (2) above and does not cure such failure within a period of 10 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of notice from the Contracting Officer specifying such failure, the Government shall have the right by contract or otherwise to replace or correct such supplies and charge to the Contractor the cost occasioned the Government thereby.

(End of Clause)

Management Comments

Defense Logistics Agency



DEFENSE LOGISTICS AGENCY
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JAN 18 2017

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL
(Acquisition and Sustainment Management)

SUBJECT: Response to DODIG Draft Report, "Defense Logistics Agency Land and Maritime Can Improve Its Processes to Obtain Restitution From Contractors That Provide Defective Spare Parts," Project No. D2016-D000AG-0085.000

Attached is the Defense Logistics Agency's (DLA) response to the subject Draft Report. We appreciate the opportunity to review and comment on the findings and recommendations. Management comments and recommendations are outlined in the attachment.

The point of contact for this audit is [REDACTED]


MICHAEL D. SCOTT
Deputy Director
DLA Logistics Operations

Attachment:
As stated

Defense Logistics Agency (cont'd)

DLA RESPONSE - DRAFT REPORT FOR DOD IG PROJECT NUMBER D2016-D000AG-0085.000

Recommendation 1

We recommend that the Director, Defense Logistics Agency, develop a plan of action with milestones to improve the agency's process of identifying defective parts, requesting repair and replacement of defective parts, and accepting consideration. The plan should establish controls and oversight and provide sufficient training to ensure Defense Logistics Agency Land and Maritime logistics operations and acquisition personnel:

- a. coordinate in a timely manner to request restitution from contractors that provide defective parts
- b. adequately search the DoD inventory to identify and remove defective parts
- c. return defective parts to responsible contractors for repair or replacement
- d. track the status of defective parts shipped back to contractors and ensure that appropriate restitution is provided in the form of repaired or replaced parts or other means

DLA Response - Recommendation 1

CONCUR. DLA has completed several actions to address concerns with restitution for defective parts.

- A Directive Type Memorandum (DTM 16-016) was developed and published December 6, 2016. This DTM provides high-level enterprise-wide guidance for pursuing restitution. Restitution may include repair, replacement or credit. DLA Land and Maritime has developed a cross-process Standard Operating Procedure (SOP) to meet the intent of DTM 16-016. The SOP provides a structured approach for PQDR investigation with continued engagement throughout the PQDR investigation, and provides management and oversight of the process. They have also developed a control sheet to document key decisions throughout the PQDR process. PQDR training for all Product Specialists and Post Award Acquisition Specialists was conducted in January 2017 to address the new procedures for PQDR processing and exhibit returns.
- The Enterprise PQDR Deskbook (October 28, 2016) and Enterprise PQDR Job Aid (October 25, 2016) were updated to ensure that the Technical/Quality community informs the Acquisition Community on all PQDRs received, and provides Acquisition with all available information to pursue restitution on PQDRs where the deficiency is due to a contractor noncompliance. In addition, these documents along with the Stock Screening Alert Job Aid (October 25, 2016) and Alert Job Aid (July 18, 2016) were updated to ensure that all actions needed to address removal of deficient materiel were defined in policy documents. Policy updates also included instruction to ensure that shipment of all exhibits associated with PQDR return and shipment to contractors could be tracked. DLA Land and Maritime updated and implemented additional local screening and alert policies along with the corresponding Acquisition Guide and Post Award Return to Vendor job aids to further define responsibilities in the PQDR process. These documents provide additional instruction and guidance to the Product Specialist for issuing and documenting stock screening and alert notifications.
- DLA has revised DLAD Part 46 (PROCLTR 2017-02 dated 07 NOV 2016) with additional language on seeking restitution and adding enterprise compliance reviews. If a PQDR cause

Defense Logistics Agency (cont'd)

DLA RESPONSE - DRAFT REPORT FOR DOD IG PROJECT NUMBER D2016-D000AG-0085.000

is associated to contractor noncompliance, the contracting officer is required request repair, replacement, or a refund for the defective part, as determined most beneficial to the Government. Contracting Officers also are to make appropriate determinations for potential listing on the Defense Contractor Review List for contractors that repeatedly provide defective parts. DLA Land and Maritime has created three new task codes to aid in tracking PQDRs. They address the oversight, handoff, and processing of the exhibit, accounting for repayment, and credit memos.

- Each Primary Level Field Activity (PLFA) was directed to review PQDRs dating from January 2014 to present and ensure that all actions needed to remove deficient stock from inventory had been and are being accomplished. DLA Land and Maritime completed 100% of their comprehensive reviews on parent PQDR cases in early October 2016. They have completed actions to purge 65% of their defective stock from inventory.
- For restitution, DLA Land and Maritime reviewed 2739 PQDR cases which resulted in 6495 quality notifications (QNs) (this count based on parent (PQDR)/child (QN) relationship). To date, they have received restitution in the amount of \$97,306.82. They have also requested \$5,215,295.79 in replacement parts and received \$3,095,755.42 of that amount. They have determined that 43% of their cases are not candidates for restitution. Cases that were not candidates for restitution includes those where:
 - No further action can be taken on restitution (e.g., contractor is no longer in business, warranty period has expired and items were ultimately found to be other than contractor-at-fault)
 - Items were being reviewed for legal action (e.g., suspected counterfeit material or unauthorized substitution).
 - Disposal was recommended.

Recommendation 2

We recommend that until corrective actions to improve product quality deficiency report processing are fully implemented, the Director, Defense Logistics Agency, require the Defense Logistics Agency Land and Maritime to continue to review all contracts with associated product quality deficiency reports for which the report investigations concluded that the contractor provided defective parts. The review should focus on high-value and mission-critical items, ensure that prompt action is taken to pursue appropriate restitution, and remove all defective parts from the DoD supply chain.

DLA Response Recommendation 2

CONCUR. DLA is reviewing all contracts with associated PQDRs for which the report investigations concluded that the contractor provided defective parts, with the focus on high-value and mission critical items. DLA Land and Maritime will conduct a monthly review of all completed PQDRs where the discrepancy was attributed to contractor noncompliance. Per the requirements of DLAID 46.407(b) (as revised by DLA HQ J7, November 7, 2016 by PROC LTR 2017-02) monthly data on restitution status will be provided to DLA Acquisition. DLA Land and Maritime has also established managerial review processes to monitor supply chain compliance to established policy and procedures.

Defense Logistics Agency (cont'd)

DLA RESPONSE - DRAFT REPORT FOR DOD IG PROJECT NUMBER D2016-D000AG-0085.000

DLA will ensure that actions are taken to pursue appropriate restitution, and all actions associated with removal of defective parts from the DoD Supply Chain are completed. DLA is continuing actions on coordination to request restitution: 1) A PQDR Continuous Process Improvement (CPI) event is underway to identify gaps in the Agency's restitution process, target completion for the CPI is December, 2017; 2) DLA will develop and issue a Manual that captures both the high level requirements that were in the December DTM and the detailed execution steps at the DLA Primary Level Field Activities (PLFAs), target completion is June 30, 2017.

Acronyms and Abbreviations

DCMA	Defense Contract Management Agency
DLA	Defense Logistics Agency
DoD OIG	Department of Defense Office of Inspector General
EBS	Enterprise Business System
L&M	Land and Maritime
PDREP	Product Data Reporting and Evaluation Program
PQDR	Product Quality Deficiency Report

Whistleblower Protection

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