Audit Report

OFFICE OF THE INSPECTOR GENERAL

PRICE CHALLENGES ON SELECTED SPARE PARTS

Report No. 96-035 December 12, 1995

Department of Defense

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Acronyms

DLA	Defense Logistics Agency
FAR	Federal Acquisition Regulation
NSN	National Stock Number

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

December 12, 1995

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Price Challenges on Selected Spare Parts (Report No. 96-035)

We are providing this report for review and comment. This is the second of two reports from our audit of allegations to the Defense Hotline involving spare parts procurements. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments, we revised Findings A and B and Recommendations B.1.a. and B.2. Navy comments on a draft of this report were responsive to all recommendations. DLA comments were responsive to Recommendation B.1.d. We request that the Defense Logistics Agency provide comments on unresolved Recommendations B.1.a., B.1.b., B.1.c., and B.2 by February 12, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Garold E. Stephenson, Audit Program Director, at (703) 604-9332 (DSN 664-9332) or Mr. Eugene E. Kissner, Audit Project Manager, at (703) 604-9323 (DSN 664-9323). See Appendix J for the report distribution. The audit team members are listed inside the back cover.

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Report No. 96-035 **December 12, 1995**
(Project No. 4CH-8010.01)

Price Challenges on Selected Spare Parts

Executive Summary

Introduction. This report is the second of two reports performed in response to allegations to the Defense Hotline concerning spare parts procurements by the Naval Aviation Supply Office and the Defense Logistics Agency. The first report (95-288) discussed the Navy source approval process for critical safety items for the F404 engine. From January 1988 through September 1994, DoD spent about $33.6 million to procure the 45 judgmentally selected spare parts that we evaluated.

Audit Objectives. The audit objectives were to evaluate the alleged overpricing of selected spare parts procured by the Naval Aviation Supply Office and the Defense Logistics Agency. We also evaluated the adequacy of the management control program as applicable to the pricing of contracts for spare parts.

Audit Results. Both allegations had merit.

o The Navy had made many improvements to the price challenge program in recent years. However, the Navy provided inadequate responses to 24 of 45 judgmentally selected price challenges submitted under the Buy Our Spares Smart price challenge program. As a result, unreasonable pricing of spare parts was not detected, and the undetected unreasonable prices may be used as a basis to justify prices for future procurements. Additionally, the price challengers were dissatisfied with the Navy responses and may decline to challenge suspected unreasonable prices in the future (Finding A).

o The Naval Aviation Supply Office and the Defense Construction, Defense General, and Defense Industrial Supply Centers paid unreasonable prices on 63 procurements of 24 of 45 price-challenged spare parts valued at $30.8 million. The prices paid ($0.6 million) for 13 of the 45 parts were reasonable. We were unable to determine the reasonableness of the prices paid ($2 million) for 8 of the 45 spare parts. The excessive pricing of the 24 unreasonably priced spare parts amounted to $15.8 million, about 47 percent of $33.6 million paid for the 45 parts evaluated. About $15.6 million (99 percent) of the excessive pricing is attributable to 5 parts procured at the Naval Aviation Supply Office, and about $0.2 million is attributable to 19 parts procured by 3 Defense Logistics Agency buying centers (Finding B).

The results of the audit are not statistically projectable to all procurements by the buying centers identified or to all DoD procurements. We have no basis to conclude that spare parts pricing problems are widespread. The price challengers suspected the spare parts procurements that we reviewed of being unreasonably priced and, therefore, we expected the procurements to have a higher percentage of unreasonable prices than would a statistical sample of spare parts procurements.

Recommendations in this report, if implemented, should reduce the number of unreasonably priced spare parts procurements, and could result in voluntary refunds from contractors for previous unreasonably priced procurements. However, we could not quantify the potential monetary benefits (Appendix H).

Summary of Recommendations. We recommend evaluation or appropriate forwarding of all price challenges received, and complete, accurate responses to the challenges. We also recommend issuing additional guidance for spare parts procurements that requires contracting officers to:

o obtain and consider independent Government estimates, field pricing support, and price comparisons for determining fair and reasonable prices and for establishing prenegotiation price objectives; and

o include alternate sources in source lists and solicit the new sources.

We also recommend that the Defense Industrial Supply Center perform a postaward pricing review of a contractor who made an unreasonably priced sale to the supply center through its automated purchasing systems.

Management Comments. The Navy agreed that 11 of 24 price challenge responses were inadequate but stated that the other 13 responses were adequate. The Navy generally agreed with recommendations concerning responses to price challenges. The Defense Logistics Agency concurred that 3 of 24 parts were unreasonably priced by about $21,000 but did not agree that the other 21 parts were unreasonably priced. The Navy concurred and the Defense Logistics Agency partially concurred with all recommendations on issuing guidance for spare parts procurements. The Defense Logistics Agency stated that the recommendations do not apply to it because the audit did not identify any instances in which Defense Logistics Agency contracting officers failed to use the recommended techniques when required by regulation to do so. The Defense Logistics Agency stated that it will discuss the specifics of entering qualified alternate sources in source lists and soliciting the new sources during its next scheduled value engineering program managers meeting. The Defense Logistics Agency will issue a letter summarizing the discussion and decisions reached. The Defense Logistics Agency partially concurred with the recommendation to conduct postaward pricing reviews of contractors who sold overpriced spares to the Defense Logistics Agency. See Part I for a summary of management comments on the recommendations; see Appendixes D and G in Part II for a summary of management comments on the findings; and see Part III for the complete text of management comments.

Audit Response. Based on our evaluation of the management comments, we reduced the number of inadequate price challenge responses from 30 to 24 and the number of unreasonably priced parts from 29 to 24. We also reduced the amount of potential overpricing from $15.9 million to $15.8 million. Actions by the Defense Logistics Agency over the seven years of purchases did resolve some overpricing of the items, but there was overpricing at a point in time. We revised one recommendation to clarify that contracting officers should obtain independent Government estimates when feasible to do so, and another to delete postaward pricing reviews of two contractors. The Navy comments were responsive to all recommendations. The Defense Logistics Agency comments were responsive to the recommendation on soliciting qualified sources identified through price challenges. For the reasons discussed in Part I of the report, we still believe that the other recommendations addressed to the Defense Logistics Agency require additional actions. We request that the Defense Logistics Agency provide final comments on the unresolved recommendations by February 12, 1996.

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Part I - Audit Results

Audit Background

This report is the second of two reports from our audit performed in response to allegations to the Defense Hotline involving spare parts procurements. The first report (95-288) discusses allegations concerning the Navy source approval process for critical safety items for the F404 engine and other procurement practices at the Naval Aviation Supply Office. This report discusses allegations that Navy responses to price challenges were inadequate and that certain spare parts were unreasonably priced. The Naval Aviation Supply Office and four Defense Logistics Agency (DLA) buying centers purchased the spare parts included in the allegations. The four DLA buying centers were the Defense Construction Supply Center (Construction Supply), the Defense Electronics Supply Center (Electronics Supply), the Defense General Supply Center (General Supply), and the Defense Industrial Supply Center (Industrial Supply). The Defense Plant Representative Office, Boeing Defense and Space Group, Helicopter Division (Defense Plant Representative Office Boeing), negotiated the prices of five of the parts purchased by the Naval Aviation Supply Office. From January 1988 through September 1994, DoD spent about $33.6 million to procure the 45 judgmentally selected parts that we examined. Appendix B summarizes prior audits of pricing of spare parts procurements.

Supply System Prices. The DoD supply system is financed through the Defense Business Operation Fund. A basic tenet of the Defense Business Operation Fund is that prices should reflect the actual cost of providing goods and services to customers. The DoD buying centers base their prices to supply system customers on the buying center's most recent acquisition cost, plus a percentage applied to the acquisition cost of each item (a surcharge). The surcharge is intended to recover the costs of getting the items into stock and issued. Since the inception of the Defense Business Operation Fund in FY 1991, the types of expenses to be recovered through the surcharge have increased to include such indirect expenses as data processing costs and Defense Finance and Accounting Service costs.

Acquisition Pricing Requirements. The Armed Services Pricing Manual, the Federal Acquisition Regulation (FAR), and the Defense Federal Acquisition Regulation Supplement require contracting officers to ensure that prices paid for spare parts are fair and reasonable. Appendix C summarizes the requirements for determining fair and reasonable prices.

Audit Objectives

The audit objectives were to evaluate the timeliness of the Navy technical qualification process (the source approval process) for contractors requesting approval to supply critical safety items to the Navy for the F404 engine and to evaluate alleged overpricing of selected spare parts procured by the Naval

Aviation Supply Office and DLA. This report discusses allegations concerning the Navy responses to price challenges and the reasonableness of prices for selected spare parts procured by the Naval Aviation Supply Office and DLA. We also evaluated the adequacy of the management control program as applicable to the pricing of contracts for spare parts. See Appendix A for a discussion of the review of the management control program. The first report discussed the objective concerning the Navy source approval process for critical safety items for the F404 engine and the management control program related to that objective.

Finding A. Responses to Price Challenges

The Navy (the Navy Fleet Material Support Office and, to a lesser extent, the Navy Price Fighter Department) provided inadequate responses to price challenges submitted under the Buy Our Spares Smart price challenge program. The inadequate responses occurred because the Navy and the cognizant buying centers did not always:

o determine whether the challenged prices were fair and reasonable,

o answer all issues raised in the price challenges, or

o communicate results of price challenge evaluations to the price challengers.

As a result, unreasonable pricing of spare parts was not detected, and the unreasonable prices paid may be mistakenly used as a reasonable cost basis to justify prices for future procurements. Additionally, price challengers were dissatisfied with responses and may decline to challenge suspected unreasonable prices in the future.

The Navy Buy Our Spares Smart Price Challenge Program

The Navy Buy Our Spares Smart Price Challenge Program invites Navy employees to submit a price challenge on any supply system item that the employee believes is unreasonably priced. The Navy "Price Challenge Hotline Operations Manual" requires that the Navy determine, for each price challenge received, whether the item was fairly and reasonably priced. The determination is to be given to the price challenger in a response letter that specifically answers the price challenger's inquiry. The price challenger is to receive a cash bonus for challenges that result in significant savings to the Government.

Until April 1994, price challenges from Navy and Marine Corps personnel were processed by the Navy Fleet Material Support Office, Mechanicsburg, Pennsylvania. In April 1994, responsibility for the price challenge program was transferred to the Navy Price Fighter Department of the Navy Fitting Out and Supply Support Assistance Center, Norfolk, Virginia. The Navy Price Fighter Department made many improvements to the price challenge program after the transfer to increase customer satisfaction with its responses to price challenges. The improvements include better communications with fleet customers and the publication of a November 1994 operations manual that, among other things, explains how to properly respond to price challenges.

Processing Price Challenges

Generally, the Navy evaluated price challenges by reviewing in-house information on the items and by consulting with the item managers at the buying centers. In cases where an item's price had been challenged at least three times, and in cases where common sense indicated that an item was grossly overpriced, the Navy would request that the Price Fighter Department perform a should-cost analysis (an independent Government estimate) to provide a benchmark price for use in negotiations with the contractor. Upon completion of its evaluation, the Navy prepared a letter advising the challenger of the results of the Navy review and authorized payment of any monetary award warranted.

Responses to Price Challenges

The Navy responses to 24 of the 45 judgmentally selected price challenges that we evaluated were inadequate. For the most part, the responses cited the year, the quantity, the unit acquisition price charged by the contractor, and the surcharge applied to the acquisition price as evidence that the price to the supply system customer (the challenged price) was a reasonable price. The Navy and the buying centers did little to determine whether the acquisition prices charged by the contractors were fair and reasonable. Also, the responses often did not answer the issues raised by the price challenger, or did not communicate the results of reviews performed as a result of the price challenges.

The unreasonable prices identified during the audit are discussed in Finding B, and the inadequate responses to the price challenges are discussed in this finding. Table 1 categorizes the 24 inadequate price challenge responses by the primary cause of the inadequate response. Most of the responses were inadequate because the Navy and the buying centers did not, after receipt of the price challenges, determine whether the prices that the contractors charged for the parts were fair and reasonable.

Table 1. Causes of Inadequate Price Challenge Responses

Primary Cause	Number of Challenges
Reasonableness not determined	18
Reasonableness not determined and results not communicated	1
Issues not answered	4
Results not communicated	1

Determining Whether Contractor Prices Were Fair and Reasonable. Of the 24 inadequate price challenge responses, 19 responses were inadequate because the Navy and the buying centers did not determine whether the prices that the contractors charged for the parts were fair and reasonable. The 19 parts were

unreasonably priced. Table 2 shows the reasons that the Navy and the buying centers did not determine that the prices for the 19 parts were unreasonable.

Table 2. Reasons That Unreasonable Prices Were Not Determined

Reasons	Number of Responses
Government estimate not used	4
Alternate source not solicited	8
Alternate source not solicited and price increase not analyzed	3
Price increase not analyzed	4

Using Government Estimates. The Navy Price Fighter Department prepared independent Government estimates for 4 of the 19 price challenged parts (National Stock Numbers [NSNs] 1560-00-761-7929, 1560-00-172-2722, 1560-00-073-1158, and 3040-00-073-6915), but the buying centers did not use the independent Government estimates to evaluate contractor prices. The Navy response to the price challenger on one of the four parts stated that the price was fair and reasonable based on the contractor's price to the Government and the Government surcharge. The independent Government estimate showed that the part was unreasonably priced. The Navy responses on the other three price challenges stated that independent Government estimates would be prepared and that the challengers would be informed of the results. The challengers were not informed of the results of the independent Government estimates, which showed that the parts were unreasonably priced.

Soliciting Alternate Source. For 11 of the 19 price challenges that had an inadequate response because the prices that the contractor charged were not evaluated, the price challenger identified another qualified source with lower prices for the parts. The Navy responses to the price challengers did not acknowledge that the challenged prices were unreasonable. The Navy responses either stated that the challenged prices were fair and reasonable or did not comment on the reasonableness of the challenged prices. The Navy also sent letters to the buying centers with a copy to the price challenger that questioned the significant differences between the prices paid and the quotes provided by the price challenger and recommended the buying centers obtain refunds from the suppliers when appropriate. The Navy responses for the 11 parts stated that the source identified by the challenger would be added to the solicitation list for future procurements of the parts.

Analyzing Price Increases. For 7 of the 19 price challenges, neither the Navy nor the buying centers evaluated increases to the challenged prices, even though procurement history documents showed contractor price increases ranging from 55 percent to 492 percent over previous procurement prices. Of the seven parts, three are also discussed under "Soliciting Alternate Source" because the Navy responses to the price challenges did not acknowledge that the parts were unreasonably priced because the parts were available from another qualified source at lower prices. Additionally, one of the seven parts is also discussed under "Communicating Results of Price Challenge Evaluations"

because the Navy response did not state the results of the price challenge evaluation. The Navy responses to the price challenges stated that the prices for the seven parts were fair and reasonable based on contractor prices plus mandatory Government surcharges.

When the Navy receives price challenges that concern contractor prices, the cognizant buying center should determine whether or not the contractor prices were fair and reasonable. The determination could result in refunds from the contractors and could prevent unreasonable prices on subsequent procurements of the parts. The Navy responses to the price challengers should state whether or not the parts were unreasonably priced and should state any actions taken as a result of the price challenge.

Answering Issues Presented in Price Challenges. Of the 24 inadequate price challenge responses, 4 responses were inadequate because the Navy did not address all the issues raised by the challenger.

Discussing Data Provided by the Price Challengers. The Navy responses to one of the four price challenges did not discuss funding and technical data provided by the challenger.

On a price challenge on a link assembly (NSN 1560-00-918-4601) procured by the Naval Aviation Supply Office, the challenger stated that the actual price for the part was $58 and provided a funding document and the contractor's drawing for the part. The Navy response quoted the price that the Government paid, quoted the Government surcharges, and stated that, based on available data, the $223-challenged price was fair and reasonable. The response did not address the funding and technical data that the price challenger forwarded to the Fleet Material Support Office with the price challenge. The data were not in the files at the Naval Aviation Supply Office, and the Naval Aviation Supply Office price challenge official stated that the Fleet Material Support Office probably did not send the data to the Naval Aviation Supply Office.

Forwarding Suggestions to the Appropriate Activity. The Navy responses to two of the four challenges did not forward suggestions by the price challengers to the command authorized to evaluate the suggestions. Both price challenges suggested alternative manufacturing processes to achieve lower prices. On a price challenge on a fixed capacitor (NSN 5910-00-781-4797) procured by Electronics Supply, the price challenger stated that the using activity could produce the fixed capacitor by making minor alterations to a less expensive part. On a price challenge on a junction box cover (NSN 5975-00-435-0133) procured by General Supply, the price challenger recommended that the junction box cover be made of plastic rather than plastic and fiberglass. The Navy responses stated that, based on available data, the prices were fair and reasonable and advised the challengers to submit their suggestions to the Naval Air Systems Command for evaluation. To ensure that all suggestions by price challengers are evaluated, the Navy should forward suggestions requiring additional evaluation to the appropriate command as part of the price challenge process.

Addressing Acquisition Alternatives. On a price challenge on the fourth part, an electronic tube (NSN 5960-01-126-4506) procured by Electronics Supply, the price challenger stated that the electronic tube was available to the price challenger from the manufacturer for the same price that Electronics Supply paid, and the price challenger queried whether the challenger could purchase the part directly from the manufacturer to avoid the high surcharges added by Electronics Supply. The Navy response explained the need for the surcharges but did not discuss whether the challenger could purchase the part from the manufacturer. On a subsequent challenge, the price challenger stated that, because of short shelf life, the electronic tube should be shipped directly from the manufacturer to the user without being stored by Electronics Supply. The second Navy response did not provide any information on the short shelf life or on whether or not the challenger should purchase the tube directly from the manufacturer. The response merely restated the reasons for the surcharge and enclosed an explanation of the surcharge structure.

Each issue raised in a price challenge is important to the price challenger and deserves an answer. Researching the issues to provide answers could result in refunds on overpriced procurements and avoidance of future overpriced procurements. In addition to answering each issue raised by price challengers, the Navy should forward price challenges that contain suggestions requiring additional evaluation to the appropriate activity for action instead of returning the price challenge to the challenger, who may not have the time or the inclination to further pursue the issue.

Communicating Results of Price Challenge Evaluations. Of the 24 inadequate price challenge responses, 2 responses were inadequate because the Navy did not communicate the results of its price challenge evaluations to the challengers. Of the two responses, one response (NSN 4810-01-041-2285) is included under "Analyzing Price Increases" because the response was also inadequate in that it did not discuss a large price increase over the price of the previous procurement of the part.

The Navy response on the price challenge on an orifice disk (NSN 4810-01-041-2285) procured by Construction Supply did not inform the challenger that an independent Government estimate performed by Construction Supply personnel showed that the part should cost $66, as opposed to the $284 that Construction Supply paid for the part. The response also did not reveal that Construction Supply lowered the supply system price of the part to conform to the independent Government estimate. Construction Supply contracting officials stated that they believed that revealing the results of the independent Government estimate would have confused the price challenger. We disagree. Telling the price challenger that the challenged price is reasonable, when the price challenger has correctly concluded otherwise, is misleading.

The Navy response on the price challenge on a bracket (NSN 5340-01-063-1288) procured by Industrial Supply did not state that the Navy evaluation of the price determined that the price was unreasonable. The response also did not tell the price challenger that, as a result of the price challenge, Industrial Supply obtained a voluntary refund from the contractor.

Navy responses to price challenges should communicate the results of price challenge evaluations and fully disclose the reasons for any actions taken or not taken as a result of the price challenge. Inclusion of the evaluation results and the reasons for actions taken or not taken will help the challenger understand the response to the price challenge, and will encourage future submission of price challenges on suspected unreasonably priced parts.

Effects of Responses to Price Challenges

As a result of the inadequate responses to price challenges, overpricing of spare parts was not detected. Also, because comparison with prior prices is often a factor in determining fair and reasonable prices, undetected overpricing on a current procurement could result in overpriced future procurements. Additionally, price challengers were discouraged by the inadequate responses to their price challenges. An official at the Naval Aviation Depot, Cherry Point, North Carolina, stated that the number of price challenges from that activity has fallen considerably because supply system customers (personnel who use the parts) have become discouraged by inadequate responses to their price challenges.

We believe that responses to price challenges that tell the price challenger whether the challenge was correct, that identify any overpricing found, and that clearly explain actions taken or not taken as a result of the price challenge will encourage personnel who use the parts to challenge suspected unreasonably priced parts. Continuing price challenges from supply system customers is important because evaluation of the price challenges often reveals previously unidentified overpricing. The DoD buying centers paid unreasonable prices to contractors on procurements of 24 of the 45 spare parts that we reviewed (see Finding B).

On September 26, 1994, DLA issued guidance on price challenges to be implemented by DLA headquarters and all DLA buying centers in January 1995. The guidance, when fully implemented, will improve the processing of price challenges and the problems with DLA evaluations of price challenges, and DLA input to the responses to price challenges discussed in this report will be corrected. Therefore, we are not including a recommendation to DLA.

Management Comments on the Finding and Audit Response

The Navy commented extensively on the finding. See Appendix D for a summary of the Navy comments and the audit response.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Commander, Naval Supply Systems Command, issue policy guidance that requires buying centers to evaluate price challenges received through the Navy price challenge program and provide input for the price challenge responses that is accurate and responsive to all issues raised by the price challengers.

Navy Comments. The Navy concurred, stating that guidance for Navy buying centers on the price challenge program exists in Naval Supply Systems Command Instruction 5400.11, "Implementation of Project BOSS in the Naval Material Establishment," October 16, 1987, and that letter guidance would be issued to reemphasize this policy by September 30, 1995, to ensure that Navy inventory control point personnel (buying center personnel) respond promptly and accurately to price challenge hotline requests for information. Additionally, the Naval Supply System Command memorandum of agreement with DLA will be amended during the next review cycle to incorporate the requirement for processing promptly and accurately Navy pricing inquiries received by DLA inventory control points.

A.2. We recommend that the Commanding Officer, Navy Fitting Out and Supply Support Assistance Center, require the Navy Price Fighter Department to coordinate with the appropriate buying centers and:

a. Evaluate all issues raised in price challenges received. For challenges that concern contractor prices to the Government, the evaluation should determine whether or not the contractor prices were fair and reasonable and should identify the causes of any overpricing detected.

Navy Comments. The Navy partially concurred, stating that the Navy Price Fighter Department will evaluate all issues in price challenges received and respond to the challenger appropriately as required by the Price Challenge Hotline Operations Manual. However, the contracting officer is responsible for the determination of fair and reasonable prices. If the Navy Price Fighter Department, using current information (which may not have been available to the contracting officer at the time of the price reasonableness determination), believes that the last procurement price is excessive, the Navy will provide the information to the buying center for consideration in future contract awards or possible refund action.

Audit Response. Although the Navy only partially concurred with the recommendation, the action that the Navy Price Fighter Department will take on excessive procurement prices is responsive to the intent of the recommendation.

b. Respond to all issues raised in each price challenge. The response should tell the price challenger whether or not the challenge was correct, should identify any overpricing found, and should clearly explain actions taken as a result of the price challenge. For price challenges that

are not correct, the response should clearly explain the reasons that the challenge is not correct and the reasons that recommended actions were not taken.

Navy Comments. The Navy concurred, stating that all issues raised in price challenges will be discussed in each response as required by the Price Challenge Hotline Operations Manual.

c. Forward price challenges that cannot be evaluated by the Navy Price Fighter Department and the buying centers to the appropriate authority for evaluation instead of returning the price challenge to the challenger. The price challenger should be notified that the price challenge was forwarded for evaluation.

Navy Comments. The Navy concurred, stating that corrective action is in place that requires the Navy Price Fighter Department to forward all pricing-related issues that cannot be evaluated by the Price Fighters to the appropriate activity (the cognizant engineering authority), via the buying center, on behalf of the price challenger. The price challenger will be a "copy to" recipient of the correspondence.

Finding B. Pricing of Spare Parts Procurements

Of 45 price-challenged spare parts reviewed, DoD buying centers paid unreasonable prices to contractors on 63 procurements of 24 spare parts. The unreasonably priced procurements occurred because contracting officers did not properly analyze the proposed prices for the procurements. Specifically, contracting officers did not always:

o use available independent Government estimates and field pricing support when determining whether contractor-proposed prices were fair and reasonable (6 parts),

o analyze price increases over previous procurements (6 parts), or

o solicit identified alternate sources (12 parts).

As a result, the DoD buying centers overpaid about $15.8 million on 63 procurements, valued at $30.8 million, of 24 unreasonably priced spare parts. Of the 63 procurements, 11 procurements of 5 Naval Aviation Supply Office parts, valued at $30.6 million, accounted for about $15.6 million of the overpricing. Overpricing of the spare parts made Government funds unavailable for other use.

Price Reasonableness Determinations

To determine price reasonableness of the 45 spare parts included in the price challenges that we evaluated, we relied primarily on whether price competition was obtained. We also used Government estimates, prices available from other contractors, prices paid on prior procurements, and prices paid on subsequent procurements. Table 3 is a summary of price reasonableness determinations for the 45 spare parts. We categorized the parts as unreasonably priced, reasonably priced, or undetermined.

Table 3. Price Reasonableness Determinations

Determination	Number of Parts	Percent of Total	Amount of Awards (millions)
Unreasonably priced	24	53	$31.0*
Reasonably priced	13	29	0.6
Undetermined	8	18	2.0

*Includes 31 reasonably priced procurements, valued at about $0.2 million, of 11 of the 24 unreasonably priced parts.

Prices

Unreasonably Priced. The 24 unreasonably priced parts fell into 3 general categories:

o prices that exceeded independent Government estimates,

o prices that increased more than 45 percent since the previous procurement, and

o prices for which lower prices were available from other sources.

Table 4 shows the primary causes of the unreasonable prices for the 24 spare parts. Contracting officer failure to use independent Government estimates to determine fair and reasonable prices and establish prenegotiation price objectives accounts for $15,661,201 (99 percent) of the total amount ($15,817,581) of overpricing. Of the total overpricing, five parts procured by the Naval Aviation Supply Office account for $15,657,751 (99 percent). The primary causes of the unreasonable pricing are discussed as follows, and Appendix E summarizes price information on the 24 unreasonably priced parts.

Table 4. Causes of Unreasonable Pricing

Primary Cause	Number of Parts*	Approximate Overpricing
Failure to:		
Use Government estimates	6	$15,661,201
Analyze price increases	6	121,562
Solicit alternate source	12	34,818

*This table reflects primary causes. Some overlapping of causes occurs among parts.

Use of Government Estimates and Field Pricing Support. Of the 24 unreasonably priced parts, 6 parts (5 procured by Naval Aviation Supply Office and 1 procured by General Supply) were unreasonably priced because the contracting officers did not use available independent Government estimates and field pricing support to evaluate contractor-proposed prices. The prices paid for the six parts exceeded the should-cost estimates (independent Government estimates) prepared by the Navy Price Fighter Department after receipt of the price challenges. The unreasonable pricing amounted to $15.7 million of the $30.6 million paid for the six parts. Additionally, the contracting officers for two of the parts did not evaluate large price increases over the previous prices.

Government Estimates. Of the six parts with prices that exceeded the independent Government estimates, the contracts for four parts (see NSNs 1560-00-761-7929, 1560-00-761-7899, 1560-00-073-1158, and 3040-00-073-6915 in Appendix E) were definitized by the Defense Plant

Representative Office Boeing. The contracts for NSN 5975-00-435-0133 (Appendix E) were definitized by General Supply. We did not determine where the contract for NSN 1560-00-472-2722 was definitized because contract files were not available for examination. We calculated the amount of overpricing for NSNs 1560-00-761-7929, 1560-00-761-7899, 1560-00-073-1158, and 5975-00-435-0133 by comparing contract prices with independent Government estimates after substituting, in the detailed independent Government estimate reports prepared by the Navy Price Fighter Department, the negotiated contractor and subcontractor labor and overhead rates for the industry standard rates used by the Navy Price Fighters. The negotiated rates were higher than the rates used by the Navy Price Fighters. For NSNs 1560-00-472-2722 and 3040-00-073-6915, we used the independent Government estimates and the contract prices to calculate the amount of overpricing because contractor rates were not available.

The Defense Plant Representative Office Boeing and General Supply contracting officers did not take into account the independent Government estimates to determine fair and reasonable prices for subsequent procurements of NSNs 1560-00-761-7929, 1560-00-761-7899, 1560-00-073-1158, 3040-00-073-6915, and 5975-00-435-0133. A subsequent procurement of NSN 1560-00-472-2722 has not taken place. The Defense Plant Representative Office Boeing contracting officer was not aware of the independent Government estimates. Contracting officials at the Naval Aviation Supply Office entered the independent Government estimates in their procurement data base, but did not provide copies to the Defense Plant Representative Office Boeing. The Defense Plant Representative Office Boeing contracting officer stated that contracting officers are not required to use independent Government estimates and that he did not believe that all independent Government estimates were useful. The General Supply contracting officer stated that she normally used independent Government estimates during price negotiations. However, the contract file for NSN 5975-00-435-0133 does not show use of the independent Government estimate. FAR 15.807, "Prenegotiation Objectives," specifically requires that contracting officers take into account Government estimates when setting prenegotiation objectives. We believe that independent Government estimates, particularly should-cost estimates prepared by an independent organization such as the Navy Price Fighter Department, are valuable tools that contracting officers should use when determining fair and reasonable prices and when establishing prenegotiation price objectives.

In addition to not using the available independent Government estimates to determine fair and reasonable prices, the Defense Plant Representative Office Boeing contracting officer for NSN 1560-00-073-1158 and the General Supply contracting officer for NSN 5975-00-435-0133 failed to question the large price increases over the previous procurement prices for the parts. Neither price increase could be explained by differences in quantities procured because the quantities procured were similar. The price of NSN 1560-00-073-1158 increased 134 percent from $139 in 1988 to $327 in 1993. The contract file stated that the $327 price was fair and reasonable based on comparison to prior prices and on comparison of proposed labor hours and material costs to previous labor hours and material costs. The contracting officer stated that the 134-percent price increase from 1988 to 1993 was to be expected because of the

shrinking Defense industry and the contractor's need to cover the same fixed expenses with fewer sales. The contracting officer provided no support for his conclusion. The price of NSN 5975-00-435-0133 increased about 50 percent from $231.94 in 1993 to $347 in 1994. The contract file did not address the price increase. The contracting officer stated that the $347 price was fair and reasonable because the price was the contractor's best and final offer and because the $347 was 22 percent below the contractor's original proposed price and 3 percent below General Supply's maximum price objective.

We do not agree with the price reasonableness conclusions reached by the Defense Plant Representative Office Boeing and General Supply contracting officers. We believe that the 134-percent and 50-percent price increases over the previous procurements should have prompted the contracting officers to perform further analyses and negotiations of the contractor-proposed prices.

Field Pricing Support. In addition to not using the should-cost estimates to determine fair and reasonable prices, the Defense Plant Representative Office Boeing contracting officer for NSNs 1560-00-761-7929 and 1560-00-761-7899 did not request field pricing support to assist in the analysis of the contractor's proposals, as required by the FAR for negotiated procurements costing more than $500,000. The contracts for NSNs 1560-00-761-7929 and 1560-00-761-7899 were valued at $6.6 million and $7.4 million, respectively. The contracting officer did not provide written justification for not requesting field pricing support as required by Defense Federal Acquisition Regulation Supplement 215.805-5, "Field Pricing Support." The contracting officer stated that he did not consider field pricing support necessary because the bulk (about 70 percent) of the price for each of the two contracts was subcontractor costs that the sole-source prime contractor negotiated with the subcontractor. The remaining 30 percent of each contract price consisted of pass-through costs (overhead and profit) added to the subcontractor costs by the prime contractor. The contracting officer stated that, because of historical data, he accepted the subcontract price as proposed. The simple price comparison was not sufficient to justify the prices of the noncompetitively awarded, multimillion-dollar contracts. In effect, the contracting officer accepted the prime contractor's proposals without any Government evaluation of subcontractor costs that amounted to 70 percent of the price for the two contracts.

FAR 15.806, "Subcontract Pricing Considerations," states that the contracting officer is responsible for analyzing subcontractor cost or pricing data in support of subcontract proposals of $1 million or more. In this case, the single subcontract that the prime contractor awarded for the two contracts was for more than $10 million. Even if the prime contractor negotiates subcontractor prices before negotiating the prime contract, the subcontractor costs must be reviewed and analyzed by the Government. In no instance should the contracting officer accept the negotiated subcontractor prices as the sole evidence that the prices are fair and reasonable. The FAR specifically recommends that the contracting officer obtain field pricing support when, as in this case, the prime contractor is sole source and subcontract costs represent a substantial part of the contract costs. We believe that the overpricing of

NSNs 1560-00-761-7929 and 1560-00-761-7899 would have been prevented had the contracting officer obtained field pricing support to analyze the contractor's proposal, including subcontractor costs.

Analysis of Price Increases Over Previous Procurement Prices. Of the 24 unreasonably priced parts, 6 were unreasonably priced because the contracting officers did not identify and analyze price increases that ranged from 59 percent to 1,233 percent more than the prices paid on the previous procurements of the parts. The price increases could not be explained by differences in quantities procured because the quantities procured were similar. Of the six parts, three parts were procured through automated purchasing systems and three parts were procured manually. The overpricing amounted to $121,562 of the $166,138 paid for the 6 parts. We identified the overpricing by reviewing contract files and procurement histories and by comparing prices.

Automated Procurements. NSN 4810-01-041-2285, procured by Construction Supply, and NSNs 5340-01-268-3618 and 5330-00-103-2014, procured by Industrial Supply, were purchased through automated purchasing systems. The price of NSN 4810-01-041-2285 increased by 492 percent, and the prices of NSNs 5340-01-268-3618 and 5330-00-103-2014 increased by 59 percent and 91 percent, respectively. Construction Supply contracting officials stated that contracting officers receive notification (exception reports) of price increases of 20 percent or more, but that time and volume of procurements do not permit preaward or even postaward reviews of all price increases. In 1992, Industrial Supply established procedures for contracting officers to receive exception report notification of price increases of 10 percent or more on automated purchases. The contracting officer judgmentally selects more significant items from the exception report and either has to refer the action for manual procurement or provide written justification for the award at the higher price. NSNs 5340-01-268-3618 and 5330-00-103-2014 were procured before Industrial Supply established the exception report procedures.

Contract pricing officials at Construction Supply, Electronics Supply, General Supply, and Industrial Supply perform postaward pricing reviews of the automated awards to individual contractors participating in their automated purchasing systems on a periodic, rotational basis, and obtain refunds from the contractors if they find a pattern of overpricing. The contract pricing officials use summary listings of awards by contractor along with other reports and past experiences with the individual contractors when initiating new and followup reviews. The contract pricing officials concentrate on the highest dollar volume contractors and on contractors where past experience or other indicators suggest a postaward pricing review should be initiated. A 1993 postaward pricing review of the contractor for NSN 5340-01-268-3618 did not reveal a pattern of overpricing. Three contractors for NSN 4810-01-041-2285 received postaward pricing reviews in 1994 and follow-on reviews were in-process in September 1995. The contractor for NSN 5330-00-103-2014 has not had a recent postaward pricing review. Industrial Supply officials should review the contractor for NSN 5330-00-103-2014 to determine whether a pattern of overpricing exists that could warrant a refund from the contractor.

Manual Procurements. NSN 1560-00-261-4990, procured by General Supply, and NSNs 5340-01-063-1288 and 4030-00-824-2327, procured by Industrial Supply, were procured manually. The price of NSN 1560-00-261-4990 increased by 1,233 percent, and the prices of NSNs 5340-01-063-1288 and 4030-00-824-2327 increased by 319 percent and 63 percent, respectively. General Supply procured NSN 1560-00-261-4990 in 1990 at a price that was 1,233 percent higher than the previous price paid by the Air Force in 1985. General Supply contracting officials stated that they did not have access to the Air Force procurement history when the procurement was made. The contracting officer recommended contract award because of a very low stock level, even though he could not determine price reasonableness. During the audit, in October 1994, General Supply determined that the contract was overpriced by $9,597 and requested a voluntary refund from the contractor. The contractor refunded $4,798, or 50 percent of the $9,597 requested. In August 1994, General Supply contracting officials stated that they started receiving procurement histories for spare parts for which management responsibility transfers to General Supply from the Military Departments. General Supply has also identified another valid manufacturer by accessing a commercial data base and has recoded the part as competitive and added the additional source to the procurement guidance for use in future procurements.

The Industrial Supply contracting officer for part NSN 5340-01-063-1288 did not notice the 319-percent unit price increase from $2.56 to $10.72 when he awarded the contract. As a result of the price challenge, Industrial Supply officials queried the contractor regarding the price. In response, the contractor stated that the proposed unit price should have been $1.72 instead of $10.72 and provided Industrial Supply a voluntary refund of $990 on the $1,179 procurement.

Industrial Supply procured NSN 4030-00-824-2327 at an unreasonable price on two of the three procurements we evaluated. The third procurement was competitively awarded and reasonably priced at $125 for each unit.

On the first unreasonably priced procurement, the sole-source contractor proposed a unit price of $471. A price analyst at Industrial Supply performed a cost analysis of the proposal and arrived at a target unit price of $331. However, the analyst noted in the report of his analysis that the $331 price was exorbitant and could not be justified from a pricing basis because it was 65 percent higher than the $200 unit price on the previous procurement, 1 year earlier. The analyst therefore placed reliance for price and cost reasonableness on field pricing support and cost analysis. The contracting officer stated that during discussions with the contractor, the contractor was told that negotiations would start on a bottom-line basis because the proposed price was much higher than the previous price. The contractor subsequently stated that the proposal was outdated and revised the unit price to $325, a 63 percent increase over the previous procurement price. The contracting officer awarded an $87,823 contract for 270 parts at the $325 unit price without negotiation, stating that the $325 price was fair and reasonable based on price analysis.

Subsequently, an Industrial Supply administrative contracting officer modified the contract to reduce the quantity from 270 to 100 and increased the unit price

from $325 to $560. The only documentation in the contract file concerning the $560 price is a record of the $560 telephone quote from the contractor. The administrative contracting officer stated that he should have negotiated the price of the contract modification and did not know why he did not negotiate the price.

The second unreasonably priced procurement of NSN 4030-00-824-2327 was split into three orders. Each order was valued at $24,461 and was noncompetitively awarded using simplified acquisition procedures. The orders were awarded within an 8-day period under a basic ordering agreement. Each order was for a quantity of 31 at a unit price of $789.07. Because of an error in the procurement history, the contracting officer believed that the last previous unit price was $207 instead of $560. However, the contracting officer accepted without question the contractor's explanation that major rate increases and changes in the manufacturing process caused the supposed 280-percent price increase. The contract file contained evidence that the procurement was intentionally split to remain within the $25,000-simplified-acquisition limitation and avoid formal, documented contract negotiations. Management officials at Industrial Supply were aware of the requirement splitting to award the three small purchase orders and of the potential overpricing of the orders. The management officials stated that they have taken appropriate action with the contracting officer and other employees involved to prevent recurrence.

During the audit, Industrial Supply and Defense Plant Representative Office Boeing determined that the contractor's proposal overstated labor hours by about 25 percent over the labor hours that the contractor's cost data showed were spent to manufacture the part for the three orders. Industrial Supply requested that the contractor provide a $10,570 voluntary refund. The contractor refused, stating that the orders were firm-fixed-price orders, that certified cost or pricing data were not required, and that the basic ordering agreement under which the orders were placed contained no requirement for the contractor to extend a voluntary refund. Also, the contractor provided cost data that showed that before the proposal for the three orders was submitted, the contractor spent a higher number of labor hours per unit to manufacture the part on the one previous order than the number of labor hours proposed for the three orders. Management officials at Industrial Supply stated that, in retrospect, based on the contractor's cost data and the fact that Boeing Defense and Space Group, Helicopter Division, was the only approved source at the time the orders were placed, the $789 unit price on the three orders and the $560 unit price on the previous order were reasonable. We understand the rationale that the Industrial Supply management officials used to conclude that the prices were reasonable. However, because Industrial Supply was later able to procure the part from another contractor for $125, we do not agree that the $560 and $789 unit prices paid to Boeing Defense and Space Group, Helicopter Division, were fair and reasonable.

The unreasonable pricing of the five parts may have been identified and prevented had the contracting officers properly evaluated the proposed prices. The contracting officers should have used exception reports from the automated purchasing systems, procurement histories that showed the significant price increases over the previous procurements, and cost analysis reports, as

appropriate, to evaluate the proposed prices. At a minimum, the contracting officers should evaluate proposed prices that increase 25 percent or more than the previous procurement price.

Soliciting Alternate Sources. Of the 24 unreasonably priced parts, 12 parts were unreasonably priced because the contracting officers did not solicit an alternate source with prices that were lower than the prices paid. The alternate source is an authorized distributor for the manufacturer of the parts in question. The contracting officers were not aware of the alternate source. We concluded that the parts were unreasonably priced because the average unit prices that the buying centers paid for the 12 parts ranged from 7 percent to 1,424 percent more than the alternate source catalog prices, after adjusting for DLA estimates of the cost of barcoding and packaging and, for the Construction Supply parts, shipping. The overpricing amounted to $34,818 of the $72,356 paid for the 12 parts. We calculated the amount of overpricing by subtracting the alternate source catalog prices and the estimated costs provided by DLA for barcoding, military packaging, and shipping (Construction Supply only) from the prices paid for the parts. The amount of potential overpricing on the Industrial Supply parts is overstated by an undetermined amount because neither the alternate source nor DLA could provide an estimate of shipping costs.

Except for cases described below of not questioning the large price increases, both Construction Supply and Industrial Supply contracting officials followed FAR guidance for pricing the small purchase contracts when they did not make an effort to identify additional sources for the parts. Extensive effort would not have been cost-effective for the contracting officers to identify and solicit the alternate source identified in the price challenges for procurements made before receipt of the price challenges. However, contracting officials at Construction Supply and Industrial Supply did not solicit the alternate source for 6 procurements of 4 of the 12 parts that occurred after receipt of the price challenges identifying the alternate source. Of the 6 procurements, 5 were automated purchases of 3 of the 4 parts. The other procurement was a manual procurement of the fourth part. During the audit, Construction Supply and Industrial Supply contracting officials stated that they invited the alternate source to participate in the Construction Supply and Industrial Supply automated purchasing systems. Management officials at Industrial Supply later stated that the alternate source had not responded to the invitation. In September 1995, Construction Supply officials again discussed participation in the automated purchasing system with the alternate source. The alternate source agreed to review the standard blanket purchase agreement executed by participants in the automated purchasing system. Construction Supply officials intend to followup with the alternate source. The contracting officer for the manual procurement stated that she was not made aware of the alternate source. Industrial Supply management officials stated that, starting in February 1995, contracting officers making manual procurements would be made aware of the alternate source. To avoid paying higher prices than necessary, Construction Supply and Industrial Supply should invite qualified sources identified by price challengers as having significantly lower prices to participate in the automated purchasing system and should solicit the alternate source on future manual procurements and, when appropriate, on automated procurements of the parts.

Additionally, the prices paid for 3 of the 12 parts that were available from the alternate source ranged from 55 percent to 186 percent higher than the prices paid on the previous procurements of the parts. All 3 parts (NSN 2930-00-367-7375 procured by Construction Supply and NSNs 5365-01-166-6633 and 5330-00-421-4849 procured by Industrial Supply) were purchased through automated purchasing systems.

The contracting officers for the NSNs 2930-00-367-7375, 5365-01-166-6633, and 5330-00-421-4849 did not compare the proposed prices with the prices of previous procurements of the parts. Industrial Supply officials performed postaward pricing reviews of the contractors participating in the automated purchasing system for NSNs 5365-01-166-6633 and 5330-00-421-4849. The postaward pricing reviews identified a pattern of overpricing and resulted in the contractors providing refunds to Industrial Supply. Construction Supply officials performed a postaward pricing review of the contractor for NSN 2930-00-367-7375 that disclosed no instance of overpricing.

Reasonably Priced. The 13 reasonably priced parts met one or more of the following criteria.

o Contract price was less than or equal to the prior procurement price.

o Price analysis and cost analysis of the contractor's cost or pricing data supported the negotiated contract price. Negotiated price was less than proposed price.

o Price escalation over the prior procurement price was adequately justified by the contracting officer.

o Alternate source prices after addition of estimated expense of barcoding and military packaging were higher than or virtually equal to prices actually paid.

o Price analysis that was performed by the contracting officer supported the small purchase price.

o Adequate price competition (price quotations from two or more qualified contractors) supported the price.

Appendix F lists the reasonably priced parts, including the criteria met.

Price Reasonableness Undetermined. We were unable to determine price reasonableness for 8 of the 45 price challenges. For four of the price challenges, the buying centers had no records of having bought the parts. For three price challenges, the contract files were not available at the buying centers because the most recent procurements of the parts were in 1987. We were unable to determine price reasonableness of the other part (NSN 5960-01-126-4506), an electronic tube for a digitizer used to test electronic boards on various aircraft, because the tube has only one known manufacturer. Electronics Supply has been unsuccessful in attempts to generate competition, obtain cost data, or negotiate a lower price from the contractor.

Effects of Not Analyzing Proposed Prices for Spare Parts

As a result of contracting officers not properly analyzing proposed prices for spare parts, the DoD buying centers paid approximately $15.8 million in additional costs on 63 procurements of 24 of the 45 spare parts reviewed. About $15.7 million of the excessive pricing is attributable to 5 parts procured at the Naval Aviation Supply Office, and about $0.2 million is attributable to 19 parts procured by 3 DLA buying centers. When the buying centers pay more than they should for a part, supply system customers also pay more than they should for the part. The price that the buying centers charge supply system customers for spare parts is the buying center's procurement cost for the part plus predetermined percentages of the procurement cost (surcharges) to cover buying center costs to acquire, store, and ship the part to the customer. The additional funds spent by supply system customers for overpriced spare parts are not available for other needs of the customer. Over longer periods, the supply system customers receive budget increases to cover rising prices. Overpriced spare parts cause larger budget increases than necessary and make Government funds unavailable for other use.

Conclusion

The audit identified problems with the pricing of selected spare parts at the DoD buying centers reviewed. However, the audit results should not be interpreted as indicative of widespread overpricing at the buying centers or within DoD. The audit reviewed only the pricing of spare parts that were already suspected of being unreasonably priced. Therefore, the number of overpriced parts found was expected to be a larger number than would be found in a statistical sample of spare parts. Nevertheless, the audit results indicate that the quality of spare parts pricing can be improved. The number of unreasonably priced spare parts procurements should decrease if contracting officers solicit all known qualified sources and use independent Government estimates, field pricing support, and price comparisons, when applicable, to evaluate proposed prices for the parts.

Management Comments on the Finding and Audit Response

DLA commented extensively on the finding. See Appendix G for a summary of DLA comments and the audit response.

Recommendations, Management Comments, and Audit Response

Revised Recommendations. As a result of management comments, we revised Recommendation B.1.a. to clarify that contracting officers should obtain independent Government estimates when feasible to do so. We also revised Recommendation B.2. to delete the recommended postaward pricing reviews of the contractors that supplied two parts to the Defense Construction Supply Center.

B.1. We recommend that the Commander, Naval Supply Systems Command, and the Director, Defense Logistics Agency, issue guidance to their respective buying centers that requires contracting officers to:

a. Obtain, when feasible to do so, independent Government estimates for negotiated procurements of spare parts as required by the Federal Acquisition Regulation and consider the estimates, including any Government-prepared should-cost estimates, when determining fair and reasonable prices and establishing prenegotiation price objectives. Contracting officers should document in the contract files reasons for not adopting recommendations made in the independent estimates.

b. Obtain field pricing support, or provide written justification for not obtaining it, for negotiated procurements expected to exceed $500,000 that require the contractor to submit cost or pricing data, and use the information to evaluate the contractor's proposal and establish prenegotiation price objectives.

c. Compare the price of the previous procurement with the proposed price and evaluate any price increase that common sense indicates is not reasonable. At a minimum, the contracting officer should evaluate proposed prices that increase 25 percent or more than the previous procurement price.

d. Include qualified alternate sources identified by price challengers in the source lists for the parts and solicit the new sources, as well as the other qualified sources, on future procurements of the parts.

Navy Comments. The Navy concurred with all elements of the recommendation. The Navy stated that although the Defense Plant Representative Office may be requested to provide a cost and price analysis and price negotiation on a procurement, the ultimate responsibility for determining whether item prices are fair and reasonable resides with the contracting officer executing the contract action that establishes the contract item prices. Accordingly, the Navy will issue policy guidance by September 30, 1995, that emphasizes the responsibility of contracting officers at Navy buying activities in addition to the elements cited in the recommendation.

DLA Comments on Recommendation B.1.a. DLA partially concurred, stating that DLA contracting officers should consider independent Government estimates along with other advisory reports that they request as well as similar information that has been provided or is readily available for their use. DLA also agreed that contracting officers should address in the contract file any independent Government estimate obtained or made available, explaining how it was used, or why it was not used, in formulating the prenegotiation position and in the resulting negotiations. However, DLA stated that the recommendation was not applicable to DLA because the audit did not identify any instances where DLA officials failed to obtain, forward, or consider in preparing prenegotiation objectives any independent Government estimate received, or where DLA contracting officers failed to document in the contract files the reasons for not adopting recommendations made in an independent Government estimate. DLA stated that the audit found that independent Government estimates were not provided to the contract administration office responsible for price negotiations of awards on 4 Navy-managed items. DLA suggested that the recommendation be modified to require offices that obtain independent Government estimates for evaluation of price challenges or for other purposes to promptly forward a copy of the independent Government estimate to the contracting office responsible for contract negotiations. DLA further stated that it agreed that independent Government estimates are a useful tool in contract negotiations and that DLA contracting officers request independent Government estimates for use when appropriate. DLA plans to discuss at the next DLA value engineering program manager's meeting, scheduled for the last week of FY 1995, the need to forward to contracting the independent Government estimates obtained in connection with price challenge evaluations. DLA also plans to discuss feedback on the utility of each independent Government estimate at the time that a decision is needed on whether the independent Government estimate warrants updating for use in a future procurement. DLA will issue a letter summarizing the discussions and decisions reached on any steps to be taken to improve utilization and feedback regarding individual independent Government estimates.

Audit Response. As a result of the DLA comments, we revised the recommendation to require contracting officers to obtain independent Government estimates when feasible to do so. We do not agree that the recommendation is not applicable to DLA, nor do we agree that the audit did not identify any instances where an available independent Government estimate was not used. As stated in the audit finding, the contracting officer for NSN 5975-00-435-0133 at General Supply did not consider an available independent Government estimate when establishing prenegotiation objectives and when negotiating the contract price. We agree with DLA that the Naval Aviation Supply Office did not forward the independent Government estimates that it obtained for NSNs 1560-00-761-7929, 1560-00-761-7899, 1560-00-073-1158, and 3040-00-077-6915 to the administrative contracting officer at the Defense Plant Representative Office Boeing. However, we believe that the contracting officer responsible for establishing prenegotiation objectives and negotiating contract prices is responsible for making reasonable inquiries to determine whether an independent Government estimate has been prepared. The administrative contracting officer should have contacted the procurement contracting officer at the Naval Aviation Supply Office to determine whether an

independent Government estimate or any other advisory report was available before establishing prenegotiation objectives and negotiating the prices for the orders awarded after receipt of the price challenges. We request that DLA reconsider its position and provide comments on the revised recommendation in response to the final report.

DLA Comments on Recommendation B.1.b. DLA partially concurred, stating that the recommendation echoes the Defense Federal Acquisition Regulation Supplement requirements for obtaining field pricing support. However, DLA stated that the recommendation does not apply to DLA because the audit did not show a failure of DLA officials to comply with the requirement. DLA stated that the requirement to obtain field pricing support does not apply when pricing and negotiation is being conducted at the contract administration office. DLA further stated that field pricing support was not necessary for the proposed subcontract cost for the procurements of head hubs (NSNs 1560-00-761-7929 and 1560-00-761-2899) because the Defense Plant Representative Office Boeing negotiator's review of prior purchase orders for the head hubs supported the determination of subcontract cost reasonableness and because the Defense Plant Representative Office Boeing negotiator reviewed the subcontract cost or pricing data, the Boeing Helicopter Division analysis of the data, and the price negotiation memorandum prepared by Boeing Helicopter Division. DLA stated that the subcontractor's estimated costs were based on actual labor cost history for 624 nearly identical parts that had been audited by Boeing Helicopter Division, and that the Boeing Helicopter Division subcontract analysis and negotiation memorandum were thorough, logical, and well documented. DLA stated that no specific threshold exists for obtaining subcontract pricing support, but that the threshold is left to the discretion of the contracting officer. DLA further stated that the Defense Federal Acquisition Regulation Supplement 215.806-3(a)(i) suggests a preference for reliance upon the prime contractor's analysis of subcontractor costs instead of on a Government review whenever possible, and that no requirement exists for the contracting officer to provide written justification for not obtaining field pricing support for subcontract costs.

Audit Response. We do not agree that the recommendation does not apply to DLA, nor do we agree with the rationale that DLA provided to show that field pricing support was not required for the head hub procurements. We could not find any regulatory or logical reason for the DLA conclusion that field pricing support is not necessary when pricing and negotiation is conducted by the administrative contracting officer. Both the FAR and the Defense Federal Acquisition Regulation Supplement require that contracting officers obtain field pricing support to assist in their analysis of fixed-price proposals exceeding $500,000. The head hub proposals each exceeded $6 million. Also, we disagree with the DLA logic that the administrative contracting officer does not need field pricing support to assist in the analysis of multimillion dollar proposals because the administrative contracting officer is located in or near the contractor's facility. Additionally, we disagree with the DLA conclusion that the review of prior purchase orders for the head hubs and the review of Boeing Helicopter Division's analysis of subcontract cost or pricing data by the Defense Plant Representative Office eliminated the need for field pricing support for the proposed subcontract costs. Further, the contract files contained no evidence of

any evaluation of subcontract cost or pricing data or the Boeing Helicopter Division price negotiation memorandum. As stated in the finding, we believe that the review performed by the Defense Plant Representative Office amounted to a price comparison that was not sufficient to justify the prices of noncompetitively awarded, multimillion dollar contracts. We agree with DLA that no specific threshold exists for obtaining subcontract field pricing support. However, as stated in the finding, the FAR states that the contracting officer is responsible for analyzing subcontractor cost or pricing data on subcontract proposals of $1 million or more and suggests that obtaining field pricing support is appropriate when, as in this case, the prime contractor is sole source and subcontract costs represent a substantial part of the contract. We disagree with the DLA statement that the Defense Federal Acquisition Regulation Supplement suggests accepting the prime contractor's analysis of subcontractor costs instead of obtaining a separate Government analysis. The Defense Federal Acquisition Regulation Supplement cited by DLA states,

> If, in the opinion of the contracting officer or auditor, the review of a prime contractor's proposal requires further review of subcontractors' cost estimates at the subcontractors' plants (after due consideration of reviews performed by the prime contractor), these reviews should be fully coordinated with the administrative contracting officer (ACO) having cognizance of the prime contractor before being initiated. The ACO for the prime contractor will initiate the request to the ACO for the subcontractor . . . .

We do not interpret the Defense Federal Acquisition Regulation Supplement language as suggesting that the prime contractor's analysis be accepted, nor do we interpret the language as eliminating the FAR requirement that the contracting officer analyze subcontractor costs. We request that DLA reconsider its position and provide additional comments on the recommendation in response to the final report.

DLA Comments on Recommendation B.1.c. DLA partially concurred. DLA stated that it concurred with the general thrust of the recommendation, but that the recommendation does not apply to DLA because no instances were identified where DLA personnel failed to compare the price of the previous procurement with the proposed price and evaluate any price increase to the extent required by regulation, or by best practices. DLA stated that it fully implemented the requirements of the FAR and the Defense Federal Acquisition Regulation Supplement, that the Defense Contract Management Command has recently issued numerous letters on the use of price analyses, and that DLA policies governing the use of price analyses are more stringent than those required by regulation. DLA further stated that Defense Contract Management Command policies do not specify a price increase threshold for conducting more detailed analyses. The decision to conduct more detailed analyses is based on price increases that are not explained by common factors such as quantity variation or the rates of change in indexes such as the Producer Price Index or Data Resources, Incorporated, forecasts. DLA points out that the Defense Federal Acquisition Regulation Supplement already requires contracting officers to identify in requests for field pricing support the proposed prices that exceed by 25 percent or more the lowest price that the Government paid within the most recent 12-month period. DLA concluded that DLA does not need to

reemphasize the FAR and Defense Federal Acquisition Regulation Supplement policies on price comparisons. DLA further concluded that the audit did not substantiate that overpricing occurred as a result of a failure to perform such analyses. Therefore, we have no basis to expect that the quality of pricing of spare parts would improve if the price comparisons were accomplished beyond the extent specified in current regulations.

Audit Response. We commend the extra effort that DLA stated that the Defense Contract Management Command has taken to emphasize the use of price analyses. However, we disagree that DLA does not need to remind contracting officers to compare prices and evaluate any price increase that does not appear to be reasonable. We also disagree that the audit did not identify any instance where DLA personnel failed to evaluate potentially unreasonable price increases. For the reasons stated in the finding and in the audit response to DLA comments on the finding, we believe that the six items identified in the finding are examples of instances where a price comparison should have been made and the price increase evaluated. Also, the DLA comments imply that the recommendation requires contracting officers to do more to evaluate price increases than is required by regulation. The intent of the recommendation is to remind contracting officers that, when determining whether a proposed price is fair and reasonable, the proposed price should be compared with the previous price (if any) as suggested by FAR Part 13, "Small Purchase and Other Simplified Purchase Procedures," for micro-purchases and for other small purchases when only one price proposal is received. The extent to which a price increase is evaluated is the contracting officer's decision and will be influenced by the size of the price increase, the value of the procurement, the factors mentioned by DLA, and such other factors as the availability of current price lists, catalog prices, and value analysis reports, and the contracting officer's knowledge of the item being procured. We request that DLA reconsider its position and provide additional comments on the recommendation in response to the final report.

DLA Comments on Recommendation B.1.d. DLA partially concurred, but stated that the recommendation did not apply to DLA because the audit identified no instances where DLA personnel failed to solicit alternate sources to the extent required by regulation and consistent with best practices. DLA stated that for years its buying centers have been including qualified alternate sources identified by price challenges in the source lists for the parts. DLA stated that buying center engineers routinely validate alternate parts and alternate sources identified by price challengers and include validated parts and sources in computerized source lists. Once validated, the new sources are eligible to be solicited for future procurements along with other previously approved sources. The engineers may also enter potential sources and estimated prices in automated files for buyer use. Similarly, contract pricing officials involved in overpricing reviews routinely include information on sources with favorable prices in the automated files. DLA further stated that during its review of responses to price challenges involving an alternate source, it noted instances where improvements should be made. DLA stated that it will discuss reporting price challenge results and promised follow-on action in the DLA value engineering program manager's meeting scheduled for the last week of FY 1995. The specifics of entering qualified alternate sources and soliciting the

new sources on subsequent procurements and the quality improvements that should be made to price challenge responses will be addressed. After the meeting, DLA will issue a letter summarizing the discussion and decisions reached on the steps taken to improve the quality of DLA responses to price challenges that involve an alternate source.

Audit Response. We disagree that the audit did not identify any instances in which DLA personnel failed to solicit a qualified alternate source. As stated in the finding, the alternate source was not solicited on six procurements (one manual and five automated) of four parts that occurred after the price challenger identified the qualified alternate source, plus an additional four procurements (two manual and two automated) of four parts that we ultimately determined to be reasonably priced. Although DLA stated that the recommendation does not apply to DLA, the action that DLA stated it is taking satisfies the intent of the recommendation. DLA should remind contracting officers to include qualified alternate sources in source lists and solicit the new sources on subsequent procurements when possible. The reminder will be accomplished when DLA publishes a summary of the discussion and decisions reached during the DLA value engineering program manager's meeting on the specifics of entering qualified alternate sources in source lists and on soliciting the new source on subsequent procurements and on improvements to responses to price challenges involving alternate sources.

B.2. We recommend the Commander, Defense Industrial Supply Center, conduct a postaward pricing review of the contractor participating in the automated purchasing system who has not been reviewed recently and who has made an overpriced sale of NSN 5330-00-103-2014 to the Defense Industrial Supply Center.

DLA Comments. DLA partially concurred, stating that Construction Supply had completed postaward pricing reviews of the contractors for NSNs 4810-01-041-2285 and 2930-00-367-7375 in 1994 and 1995, respectively. DLA stated that no postaward pricing review has been scheduled for the contractor for NSN 5330-00-103-2014 on the questioned procurement because Industrial Supply has contractors with higher sales and review priorities and has no indication of pricing irregularities that warrant selection for review. DLA stated that the procurement of NSN 5330-00-103-2014 was an automated noncompetitive small-business small-purchase set-aside and that the contractor purchased the item from the manufacturer for $59 and sold it to the Government with a reasonable 7.03-percent markup. DLA stated that it is unclear why the manufacturer charged the small-business contractor $59, an amount in excess of the price that the Government had been paying (average $39.73) on prior purchases, but that the fact that the small-business contractor did not overcharge the Government is clear.

Audit Response. Based on the DLA information that Construction Supply had recently reviewed the contractors for NSNs 4810-01-041-2285 and 2730-00-367-7375, we deleted the recommendation on the Construction Supply parts and revised the finding accordingly. We disagree with DLA that a postaward pricing review of the contractor for NSN 5330-00-103-2014 is not warranted. The blanket purchase agreement that the contractor executed with Industrial Supply requires the contractor to control costs, including base costs and contractor markup. Although the contractor's 7-percent markup is reasonable, the $59 base cost that the contractor paid indicates that the contractor may not be controlling costs. Additionally, Industrial Supply officials stated that the contractor's last postaward pricing review was in 1988. We believe that contractors participating in the automated purchasing system should not go indefinitely without a pricing review, especially if a possibility exists that the contractor is not controlling costs that are passed on to the Government. We request that DLA reconsider its position and provide comments on the revised recommendation in response to the final report.

Part II - Additional Information

Appendix A. Scope and Methodology

Audit Scope

Limitation to Audit Scope. For the purpose of this report, we are covering only the audit objective concerning the pricing of the spare parts included in the price challenges submitted in the complaint to the Defense Hotline.

Expansion of Audit Scope. In addition to evaluating the pricing of the selected spare parts, we evaluated the adequacy of the Navy responses to the price challenges.

Universe and Sample. The audit universe consisted of 85 price challenges on spare parts and the Navy responses to the price challenges. The 85 price challenges were included in a complaint to the Defense Hotline. We judgmentally selected 45 of the 85 price challenges for our audit sample. We did not select 25 of the 85 price challenges for the audit sample because the buying centers never bought the parts (21 parts) or had not bought the part since 1988 (4 parts). During the audit, we eliminated an additional 15 price challenges from the audit sample because we had already identified problems with the Navy responses to the price challenges and with the pricing of certain spare parts. Performing the additional audit work necessary to evaluate the 15 price challenges would not have been cost-effective. In October 1994, the complainant gave us an additional 13 price challenges with Navy responses. We did not include the additional price challenges and responses in the audit universe or the audit sample. We forwarded the 13 price challenges and responses to the Navy Price Fighter Department, Navy Fitting Out and Supply Support Assistance Center, Norfolk, Virginia, for appropriate action.

The 45 price-challenged spare parts included in the audit sample were procured and managed by 1 Navy and 4 DLA buying centers. We evaluated 10 parts procured by the Naval Aviation Supply Office, 3 parts procured by Construction Supply, 2 parts procured by Electronics Supply, 3 parts procured by General Supply, and 27 parts procured by Industrial Supply. From January 1988 through September 1994, the buying centers awarded 146 contracts, valued at $33.6 million, to procure the 45 parts.

Audit Methodology

At the Navy Price Fighter Detachment, we examined price challenge files and, where applicable, should-cost files to evaluate information obtained and analysis work performed after the Navy responded to the price challenges. At the buying centers, we examined contract files, price challenge files, and

procurement histories. We also interviewed item managers, contracting personnel, and respondents to the price challenges to evaluate the responses to the price challenges and to determine whether or not the spare parts were reasonably priced. At the Defense Plant Representative Office Boeing, we examined the contract files and interviewed the contracting officer for five Naval Aviation Supply Office contracts that were definitized by the Defense Plant Representative Office Boeing to determine whether or not the definitized prices were fair and reasonable.

Use of Computer-Processed Data. We used computer-processed procurement history data provided by the buying centers to determine quantities procured and unit prices paid and to select contracts to examine.

Reliability of Computer-Processed Data. We assessed the reliability of the data in the procurement history data bases concerning the quantities procured and the unit prices paid. We determined that the quantities and unit prices in the computer-processed data generally agreed with the quantities and unit prices in the contracts. We did not find errors concerning quantities and prices that would preclude the use of the computer-processed data to meet audit objectives or that would change the conclusions in the audit report.

Audit Period, Locations, and Standards. We performed this economy and efficiency audit from March 1994 through April 1995 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included a review of management controls considered necessary. Appendix I lists the organizations visited or contacted during the audit.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and that evaluates the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of management controls over the pricing of the spare parts contracts at the Naval Aviation Supply Office, Construction Supply, Electronics Supply, General Supply, and Industrial Supply. Specifically, we reviewed management controls over the processes used by contracting officers to determine fair and reasonable prices and to establish prenegotiation price objectives for the 45 spare parts that we reviewed. We did not assess the adequacy of management's self-evaluations of those controls.

Adequacy of Management Controls. The management controls over contract pricing at the five buying centers were adequate as they applied to the audit objectives. As discussed in Finding B, the unreasonable prices paid for 29 of the 45 suspected unreasonably priced spare parts that we reviewed resulted from contracting officer errors in judgment and errors in the procurement process that have been corrected, not from any identified material weakness in the established management controls.

Appendix B. Prior Audits and Other Reviews

Inspector General, DoD

Report No. 95-312, "Validation of Technical Data Rights Restrictions for Spare Parts at Military Department Program Offices and Inventory Control Points," September 27, 1995. The report states that program offices and inventory control points for programs at each of the 3 military services did not adequately validate technical rights assertions on technical data for 132 spare parts purchased on contracts totalling $66.5 million. The program offices also did not purchase complete technical data packages. As a result, spare parts were purchased without full and open competition, without challenges to limited rights assertions, and without breakout screening. The report estimates that improved management control procedures, leading to increased competitive contracting, could potentially result in about $4.4 million of cost savings on $17.5 million of forecasted buys of spare parts for the three weapons systems reviewed. The report recommends establishing procedure to identify, evaluate, and challenge limited rights assertions by contractors; performing full breakout screening reviews on spare parts; issuing informal requests, prechallenges, and formal challenges; performing cost benefit analyses; establishing performance measures for challenging limited rights assertions; and including inventory control points during the early weapon acquisition process. Management has not provided comments on the report.

Report No. 95-288, "Source Approval Process for F404 Engine Critical Safety Items and Other Procurement Practices at the Naval Aviation Supply Office," August 7, 1995. The report discusses three allegations to the Defense Hotline concerning the timeliness of the source approval process for F404 engine critical safety items and eight additional allegations on procurement practices. The report states that all three allegations concerning the timeliness of the source approval process and two of the additional allegations had merit. The Navy had decreased the time needed for source approval from 517 days in 1991 to 322 days in 1995, but was still short of the 180-day performance goal. The resulting backlog of source approval requests hindered competitive procurement of critical safety items for the F404 engine. The Naval Aviation Supply Office also failed to provide to the complainant the results of a production lot test of an item within 30 days as required by the contract, and described an item in the postaward announcement of a procurement only by its national item identification number. The report estimates that about $1.4 million could be put to better use if processing is expedited for the source approval requests for four critical safety items with pending procurement requirements, and the items are then competitively procured. The report recommended that the Navy promptly complete the evaluation of source approval requests on the four items; implement performance measurement systems for the source approval process; designate a responsible official at each activity involved in the source approval

process; reconcile management information systems; and train personnel in the source approval process. The Navy concurred with the recommendations and the potential monetary benefits.

Report No. 94-106, "Validation of Technical Data Rights Restrictions for Spare Parts at the Defense Logistics Agency," May 19, 1994. The report states that DLA did not adequately validate limited rights assertions on technical data for 1,303 spare parts, valued at $84 million, and did not maximize informal requests and challenge limited rights assertions. As a result, parts were purchased sole source, without challenges to limited rights, and without breakout screening. The report estimates that competitive contracting could reduce costs by about 25 percent over sole-source contracting. The report recommended that the Director, DLA, reinstate the program for validating restrictive markings on technical data and direct the supply centers to establish a performance management system for the validation program. The report also recommended that the commanders of DLA supply centers include challenge procedures for limited rights assertions in management control reviews and risk assessments. Management issued guidance, effective November 1994, to reinstate the program and management established the performance management system in September 1993. Management did not concur with including the challenge procedures in management control reviews, but stated that DLA continuously works with the originating contracting offices to validate restrictive markings.

Report No. 94-004, "Contracting Officer Price Analyses," October 15, 1993. The report states that DoD contracting officers did not always perform and adequately document the use of price analyses on contractor proposal prices, resulting in inadequate assurance that fair and reasonable prices were obtained in negotiated contracts. The report recommended that the Military Departments and DLA issue written management control objectives and techniques to verify performance and documentation of price analyses by contracting officers. The report also recommended that the Deputy Under Secretary of Defense (Acquisition Reform) restructure training requirements to emphasize the performance and documentation of price analysis techniques. The Navy, the Air Force, and DLA had all complied with the recommendations as of March 1994. The Army believed that existing guidance was adequate. The Deputy Under Secretary of Defense (Acquisition Reform) restructured acquisition courses as recommended by August 1994.

Report No. 93-105, "Procurement of Spare Parts and Supplies," June 4, 1993. The report does not identify indicators of widespread overpricing, but states that 18.3 percent of 120 randomly selected items were overpriced by about $596,166, about 9.7 percent of the total amount paid for all 120 items. Of 21 other items specifically brought to the attention of the auditors, 10 were unreasonably priced by an estimated $25,406. As a result of the audit, one contractor made a voluntary disclosure of defective pricing, resulting in a price reduction of $650,229. The report recommended that guidance be issued to obtain independent Government estimates based on engineering analyses for use in evaluating proposed prices on some items, and that contractors identify manufacturers during the acquisition process. The report also recommended establishing reporting requirements for existing programs that examine the

reasonableness of spare parts prices and developing a definition for intrinsic value as it applies to spare parts. Management had completed responsive actions as of July 1994, except that DLA considered existing DoD guidance sufficient for requiring contractors to identify manufacturing sources, and the Army concluded that it did not need to develop a definition of intrinsic value.

Report No. 92-072, "Quick-Reaction Report on Acquiring Competitive Technical Data Packages for Engine Parts Used on the UH-60 Black Hawk Helicopter," April 6, 1992. The report states that the Army Aviation Systems Command had not used a contractual provision that would have enabled it to increase competition in procurements of 54 of the engine parts. Of the 54 parts, the auditors reviewed procurements of 27 parts. The report estimates that $1.9 million more than necessary may have been paid on previous procurements, and an additional overpayment of $4.7 million might occur on future procurements of these 27 parts between FY 1993 and FY 1997. The report recommended obtaining the required technical data packages and constraining future sole-source procurements until competition could be established. The Army concurred and reported having obtained all of the technical data packages by January 1993. In July 1993, the Army reported that only one part had been bought since the technical data packages had been obtained, and that no new sources for that part had been developed to enable competition.

Report No. 91-117, "Hotline Allegations for the Hover Infrared Suppression System for the UH-60 Black Hawk Helicopter," September 6, 1991. The report states that the Army Aviation Systems Command's Competition and Spares Management Office did not develop a competitive technical data package to enable competitive procurement of the core kits for the Hover Infrared Suppression System. As a result, the Army lost about $18.3 million in savings and could lose about $7.5 million in future savings. The report recommended immediate development of a technical data package leading to competitive procurements of the kits. The report also recommended management action to preclude recurrence of inappropriate use of other than full and open competition. The Army obtained the technical data package and issued a competitive request for proposals in February 1994, with offers due in April 1994. The Army canceled this solicitation in September 1994 because of inadequacies in the technical data package, but planned a competitive acquisition for November 1994. The Army stated that it would continue to work within existing guidelines to prevent a recurrence.

Report No. 91-060, "Advisory Report on the Acquisition of Components and Spare Parts," March 7, 1991. This report was a survey of audits, inspections, internal reviews, and special studies from 1985 to the time of the audit. The report states that excessive pricing of spare parts had decreased, that the percentage of competitive procurement actions had increased, and that breakout was increasingly used, resulting in a savings increase from $421.7 million in 1986 to $633.8 million in 1988. The report also states that problems continued to exist in procurement planning, reduction of the risk of overpricing, breakout reviews, compliance with competition in contracting requirements, and quality assurance. The report does not make any new recommendations.

Report No. 91-018, "Component Breakout Program for Major Systems," December 5, 1990. The report states that the Military Departments frequently were not performing adequate breakout reviews or aggressively pursuing component breakout on major systems. The report estimates monetary benefits of $2.36 billion during FYs 1991 through 1994 if 10 percent of the required breakout reviews resulted in breakout. The report recommended that the Under Secretary of Defense (Acquisition) require documented breakout reviews as part of system acquisition, and provide detailed guidance on breakouts. The report also recommended that the Service Acquisition Executives direct program executive officers and program managers to comply with the component breakout requirements in the Defense Federal Acquisition Regulation Supplement and direct program managers to complete component breakout reviews as a required step in acquisition strategies. Finally, the report recommended that Service Acquisition Executives verify, on a continuing basis, compliance with Secretary of Defense guidance on component breakout, and specifically recommended breakout reviews on four systems. The Under Secretary of Defense (Acquisition) issued additional guidance in February 1993. Management reported compliance with all other recommendations as of October 1994.

Report No. 90-101, "DoD Hotline Allegation of Overpricing of F-15 Spare Parts," August 15, 1990. The report states that the Air Force had not complied with the Defense Federal Acquisition Regulation Supplement and Air Force regulations on breakout analyses, resulting in inflated spare parts proposals. The report estimates that DoD could avoid as much as $12.3 million in overpricing as a result of the audit and stop-work orders issued by the Air Force. The report recommended performance of mandatory breakout analyses before negotiation of spare parts contracts, with reporting to higher-level management of the results of the analyses or the reasons for not performing analyses. Management comments were a mixture of concurrences and nonconcurrences. Management reported that analyses had been performed as of April 1991, with a resulting determination not to break out production components.

Report No. 90-056, "The Spare Parts Breakout Program," April 5, 1990. The report states that the Military Departments and DLA had achieved savings since issuance of the Secretary of Defense Spare Parts Initiatives in 1983. However, the report also cites deficiencies in accumulating and reporting costs and savings through breakout and in screening items for breakout. The report estimates monetary benefits of $107.5 million at the 4 buying activities visited from compliance with recommendations, with probable additional savings at 13 other buying activities. The report recommended greater oversight of costs of and savings from breakout screening; emphasis on full screening of items with a high annual buy requirement; improvement in maintenance of acquisition method code data; and making source-of-supply data a contract line item subject to the same conditions as other deliverables. The report also recommended that certain buying centers obtain source-of-supply information that should have already been obtained. Management generally concurred and reported compliance as of January 1993.

Appendix C. Requirements for Determining Price Reasonableness

The Federal Acquisition Regulation (FAR), the Defense Federal Acquisition Regulation Supplement, and the Armed Services Pricing Manual require contracting officers to ensure that prices paid for spare parts are fair and reasonable. Exact procedures depend on the dollar value of the contract and whether the contract is awarded under simplified acquisition (under $25,000, increased to $50,000 on July 3, 1995), sealed-bid, or negotiation procedures. The following is a summary of the FAR requirements.

Simplified Acquisition Requirements

For simplified acquisitions, the FAR requires that price fairness and reasonableness be addressed, either by an actual determination of fairness and reasonableness or by a valid decision that a determination is not necessary.

Simplified Acquisitions of $2,500 or Less (Micro-Purchases). The price reasonableness determination does not have to be documented for contract awards of $2,500 or less. Because of low potential for cost savings compared with the administrative cost to verify price reasonableness, the FAR even permits noncompetitive award of contracts valued at $2,500 or less without a determination, if the contracting officer has a basis for price comparison, and has no indication that the price is not fair and reasonable. Unfavorable comparison with prior prices and personal knowledge of the item involved are cited as indicators that the price might not be fair and reasonable.

Simplified Acquisitions of More Than $2,500. The determination of price fairness and reasonableness for simplified acquisitions of more than $2,500 should be based on competitive quotes. For oral solicitations, the contracting office should maintain informal records of oral price quotations to reflect clearly the propriety of placing the order at the price paid with the supplier concerned. For written solicitations, documentation may be limited to notes or abstracts to show prices, delivery, references to price lists used, the supplier or suppliers contacted, and other pertinent data. If only one response is received, or the price variances between multiple responses reflect lack of adequate competition, the basis of the determination that the price is fair and reasonable must be documented in the contract file. The basis for the determination can be comparison with prior prices, current price lists, catalogs, or any other reasonable basis. Additional contract file documentation is required when an award is based on other than price-related factors and when only one source is solicited.

Large Purchase Requirements

Price Analysis. Contracting officers are required to perform and document price analyses before contract award for sealed-bid and negotiated procurements. Price analysis is the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit, which together make up the price. The FAR defines several techniques for performing price analyses, including comparison of all proposal prices received, comparison of proposed prices with prior prices, and comparison of proposed prices with independent Government cost estimates.

Requirements Applicable Only to Negotiated Procurements. The following requirements appear in FAR Part 15, "Contracting by Negotiation." The FAR considers any large purchase that does not use sealed bidding procedures to be a negotiated contract.

Cost Analysis and Technical Analysis. Contracting officers are required to perform a cost analysis in addition to a price analysis for negotiated procurements costing more than $500,000 that require the contractor to submit cost or pricing data. Cost analysis is the evaluation of the separate cost elements and proposed profit in the cost or pricing data that the contractor submits. Additionally, when cost or pricing data are required, the contracting officer should obtain a technical analysis of the proposal from requirements, logistics, or other qualified personnel.

Field Pricing Support. Contracting officers should obtain field pricing support for negotiated procurements expected to exceed $500,000 that require the contractor to submit cost or pricing data. The Defense Federal Acquisition Regulation Supplement restricts the use of field pricing support to fixed-price proposals exceeding $500,000, cost-type proposals exceeding $500,000 with significant estimating system deficiencies, and cost-type proposals exceeding $1 million from offerers without significant estimating system deficiencies. Contracting officers may, with adequate written justification, waive the requirement for field pricing support. Field pricing support provides the contracting officer a detailed analysis of the contractor's proposal. The sources of field pricing support include, but are not limited to, administrative contracting officers, contract auditors, price analysts, and engineers. The contracting officer must take the results of field pricing support into account when setting prenegotiation objectives and must document, in the price negotiation memorandum, the reasons for variances from field pricing support recommendations.

Independent Government Estimates. When it is feasible to do so, contracting officers should obtain independent Government estimates for negotiated procurements and consider these estimates in setting prenegotiation objectives. The estimates can range from simple budgetary estimates to complex estimates based on inspection of the product itself and based on review of such items as drawings, specifications, and prior data. Should-cost estimates prepared by the Navy Price Fighter Department and buying center personnel fit the FAR description of complex independent Government estimates.

Appendix D. Navy Comments on Finding A and Audit Response

Navy Comments on the Finding. The Navy did not agree that the Government paid more than it should have for spare parts because of inadequate responses to price challenges. The Navy agreed that 11 of the 30 price challenge responses shown in the draft of this report as inadequate were inadequate, and stated that the other 19 responses were adequate. The Navy stated that 13 of the 19 responses were adequate because the responses contained either the reason for the price difference or the justification for the price that the buying centers provided to the Navy. The 13 responses were on NSNs 5306-00-059-3529, 5330-01-301-0076, 3110-01-319-2482, 5340-00-786-6469, 5365-01-255-5047, 5330-01-299-3160, 5330-01-320-2009, 5340-01-319-4264, 5365-01-227-9163, 5330-00-363-8211, 5315-01-304-9174, 5360-01-101-1956, and 5360-01-166-6633. The Navy further stated that it provided to the price challenger a copy of a letter that the Navy sent to the buying centers questioning the significant price differences between the prices that the Government paid and the quotes provided by the price challenger on the 13 price challenges. The Navy stated that the other 6 of the 19 responses were adequate for the following reasons.

o For NSN 4330-00-200-8095, the price challenge response told the price challenger the cause of the difference between the price from the alternate source and the price paid by the buying center.

o For NSN 1560-01-109-2492, the response provided a detailed explanation of why the suggested substitute NSN was no longer recommended and why the price challenged NSN was preferred.

o For NSN 4810-01-041-2285, the response stated that the part has had approximately the same price for the last 5 years. Also, upon review by the buying center cost and price analysis branch, the part appeared reasonably priced. Further, the Navy was not given a copy of the buying center's "should cost" review, nor was the Navy made aware of the price reduction incident to the review.

o For NSN 5330-00-103-2014, the response explained that the price increased because the item was procured as a small business set-aside in 1992, and that the small business procured the item from the manufacturer, marked up the price, and passed it to the Government. The response further stated that the current price had gone down.

o For NSN 1560-00-918-4601, the response discussed the pricing issue and explained that the $58 price cited by the price challenger could not be substantiated without additional data. The Navy further stated that the price challenger never responded to a request for additional supporting information, and that the technical data that the price challenger provided appeared to serve only to support part identification and were not sufficient to support that the item was overpriced.

o For NSN 5340-01-063-1288, the response explained the rationale provided by the buying center for the procurement price. Also, the Navy sent a letter to the buying center disagreeing with the buying center determination that the procurement price was reasonable. A copy of the Navy letter was provided to the price challenger.

Audit Response. As a result of the information provided by the Navy, we deleted the statement in the finding that inadequate responses to price challenges resulted in the Government paying more for spare parts than it should have paid. We also changed the number of responses that we determined inadequate from 30 responses to 24 responses.

We agree with 6 of the 19 responses that the Navy stated were adequate. We determined that five of the six responses (NSNs 3110-01-319-2482, 5330-01-299-3160, 5330-01-320-2009, 5315-01-304-9174, and 5360-01-101-1956) were adequate based on information provided by DLA that showed that the parts were not overpriced. The other response adequately discussed the data provided by the price challenger on a substitute part for NSN 2835-01-109-2492.

We disagree with the Navy that the other 13 responses were adequate. As stated in the finding, the Navy responses for 8 of the 13 price challenges either stated that the challenged prices were fair and reasonable or did not comment on the reasonableness of the challenged prices. The Navy sent letters to the buying centers with a copy to the price challenger that questioned the significant price differences between the prices paid and the prices provided by the price challenger. The letters basically confirmed the inadequacy of the response. Additionally, the Navy never informed the price challenger of any actions that the buying centers took in response to the letters.

We disagree that the other 5 of the 13 price challenge responses were adequate for the following reasons.

o Although the response on NSN 4330-00-200-8095 explained the cause of the difference between the alternate source price and the price paid by the buying center, it did not state whether the challenged price was reasonable.

o As stated in the finding, the response on NSN 4810-01-041-2285 did not inform the price challenger that an independent Government estimate showed that the part should cost $66, as opposed to the $284 paid, and that the supply system price was lowered to conform to the independent Government estimate. The fact that Construction Supply did not provide information to the Navy on the independent Government estimate does not change our conclusion that the response that the price challenger received was inadequate.

o The information was not accurate in the response on NSN 5330-00-103-2014 that the price increase was a result of the purchase being set-aside for small business. Virtually all purchases of the NSN were set-asides for small businesses. Therefore, the large price increase (about 91 percent) cannot be explained by the small business set-aside. The fact that

later prices have gone down is more evidence, not less evidence, that the challenged price was excessive and that the response provided to the price challenger was inadequate.

o As stated in the finding, we disagree that the Navy response on NSN 1560-00-918-4601 adequately addressed the funding and technical data that the price challenger forwarded with the price challenge. We also disagree with the Navy assumption that the data forwarded by the price challenger merely served to identify the part. The language in the response that the Navy states requested the price challenger to provide additional supporting information for the suggested $58 price is the standard "pat" language in the closing responses to at least 34 of the 45 price challenges we examined. The language in no way addresses the funding and technical information that the challenger forwarded with the price challenge. The response does not acknowledge receipt of the data, does not state whether the data were evaluated, does not state whether the data were adequate, and does not request that the data be resubmitted if they were inadequate.

o As stated in the finding, the response on NSN 5340-01-063-1288 did not acknowledge that the challenged price was found to be unreasonable and that, as a result of the price challenge, a voluntary refund was obtained from the manufacturer. The omission of information about the refund from Industrial Supply's response to the Navy does not change our conclusion that the response that the price challenger received was inadequate.

Appendix E. Summary of Parts Unreasonably Priced

NSN/ Part Name	Contracting Activity	Total Quantity Overpriced	Average Unit Price/ Number of Contracts	Reasonable Unit Price/ Basis	Total Actually Paid	Total at Reasonable Price	Approximate Overpricing/ Percent Overpriced	Causes of Overpricing
1560-00-761-7929 Forward Head Hub	ASO*	1,023	$13,353.66 4	$6,870.13 Adjusted Estimate	$13,660,798.31	$ 7,028,142.99	$ 6,632,655.32 94	1
1560-00-472-2722 Rudder Tip	ASO*	13	3,470.00 1	308.19 Government Estimate	45,110.00	4,006.47	41,103.53 1,026	1
1560-00-761-7899 Aft Head Hub	ASO*	1,045	13,215.01 3	6,860.78 Adjusted Estimate	13,809,684.01	7,169,515.10	6,640,168.91 93	1
1560-00-073-1158 Link Assembly	ASO*	51	239.05 2	131.43 Adjusted Estimate	12,191.73	6,702.93	5,488.80 82	1,2
3040-00-073-6915 Shaft and Carrier	ASO*	84	36,033.00 1	8,195.68 Government Estimate	3,026,772.00	688,437.12	2,338,334.88 340	1
2930-00-367-7375 Engine Radiator	Construction Supply	30	878.85 2	821.17 Alternative Source	26,365.55	24,635.10	1,730.45 7	2,3
4810-01-041-2285 Orifice Disk	Construction Supply	8	320.08 3	179.24 Government Estimate	2,560.67	1,433.92	1,126.75 79	2
4330-00-200-8095 Fluid Filter Element	Construction Supply	135	8.79 4	4.00 Alternative Source	1,187.07	540.00	647.07 120	3
5975-00-435-0133 Junction Box Cover	General Supply	162	344.23 2	322.93 Adjusted Estimate	55,764.58	52,314.66	3,449.92 7	1,2
1560-00-261-4990 Assembly of Elevator Tab Fitting	General Supply	79	278.00 1	156.52 Subsequent Cost Data	21,962.00	12,365.08	9,596.92 78	2
5330-01-298-7702 Gasket	Industrial Supply	25	2.25 1	0.61 Subsequent Price	56.25	15.25	41.00 269	3
5306-00-059-3529 Machine Bolt	Industrial Supply	1,370	5.56 2	0.86 Alternative Source	7,622.20	1,178.20	6,444.00 547	3

(Continued)

Causes of overpricing:
1 Did not use Government estimates or field pricing support in negotiations.
2 Did not question large increase over previous prices.
3 Did not consider alternative source from price challenge.

*Naval Aviation Supply Office

Appendix E. Summary of Parts Unreasonably Priced

NSN/ Part Name	Contracting Activity	Total Quantity Overpriced	Average Unit Price/ Number of Contracts	Reasonable Unit Price/ Basis	Total Actually Paid	Total at Reasonable Price	Approximate Overpricing/ Percent Overpriced	Causes of Overpricing
5330-01-301-0076 Plain Encased Seal	Industrial Supply	230	$ 25.53 13	$ 21.42 Alternative Source	$ 5,872.88	$ 4,926.60	$ 946.28 19	3
5340-00-786-6469 Anode	Industrial Supply	385	53.96 2	3.54 Alternative Source	20,773.50	1,362.90	19,410.60 1,424	3
5365-01-255-5047 Sleeve Spacer	Industrial Supply	171	21.30 2	7.25 Alternative Source	3,641.82	1,239.75	2,402.07 194	3
5340-01-319-4264 Angle Bracket	Industrial Supply	21	7.08 1	4.56 Alternative Source	148.68	95.76	52.92 55	3
5365-01-166-6633 Retaining Ring	Industrial Supply	128	15.28 3	7.39 Alternative Source	1,955.32	945.92	1,009.40 107	2,3
5340-01-063-1288 Bracket	Industrial Supply	110	10.72 1	1.72 Contractor Refund	1,179.20	189.20	990.00 523	2
5365-01-227-9163 Sleeve Spacer	Industrial Supply	7	103.69 2	19.60 Alternative Source	725.82	137.20	588.62 429	3
5330-00-363-8211 Gasket	Industrial Supply	39	33.06 4	24.05 Alternative Source	1,289.28	937.95	351.33 37	3
5330-00-421-4849 Gasket	Industrial Supply	150	18.12 2	10.16 Alternative Source	2,718.00	1,524.00	1,194.00 78	2,3
4030-00-824-2327 Wire Rope Terminal	Industrial Supply	193	670.38 4	125.00 Subsequent Competition	129,383.51	24,125.00	105,258.51 436	2
5340-01-268-3618 Butt Hinge Leaf	Industrial Supply	51	127.50 2	80.00 Recent Prior Price	6,502.38	4,080.00	2,422.38 59	2
5330-00-103-2014 Preformed Packing	Industrial Supply	72	63.20 1	33.10 Recent Prior Price	4,550.40	2,383.20	2,167.20 91	2
		Total			$30,848,815.16	$15,031,234.30	$15,817,580.86	

Causes of overpricing:
1 Did not use Government estimates or field pricing support in negotiations.
2 Did not question large increase over previous prices.
3 Did not consider alternative source from price challenge.

Appendix F. Summary of Parts Reasonably Priced and Criteria Met

Contracting Activity	NSN	Name	Criteria Met
ASO*	1615-00-909-5569	Gear Assembly	1, 2
	2915-00-014-1897	Subassembly Valve	2, 3
Electronics Supply	5910-00-781-4797	Fixed Capacitor	1, 4
General Supply	6150-00-949-5858	Remote Control Cable Assembly	1, 5
Industrial Supply	5340-01-272-8406	Butt Hinge Leaf	1, 4
	5315-01-304-9174	Special Key	6
	3110-01-319-2482	Annular Ball Bearing	6
	5330-01-299-3160	Gasket	6
	5360-01-101-1956	Latch Spring	6
	5330-01-320-2009	Encased Plain Seal	6
	2835-01-109-2492	Spline Adapter	5
	5365-00-013-1343	Through Bolt Spacer	3, 4
	5310-00-780-9554	Self Locking Barrel Nut	1, 4

Criteria

1 Contract price was less than or equal to the prior procurement price.

2 Price analysis and cost analysis of the contractor's cost or pricing data supported the negotiated contract price. Negotiated price was less than the proposed price.

3 Price escalation over the prior procurement price was justified by the contracting officer.

4 The price fairness and reasonableness determination that was performed by the contracting officer supported the small purchase price.

5 Adequate price competition (price quotations from two or more qualified contractors) supported the price.

6 Alternate source prices, after addition of DLA estimates of barcoding and military packaging costs, were higher than or virtually equal to the prices paid.

*Naval Aviation Supply Office.

Appendix G. Defense Logistics Agency Comments on Finding B and Audit Response

DLA Comments on the Finding. DLA partially concurred. DLA stated that it agreed that contracting officers did not always use available independent Government estimates and field pricing support, did not always analyze price increases, and did not always solicit identified alternate sources. DLA disagreed that most of the procurements discussed in the finding were unreasonably priced. DLA stated that contracting officers exercise considerable judgment in making price reasonableness determinations. Many considerations go into reaching the decision, which is time-specific and based on information that is available to the contracting officer when the determination is made. Information may become available on an alternate source, a lower priced subsequent buy, or an in-depth cost estimate. However, a higher price on a previous or subsequent buy does not confirm that another buy was unreasonably priced or that overpricing occurred. A range of prices may be considered fair and reasonable depending on the circumstances. DLA further stated that unless the price paid is attributable to erroneous and misleading information furnished by the contractor, or the contracting officer's price reasonableness determination was not supported and should have been substantially lower, the price reasonableness determination made at the time of the procurement was correct.

Audit Response. We agree that determination of an unreasonably priced procurement is difficult and that a range of prices may be reasonable depending on the circumstances surrounding the procurement. Decisions made in response to the various circumstances that affect procurements are difficult and judgmental. Determining when obtaining independent Government estimates is feasible to evaluate proposed prices, when to analyze price increases, and when to solicit alternate sources are judgmental decisions by the contracting officer. During the audit, we determined that a procurement was unreasonably priced if any of the following applied.

o An independent Government estimate indicated that the part should cost less than the price paid and the contracting officer did not use the estimate during the price negotiation process.

o The price paid for a part was 45 percent or more higher than the price of previous or subsequent procurements of the part.

o The part was available for a lower price from another source.

Obtaining Independent Government Estimates. DLA disagreed that overpricing occurred on any of the six parts that the report states were unreasonably priced because contracting officers did not use available independent Government estimates to evaluate contractor-proposed prices. DLA stated that FAR 15.803(b) does not establish any requirement regarding the use of independent Government estimates for the analysis of offers received. DLA stated that the estimate discussed in FAR 15.803(b) is aimed at assuring adequate and accurate financial planning during acquisition planning and that

this type of budgetary estimate would be of limited value for price proposal evaluation and is not used by DLA for price evaluations. DLA stated that its contracting officers are not required to use an independent Government estimate when determining a fair and reasonable price for any procurement and that use of an independent Government estimate is only one of the various price analysis techniques that a contracting officer may select for use. If an independent Government estimate is requested and obtained, or if a previously performed independent Government estimate is received, the contracting officer should consider it in setting prenegotiation objectives. DLA pointed out several limitations to the usefulness of independent Government estimates and stated that despite the limitations, DLA contracting officers use independent Government estimates where appropriate to set prenegotiation objectives. The independent Government estimate is used only to the extent that the contracting officer deems the estimate to be a reasonably reliable basis for price negotiation. DLA stated that the value of each procurement dictates the type or depth of cost and price analysis conducted by the Government and that DLA officials followed FAR and Defense Federal Acquisition Regulation Supplement guidance when pricing procurements.

DLA further stated that the independent Government estimates prepared by the Navy Price Fighter Department for the head hubs (NSNs 1560-00-761-7929 and 1560-00-761-7899) procured by the Navy and priced by the Defense Plant Representative Office Boeing were based on illegible drawings. For the junction box cover (NSN 5975-00-435-0133) procured by General Supply, DLA stated that the independent Government estimate was considered in evaluating the contractor's proposal for the 1994 procurement. DLA stated that direct material in the independent Government estimate was comparable to the contractor's proposed material costs and that the principal point of departure between the Government's position and the independent Government estimate was the fact that the independent Government estimate used nationwide average rates, which underestimate the proper price level for the high-cost producer by a substantial amount. DLA also pointed out that, when adjusting the independent Government estimate to include the contractor's rates, the auditors did not include five applicable direct support labor factors. DLA stated that if the shortcomings in the independent Government estimate were eliminated and the applicable markups added, the adjusted independent Government estimate would have been comparable to the amount negotiated, which demonstrates that the price was fair and reasonable. DLA also stated that our report implies that field pricing support should be obtained for all procurements.

Audit Response. DLA did not provide any additional information on the six parts that would cause us to change our conclusion that the prices were potentially unreasonable for the reasons stated in the finding and in the audit response to DLA comments on Recommendation B.1.a. Based on the DLA comments, we recalculated the independent Government estimates for two parts to include the direct support labor factors and reduced the estimated amounts of overpricing for the parts.

We do not agree that FAR 15.803(b) does not establish any requirement to use independent Government estimates to analyze offers received. FAR 15.803(b) states that the contracting officer shall develop an estimate (when it is feasible to

do so) before issuing a solicitation. We disagree that the estimate is a budgetary estimate to be used during acquisition planning. FAR 15.805-2, "Price Analysis," specifically refers to the estimate in FAR 15.803(b) as an independent Government estimate and mentions comparison of proposed prices with the independent Government estimate as one of the techniques that may be used to perform a price analysis. Budget estimates and funding for acquisition planning are discussed in FAR Part 7, "Acquisition Planning." Additionally, FAR 15.807(a) states that, in setting prenegotiation objectives, the contracting officer shall take into account pertinent data such as independent Government cost estimates.

We disagree with the DLA implication that the independent Government estimate for the head hubs was not valid because the drawings were not legible. DLA failed to note that the independent Government estimate report refers to illegible drawings only in the context of the adequacy of the technical data package for breakout to competition. The Navy Price Fighter Department confirmed that its ability to prepare an independent Government estimate was not impaired by the quality of the drawings. Concerning the junction box cover, we disagree that the independent Government estimate prepared by the Navy Price Fighter Department was taken into account when setting prenegotiation objectives and that the material cost in the prime contractor's proposal ($57.81) was comparable to the independent Government estimate ($20.89). Contract files at General Supply contain no evidence that the contracting officer used the independent Government estimate during the negotiation process or that the contracting officer addressed the General Supply cost analyst's note on the independent Government estimate. The cost analyst noted that he did not use the independent Government estimate because it was based on a prime contractor making the item as opposed to buying the part almost complete and performing minimal labor to complete. The cost analyst did not address the fact that the prime contractor's proposed labor hours (1.73) were comparable to the independent Government estimate labor hour estimate (1.623). If a prime contractor purchases a part almost complete as noted by the cost analyst, the labor hours should be much lower that the labor hours required to manufacture the part from raw material.

We disagree that the report suggests that field pricing support be obtained for all procurements. Appendix C of the report clearly states that field pricing support is only applicable to large purchases and specifically to negotiated procurements expected to exceed $500,000 that require the contractor to submit cost or pricing data. We believe that the contracting officer should have obtained field pricing support for the procurements of NSNs 1560-00-761-7929 and 1560-00-761-7899 for the reasons stated in the finding.

Analyzing Price Increases. DLA stated that analysis of price increases over previous procurements is only required on large purchases. Of the five parts that the draft report stated were overpriced because price increases were not analyzed, DLA agreed with the amount of overpricing on one part, agreed that two parts were overpriced by a smaller amount than reported, and disagreed that two parts were overpriced.

On the assembly of elevator tab fitting (NSN 1560-00-262-4990), DLA agreed that the item was overpriced. General Supply requested a refund of $9,596.92 from the contractor. The contractor stated that it completed the order at $9,596.92 below the contract price and voluntarily refunded half of that amount.

On the orifice disk (NSN 4810-01-041-2285), DLA stated that the independent Government estimate we used to calculate the amount of overpricing was not a detailed estimate and should not be used as a basis for a fair and reasonable price. DLA also stated that in 1991, the unit price to Construction Supply for 3 orifice disks increased from $48 to $284.25 because of a $750 minimum order charge that the original manufacturer imposed on the supplier. The original manufacturer was subsequently bought out, and the new manufacturer apparently adopted the $250 minimum order charge ($750 divided by 3) as a baseline unit price, and charged the DLA suppliers unit prices $257 and $267 on two procurements. DLA further stated that in July 1995, Construction Supply obtained an independent Government estimate from the Navy that showed an estimated unit price of $90.68 based on a review of the proprietary drawing. Construction Supply recalculated the estimated price at $85.49 and applied a $250 minimum order charge to determine a reasonable price for the three procurements of the part ($1,433.92 instead of $2,560.67 paid). The $1,126.75 difference constitutes overpricing. DLA stated that on future procurements, the manufacturer will be contacted to determine the least costly source of supply for the part.

On the wire rope terminal (NSN 4030-00-824-2327), DLA agreed that the three split procurements were overpriced and calculated the overpriced amount based on an overstatement of labor hours in cost data provided by the contractor. DLA disagreed with our use of the price of a subsequent procurement from an alternate source to compute the overpricing amount. DLA stated that the difference in prices should principally be attributed to the difference between a high-cost and a cost-efficient producer. DLA did not agree that the reduced quantity procurement of the wire rope terminal was overpriced at the original $325 unit price and stated that the price increase from $325 to $560 after the quantity was reduced was to reimburse the contractor for cost incurred.

On the butt hinge leaf (NSN 5340-01-268-3618) and the preformed packing (NSN 5330-00-103-2014), DLA disagreed the parts were overpriced. DLA stated the parts were purchased noncompetitively through its automated purchasing system from a small business dealer, and that the prior (lower priced) procurements were manual procurements from the manufacturer. DLA further stated that the procurements were made during the period when DLA had authority to make awards up to $5,000 noncompetitively because of Operation Desert Storm. DLA stated that prices for items supplied by middlemen generally exceed the prices of manufacturers that sell directly to the Government, and that on low value procurements, the addition of a dealer markup is incidental to the total amount paid. Further, the cost to cancel or dissolve the set-aside on individual buys virtually precludes this option. DLA stated that Industrial Supply has made no further purchases of the butt hinge leaf, but with the 1995 elimination of set-asides for micro-purchases, reason

exists to believe that the pricing problem for this item will not recur. Also, the eight subsequent procurements of the preformed packing were manual procurements with an average unit price of $39.73.

Audit Response. We disagree that analysis of significant price increases is only required on large purchases. The FAR requires price comparison for noncompetitive simplified acquisitions above and below $2,500 when comparable pricing data are readily available. We believe that the contracting officers should have evaluated the price increases for the parts discussed in the finding that had price increases ranging from 59 percent to 1,233 percent.

We reduced the estimated overpricing on the orifice disk based on DLA adjustments to the most recent (July 1995) independent Government estimate prepared by the Navy Price Fighter Department and the DLA assumption that the new contractor will have a minimum charge of $250 for each order. We based our initial estimate of a reasonable price on the independent Government estimate that Construction Supply prepared because engineering personnel prepared it, because Construction Supply used it to pursue a voluntary refund from the contractor, and because Construction Supply used it to adjust the standard price for the part.

On the wire rope terminal, we disagree that we should use the price as adjusted by DLA ($675) from a high-cost producer to calculate potential overpricing even though another contractor was able to produce the part for a much lower price ($125). We believe that if an acceptable part can be provided for a price that is lower than the price paid, the lower price is the fair and reasonable price. The fact that a high-cost producer will only provide a part at a high price does not make the high price fair and reasonable. On the reduced quantity procurement, we continue to believe that both the $325 original unit price and the $560 price after the quantity was reduced were unreasonable for the reasons stated in the finding.

Concerning the butt hinge leaf and preformed packing, we disagree that the parts were not potentially overpriced. As stated in the finding, the prices of the parts increased by 59 percent and 91 percent, respectively, over the previous procurement prices. We believe that the contracting officer should have questioned the large price increases even if the parts were procured from small businesses through an automated purchasing system. FAR 13.105(d)(3) states that the contracting officer need not proceed with a small business-small purchase set-aside if a reasonable quote from a responsible small business is not received. At the very least, the contracting officer should have acknowledged the large price increase and documented the file to show a determination to proceed with the procurement at the potentially unreasonable price to meet the requirements of Operation Desert Storm.

Soliciting Alternate Sources. DLA disagreed with our conclusion that 18 parts shown in the draft audit report were unreasonably priced because an alternate source with lower prices was not solicited. DLA stated that existing regulations on simplified acquisitions do not require contracting officers to solicit alternate sources on all procurements. Micro-purchases may be awarded without soliciting competitive quotations if the contracting officer determines that the

price is reasonable, and contracting officers need only solicit a reasonable number of sources to ensure that the purchase is advantageous to the Government for simplified purchases that exceed $2,500. DLA further stated that contracting officers were not required to solicit the alternate source before Construction Supply and Industrial Supply were informed of the existence of the alternate source through the price challenges, and that even after they were informed, contracting officers were not required to solicit the alternate source on all applicable procurements. DLA stated that most procurements of the applicable parts were through automated purchasing systems and that the report suggests that DLA manually procure the parts for the sole purpose of soliciting the alternate source. DLA further stated that pursuit of the lowest possible purchase price could significantly increase administrative costs and adversely impact administrative and production lead times and awards to small businesses if implemented across the board to any sizeable degree.

DLA provided cost estimates for military packaging and barcoding to be added to the alternate source prices to determine reasonable prices for the parts. DLA also stated that an additional $2 or $3 should be added to the unit price of each gasket for special packaging requirements. DLA stated that one procurement of a bracket (NSN 5340-01-063-1288) was not overpriced because Industrial Supply obtained a refund from the contractor. DLA also stated that we double counted the contracts for NSNs 2930-00-367-7375 and 5330-00-421-4849, misstated the price for NSN 5365-01-166-6633, and quoted the wrong part number for NSN 5330-00-421-4849. DLA further stated that a technical review to determine whether the proposed alternate source is a valid source for the identical items would be required before the buying centers could solicit the alternate source.

Audit Response. As stated in the finding, we agree that Construction Supply and Industrial Supply followed FAR guidance when they did not make an effort to identify alternate sources for the parts. Extensive effort to identify the alternate source would not have been cost-effective for procurements made before receipt of the price challenges. However, the fact remains that the parts were available from an alternate source for lower prices. Based on the DLA comments, we recalculated the reasonable unit prices by adding the cost estimates that DLA provided to the alternate source prices and we reduced the number of overpriced parts from 18 parts to 13 parts. We also changed the cause of overpricing for one part from failure to solicit an alternate source to failure to evaluate a large price increase. Additionally, we revised the finding to clarify that we did not intend for DLA to manually procure the parts in order to solicit the alternate source. We recognize the cost saving from automatically procuring parts. On the issue of a technical review of the alternate source, we do not believe that a technical review is necessary because the alternate source is an authorized distributor for the manufacturer of the parts.

We used the highest cost estimates provided by DLA to recalculate the reasonable unit prices for all but one of the 18 parts. For NSN 5330-01-298-7702, we did not add the $2 or $3 per gasket special packaging charge because DLA stated that Industrial Supply recently purchased the gasket

for a unit price of $0.61. We therefore concluded that NSN 5330-01-298-7702 did not require the special packaging, and further concluded that $0.61 was the best available estimate of a reasonable unit price for the gasket.

We disagree with the DLA conclusion that the procurement of a bracket (NSN 5340-01-063-1288) was not overpriced because Industrial Supply obtained a refund from the contractor. Further, the more prominent issue in the procurement was the contracting officer's failure to question the 319-percent unit price increase from $2.56 to $10.72. We therefore changed the primary cause of overpricing of this part from failure to solicit the alternate source to failure to question the large price increase. We also changed the reasonable unit price for the bracket to the contractor's actual price, $1.72. As noted in Finding A, the contractor, in response to a price challenge, stated that the $10.72 unit price should have been $1.72 and refunded $990 (5 years after contract award). The price presumably would have been adjusted before contract award if the contracting officer had asked about the price increase at that time. We concluded that the other procurement of the bracket included in our previous analysis was not overpriced after we added the estimated costs of barcoding and packing provided by DLA to the alternate source price and deleted the procurement from the finding.

We do not know how DLA determined that the two contracts for NSNs 2930-00-367-7375 and 5330-00-421-4849 that DLA stated we double counted were duplicates and that the price for NSN 5365-01-166-6633 was incorrect. However, we assumed that the information that DLA provided was more recent and accurate and deleted the two contracts from the finding, and we revised the unit price for NSN 5365-01-166-6633. The procurement histories that we obtained from Construction Supply and Industrial Supply for the two contracts showed two different awards under the same contract numbers at different unit prices for the two parts. Also, the unit price for NSN 5365-01-166-6633, which DLA stated was incorrect, came from the procurement history provided by Industrial Supply. For the part (NSN 5330-00-421-4849) that DLA stated we used the wrong part number, we used the correct part number (5144590) and price ($7.16) quoted by the alternate source. According to documents provided by Industrial Supply, part number 5144590 corresponds to NSN 5330-00-421-4849. The alternate source stated that part number 5144590 has recently been replaced by alternate part number 5125635, which has a much lower price ($1.89 as opposed to the $7.16 price for part number 5144590). We did not revise the finding because the price challenge was processed in April 1993, before part number 5144590 was replaced.

Appendix H. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefits	Amount of Benefit
A.1., A.2.	Program Results. Improves the value of the price challenge process in detecting and preventing overpricing and increases the probability of getting refunds for overpriced past procurements.	Monetary. Undeterminable because the number and dollar value of future procurements and refunds are unknown.
B.1., B.2.	Program Results. Increases probability of getting fair and reasonable prices for spare parts.	Monetary. Undeterminable because the number and dollar value of future procurements is unknown.

Appendix I. Organizations Visited or Contacted

Department of the Navy

Naval Supply Systems Command, Arlington, VA
- Naval Aviation Supply Office, Philadelphia, PA

Naval Fitting Out and Supply Support Assistance Center, Norfolk, VA
Naval Aviation Depot, Cherry Point, NC

Defense Organizations

Defense Logistics Agency, Alexandria, VA
- Defense Construction Supply Center, Columbus, OH
- Defense Electronics Supply Center, Dayton, OH
- Defense General Supply Center, Richmond, VA
- Defense Industrial Supply Center, Philadelphia, PA
- Defense Plant Representative Office, Boeing Defense and Space Group, Helicopter Division, Philadelphia, PA

Appendix J. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Assistant Secretary of the Navy (Research, Development, and Acquisition)
Inspector General, Department of the Navy
Commander, Naval Air Systems Command
  Commanding Officer, Naval Aviation Depot, Cherry Point
Commander, Naval Supply Systems Command
  Commanding Officer, Naval Aviation Supply Office
  Commanding Officer, Navy Fitting Out and Supply Support Assistance Center
Auditor General, Department of the Navy

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Commander, Defense Construction Supply Center
  Commander, Defense Contract Management Command
    Commander, Defense Contract Management District, Boston
      Commander, Defense Plant Representative Office, Boeing Defense and Space Group, Helicopter Division
  Commander, Defense Electronics Supply Center
  Commander, Defense General Supply Center
  Commander, Defense Industrial Supply Center
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations and Individuals

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

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

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

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Part III - Management Comments

Department of the Navy Comments

Final Report Reference

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

SEP 06 1995

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR GENERAL FOR AUDITING

Subj: DODIG DRAFT AUDIT REPORT ON PRICE CHALLENGES ON SELECTED SPARE PARTS (PROJECT NO. 4CH-8010.01)

Ref: (a) DODIG memo of 12 Jun 95

Encl: (1) Department of the Navy Comments

1. We have reviewed the findings and recommendations in the subject report provided by reference (a). In summary:

Revised

a. Of the 30 Navy responses to price challenges that the audit considered non-responsive in finding A, we agree with the auditors in 11 cases but we disagree with them in 19 cases.

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b. We do not agree with the implication in your Executive Summary and in finding A that the Government paid more than it should have for spare parts due to inadequate responses to price challenges for Naval Aviation Supply Office (ASO) items. Allegations of overpricing are discussed in finding B. We concur with that part of finding B that ASO did not always forward should cost data from the Price Fighter department to the definitizing activity. ASO has provided additional training to contracting personnel on pricing including the use of should cost data.

c. We concur with recommendations in finding A to evaluate and respond accurately and responsively to all issues raised in price challenges received. Also, we concur with recommendations in finding B to require buying centers to use independent Government estimates for negotiated procurements, obtain field pricing support, make price comparisons, and include approved alternative sources identified by price challengers in the source lists for parts. NAVSUP will issue guidance to field activities by 31 August 1995.

d. In addition to the above planned action, it should be noted that many improvements to the Price Challenge Hotline have been instituted since the Price Fighter Hotline transferred to the Fitting Out and Supply Support Assistance Center's (FOSSAC) Price Fighter department in April 1994. Faster in-house processing and tracking of hotlines; reconciliation of cases with buying centers; installation of a 1-800 number to improve

communication with customers; development of a video to educate the fleet about the hotline; publication of an in-house operations manual; and customer surveys are some of the innovations implemented within the past year designed to make the Price Challenge Hotline more responsive to the customer.

2. Detailed comments are in enclosure (1).

W. C. BOWES
Vice Admiral, U.S. Navy
Principal Deputy

Copy to:
FMO-13
NAVINSGEN

Final Report Reference

DEPARTMENT OF THE NAVY COMMENTS
TO
DODIG DRAFT AUDIT REPORT OF 5 JUNE 1995
ON
PRICE CHALLENGES ON SELECTED SPARE PARTS
(PROJECT NO. 4CH-8010.01)

FINDING A. RESPONSES TO PRICE CHALLENGES

The Navy (the Navy Fleet Material Support Office and, to a lesser extent, the Navy Price Fighter Detachment) provided inadequate responses to price challenges submitted under the Buy Our Spares Smart (BOSS) price challenge program. The inadequate responses occurred because the Navy and the cognizant buying centers did not always:

- determine whether the challenged prices were fair and reasonable,

- answer all the issues raised in the price challenges, or

- communicate results of price challenge evaluations to the price challengers.

As a result, unreasonable pricing of spare parts was not detected and the Government paid more than it should have paid for the parts. Also, the unreasonable prices paid may be mistakenly used as a reasonable cost basis to justify prices for future procurements. Additionally, price challengers were dissatisfied with responses and may decline to challenge suspected unreasonable prices in the future.

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DON Background Comments: Navy Price Challenge Hotline

The Navy established the Price Challenge Hotline in 1979 at the Fleet Material Support Office. In 1983, the Navy realigned the Price Challenge Hotline under the new initiative BOSS. The BOSS initiative also established the "break-out" program and the Navy Price Fighters Detachment (now a department under the Navy Fitting Out and Supply Support Assistance Center (FOSSAC)). The Price Challenge Hotline was transferred to FOSSAC's Price Fighters Department in April, 1994.

The Navy has always valued the input from the supply system customer (Navy military and civilian) because they are in many instances the best source of information regarding pricing discrepancies. Since 1983, over 106,000 price challenges have been answered with cost avoidances in excess of $600 million.

1

The Price Fighters Department has achieved savings in excess of $540 million. By combining these two programs in 1994, the Navy sought to provide a "one-stop" pricing center that would be more responsive to customer concerns. Indeed, combining the Supply Systems Analysts of the Price Challenge Hotline with the General Engineers, Industrial Engineering Technicians, and Equipment Specialists of the Price Fighters Department provides a synergistic effect that allows and promotes direct Independent Government Estimate (IGE) analysis support between the Price Challenge Hotline personnel and the Price Fighters value analysis technical staff.

Many improvements and initiatives have been realized since the Price Challenge Hotline transferred. These improvements (which were implemented after the auditors visited FOSSAC in the spring of 1994) include:

- Better communication between supply systems analysts and value analysis technical staff within the Naval Supply System Command (NAVSUP).

- A complete revamping of the Price Challenge computer system which facilitates faster in-house processing and better tracks on-going actions with all cognizant activities.

- Followup action files have been completely reconciled with the buying centers to ascertain Inventory Control Point (ICP) disposition of closed and outstanding cases.

- In-process cases have been reconciled with all buying centers to improve ICP focus on outstanding cases.

- Better communication with the Fleet customer has been achieved by installing a Streamlined Automated Logistics Transmission System (SALTS), a "1-800" number (1-800-NAV-CHAL), and a 24-hour phone answering system.

- A new video has recently been produced to educate the Fleet about the Price Challenge Hotline.

- Two Price Challenge conferences have been held. The first, in November 1994, was initiated by the Price Fighters Department to provide a foundation of better relations between the Price Challenge Hotline personnel and the Navy and Defense Logistics Agency (DLA) buying centers.

- Customer Survey cards are provided to each price challenger for feedback in the areas of: Timeliness of Acknowledgment Letter, Timeliness of Response Letter,

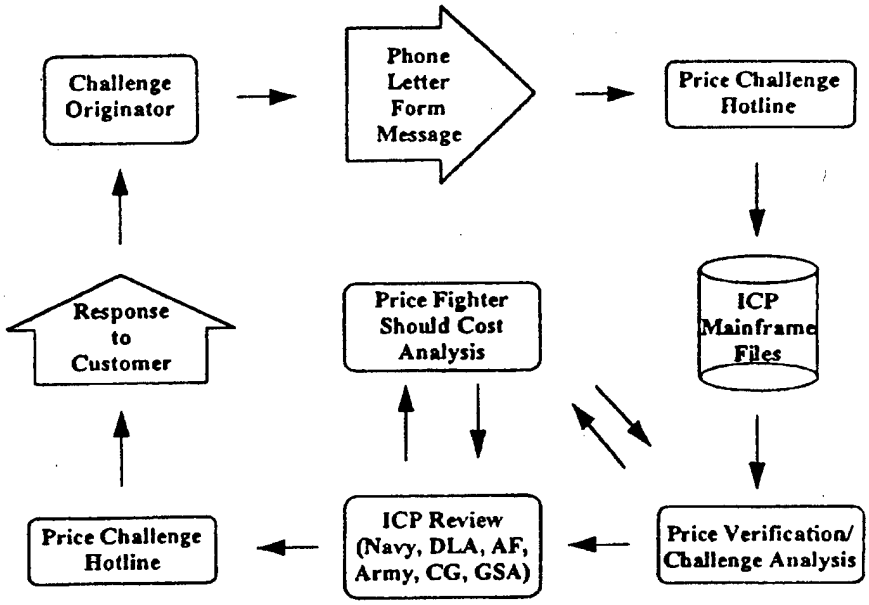
Satisfaction with Response (all questions answered, clear explanation), and Personnel Support (courtesy, professionalism).

- An Operations Manual (November 1994) for the Price Challenge Hotline explains how to administer the program, how to properly respond to price verifications and price challenges, and how to administer awards to price challengers. (Indeed, the Operations Manual covers many of the same areas as the DLA instruction cited in the draft report.)

Since the implementation of these improvements, the customers have responded positively. Even the Naval Aviation Depot (NADEP), Cherry Point, NC, (the activity whose concerns prompted this audit) sent the new Price Challenge Hotline personnel a letter dated 20 July 1994, expressing their great appreciation for the level of detail and clarity of current responses and for the extremely courteous and helpful employees.

Processing Price Challenges

The following chart gives an overview of how the Price Challenge Hotline processes price verifications and challenges. Normally, the price challenger will send a case into the Price Challenge Hotline process via mail, phone, or message.



3

The draft audit infers that all price challenges received are subjected to an Intrinsic Government Estimate analysis (i.e., "should cost"). This is not the case. The Price Challenge Program employs three levels of pricing analysis. The level of analysis depends upon the amount of information provided or derived and possible indications of further review requirements.

- Price Verification Process

A price verification is performed when a challenger provides a suspect price, NSN, and nomenclature of the item and explains why overpricing is suspected. With this limited amount of information, the Price Challenge Hotline is restricted to verifying whether the list price is correct or incorrect based on the actual procurement history plus the appropriately applied DOD mandatory surcharge rate. If the list price is verified as correct, then the challenger is informed as to how the price was derived. If the list price is incorrect, then the challenger is informed that the price is incorrect, what the correct price is, and how it was derived.

If the price verification study warrants, the case will be passed to the cognizant ICP point of contact for further research and analysis. This happens when the Price Challenge Hotline has determined that the price is incorrect or there is no pricing and/or procurement history available to determine the correct price. In either case, the Item Manager (IM) is required to perform further research and analysis before a final determination is made. The IM, when warranted, will request a detailed "should cost" analysis be performed. The result of this analysis is an estimated price of what the average company would charge to produce the item in question. The IM uses this analysis, among other things, to determine whether the item is overpriced due to the government paying too much to a supplier, whether to pursue a voluntary refund from the supplier, and/or whether to close the case based upon a determination that the item's price is justifiable. Upon receipt of the IM's response, the Price Challenge Hotline will evaluate that response to determine its suitability in terms of providing the challenger with a quality response which specifically answers their initial inquiry.

- Price Challenge Process

A price challenge is performed when the challenger provides ample information to conduct a price analysis which is not restricted to price verifications only. This type of analysis involves a verification of the list price plus addressing the interchangeability of NSNs (alternate items), alternate sources of supply

and/or alternate sources of repair. These price challenges require assistance from the cognizant IM to provide an accurate, complete response to the challenger. The IM's response is then evaluated, again to determine suitability of providing a quality response to the challenger specifically answering their initial inquiry.

- Independent Government Estimate ("should cost" review)

If ICP or Hotline personnel seriously question pricing information on file or otherwise available, an IGE, or "should cost" may be performed and made part of the challenge case and response.

- Response to the Customer

Once the price verification/challenge analysis is completed, the Price Challenge Hotline will summarize the results and provide a response to the challenger. There is a 90-day processing goal to complete cases. Delays of greater than 90 days could be the result of insufficient information provided by the challenger at case inception or unacceptable replies from the cognizant IM or ICP. In any event, the Price Challenge Hotline will strive to complete each case as soon as possible while providing the challenger with a complete, accurate and understandable response.

The Price Challenge Hotline determines and centrally manages cash bonuses for price inquiries that realize significant cost avoidances. Only Government employees and military personnel are eligible to receive cash bonuses. Funding is provided by NAVSUP under the Beneficial Suggestions program and forwarded to the challenger's chain of command using an appropriate funding document. The funding document gives the paying activity authorization to pay the challenger in the amount determined by the Price Challenge Hotline. The command's paying activity is required to accept, sign and return an acceptance copy. A 60-day letter is sent as a reminder that if no response is received within another 60 days (a total of 120 days) the award will be canceled. A Certificate of Recognition will accompany the funding document. A cash bonus and certificate will not be prepared if the challenger is unknown and cannot be determined/identified by the challenger's listed activity or command.

Responses to Price Challengers

Responses to price challengers are a joint effort and a shared responsibility. The Price Challenge Hotline, under the Price Fighters Department, is responsible to the customer, the price challenger, for accurate and timely responses. The Price

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Challenge Hotline's customer is not the buying center. They work solely on the behalf of the Navy military and civilian personnel in resolving their pricing concerns. The buying centers are completely separate from the Price Challenge Hotline.

As mentioned in the draft DODIG report, the determination of fair and reasonable is the sole responsibility of the contracting officers at the buying centers. The Price Challenge Hotline supply systems analysts are not tasked to determine price fairness and reasonableness. However, the Price Challenge Hotline will agree or disagree with the information provided by the buying centers in response to a price challenge. In fact, the buying centers were notified in writing that the Price Challenge Hotline did not agree with the determination of the buying centers for 14 of the 30 price challenges found to be inadequate. The recommendation was made to contact the original contractor to discuss the possibility of overpricing and recovery of voluntary refunds. Copies of this written notification were provided to the price challenger, NADEP, Cherry Point, NC.

DON Comments on Finding A

Of the 30 price challenge responses that the DODIG considers inadequate, Navy concurs in 11 but does not concur with the remaining 19. A summary table of the 30 responses and the rationale for the Navy position appears at Attachment (A). Detailed comments on the 30 price challenges follow. Revised

The DODIG stated that the causes for inadequate price challenge responses were as follows:

Primary Cause	Number of Challenges
- Reasonableness not determined	23
- Reasonableness not determined and results not communicated	1
- Issues not answered	5
- Results not communicated	1

Revised

Revised

- **Determining Whether Contractor Prices Were Fair and Reasonable**

Partially concur that "the Navy and the cognizant buying centers did not always determine whether the challenged prices were fair and reasonable." The Navy wishes to make clear that the terminology "fair and reasonable" applies to a decision made by the government contracting officer prior to contract award regarding the price being offered by the contractor for goods and services. In responding to a subsequent price challenge, it is not the role of the Navy Price Challenge Program to make after

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the fact determinations regarding whether the contracting officer's original determination was correct.

Revised

Of 24 responses, the DODIG stated that the reasons for unreasonable prices were:

Reasons	Number of Responses
- Government estimates not used	4
- Alternate source not solicited	11
- Alternate source not solicited and price increase not analyzed	5
- Price increase not analyzed	4

Revised
Revised

Specifics are as follows:

•• **Using Government Estimates**

Revised

The draft audit states "The Navy Price Fighter Detachment performed a should cost analysis for four of the 24 price challenged parts (NSNs 1560-00-761-7929, 1560-00-172-2722, 1560-00-073-1158, and 3040-00-073-6915) but that the buying centers did not use the results of the "should cost" analysis to evaluate contractor prices. The challengers were not informed of the results of the should cost analysis, which showed that the parts were unreasonably priced."

Concur. The contracting personnel at ASO did not forward the IGE provided by Price Fighters to the contracting officers at the Defense Plant Representative Office (DPRO), Boeing who were responsible for definitizing contract prices. Navy defers to DLA regarding specific information relating to the pricing of these four items. Results of the should cost analyses performed should have been communicated to the price challenger once the results were known by the Price Challenge Hotline based on information from the buying center. Corrective action has already been implemented. With the transfer of the Price Challenge Hotline, followup actions (promised actions by buying centers) have been reconciled with the buying centers and are routinely reviewed for pending actions.

•• **Soliciting Alternate Source**

Revised

The draft audit states "For 16 of the 24 price challenges that had an inadequate response because contractor proposed prices were not evaluated, the price challenger identified another qualified source with lower prices for the parts. The Navy responses for the 16 parts stated that the source identified by the challenger would be added to the solicitation list for future

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procurements of the parts. However, the buying centers did not solicit the new source on the eight parts that were subsequently procured."

Partially concur. The phrase "contractor proposed prices" is misleading, implying that there was a "live buy" in progress and the buying centers chose to ignore a valid bid that was lower in price. These "contractor proposed prices" were in fact price quotes obtained by the price challenger well after any procurement action was accomplished by the buying centers. The situation is as follows: the buying centers procured material from the original equipment manufacturer (OEM) for the 16 items cited. Several of these items were coded as numeric stock objective or "insurance" items, several were coded for local procurement, and the balance were coded for normal stocking objectives. Price challenges citing lower prices from an alternate source were provided by the price challenger. Upon investigation, the alternate source was discovered to be an authorized dealer for the OEM. The buying activities placed the alternate source on the buying list for upcoming procurements. The buying centers for these items were DLA activities. DLA is responding by separate cover to DOD IG regarding actions by their buying centers. Revised

Navy concurs that two of the 16 price challenge responses were inadequate. NSNs 2090-00-367-7375 and 5330-00-421-4849 do not have correspondence from the Price Challenge Hotline explaining the price differences between the OEM and the authorized dealer. As corrective action, the Price Challenge Hotline will send adequate responses fully explaining all issues to price challengers. Also, in the interest of clarity, the Price Challenge Hotline has eliminated the use of the term "fair and reasonable" in responses to the price challenger when cases of alternate sources with better prices warrant additional action by the buying centers. Revised

Non-concur with audit findings on NSN 4330-00-200-8095 in that the Price Challenge Hotline did tell the price challenger the cause of the price difference between the alternate source and the price paid by the buying center. The Hotline provided the alternate source to the buying center. Defer to DLA on source solicitation issues.

Non-concur with audit findings on NSNs 5306-00-059-3529, 5330-01-301-0076, 3110-01-319-2482, 5340-00-786-6469, 5365-01-255-5047, 5330-01-299-3160, 5330-01-320-2009, 5340-01-319-4264, 5365-01-227-9163, 5330-00-363-8211, 5315-01-304-9174, 5360-01-101-1956, and 5360-01-166-6633. The Price Challenge Hotline passed to the buying center, Defense Industrial Supply Center (DISC), responses to the price challengers. However, the Price Challenge Revised

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Hotline personnel still questioned the significant price differences between what the government paid to the OEM and the quotes provided by the price challenger. Two letters were sent by the Price Challenge Hotline personnel to the buying center recommending that the prices of the OEM be scrutinized and possible refund action be initiated if deemed appropriate. Copies were sent to NADEP, Cherry Point as feedback.

- **Analyzing Price Increases**

Revised The draft audit states "For nine of the 24 price challenges, neither the Navy nor the buying centers evaluated the challenged prices, even though procurement history documents showed contractor price increases ranging from 55 percent to 492 percent over previous procurement prices."

Revised Of the nine price challenges cited, concur with four.

NSNs 2090-00-367-7375 and 5330-00-421-4849 do not have correspondence from the Price Challenge Hotline explaining the price increases. As corrective action, the Price Challenge Hotline will send adequate responses fully explaining all issues to price challengers. The response to the challenger on NSN 4030-00-824-2327 did not explain to the price challenger the large price difference between several procurements with similar quantities. (The Price Challenge Hotline at Price Fighters, however, responded to another price challenger by providing an "intrinsic value" analysis of the prices paid by the government for the item. The prices were validated based on this detailed independent government estimate.) The Hotline response on NSN 5340-01-268-3618 also did not explain the price increase between several procurements for similar quantities.

Revised Non-concur for five of the nine price challenges in this group.

Revised Three of the five, NSNs 5315-01-304-9174, 5360-01-101-1956, and 5360-01-166-6633, are discussed in detail in the **Soliciting Alternate Sources** section above. Responses were provided to the challenger, and correspondence taking exception to the prices involved was sent to DISC.

Non-concur with NSN 4810-01-041-2285. The Price Challenge Hotline was cited for this NSN as not evaluating the price increase and not communicating the price challenge evaluation to the challenger. The item has had approximately the same price for the last five years. The price was challenged due to "part simplicity." The information provided in a letter from the buying center (DCSC) stated that the part, upon review by the center's cost and price analysis branch, appeared reasonably priced. The Price Challenge Hotline was not given the actual

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"review" price nor was it made aware by the buying center of the price reduction incident to this "review." The closing letter from the Price Challenge Hotline was based upon the information provided at the time by the buying center, which was considered complete. The Navy feels that the closing letter provided an accurate assessment of the price of the item under the circumstances. The Price Challenge Hotline was not made aware of the "review" price until after the publication of this draft audit.

Non-concur with NSN 5330-00-103-2014. The Price Challenge Hotline letter response to the challenger provided very explicit information for the price increase. The challenged price was based on procuring the item as a Small Business set-aside in 1992. The small business procured the item from the OEM, marked up the price and passed it on to the government. The letter further stated that the current price had gone down and was in line with prices of similar parts given by the price challenger.

- **Answering Issues Presented in Price Challenges**

The draft audit states "Of the 30 inadequate price challenge responses, five responses were inadequate because the Navy did not address all the issues raised by the challenger." Revised

Partially concur. Of the five cases cited, concur with three. Specifics on the five cases are as follows:

- **Discussing Data Provided by the Price Challengers**

For NSN 1560-00-918-4601 the draft audit states "The response did not address the funding and technical data that the challenger forwarded to the Fleet Material Support Office with the challenge."

Non-concur. The pricing issue was discussed in a letter response to the challenger's question as to why the supply system shows a Standard Unit Price (SUP) of $223.00 when the procurement price is actually $58.00 (according to the challenger). The $58.00 price cited by the challenger could not be substantiated without additional data. Records indicate the challenger never responded to a request in the letter for additional supporting information. In this case, the "technical data" appeared to serve only as a means of supporting part identification and was not sufficient to support the contention that the item was overpriced.

For NSN 2835-01-109-2492 the draft audit states "The Navy response did not discuss the specifications the challenger provided." Deleted

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Non-concur. The 6 July 1994 closing letter from FOSSAC provided a detailed explanation to the challenger regarding why the suggested substitute NSN was no longer being recommended, and explained why the challenged NSN was preferred. This letter went on to explain that the alternate NSN suggested for use by the price challenger's technical manual (not the same as specifications) would be deleted as a managed stock numbered item. A recent followup letter notified the price challenger of the actual deletion of the inferior part.

- **Forwarding Suggestions to the Appropriate Activity**

Revised

The draft audit states that for NSNs 5975-00-435-0133 and 5910-00-781-4797 "The Navy responses to two of the five challenges did not forward suggestions by the price challengers to the command authorized to evaluate the suggestions."

Concur. No record is on file of the challenger's suggestion of alternative manufacturing processes being forwarded to the cognizant Engineering authority (NAVAIR) for review. Corrective action currently in place tracks technically related issues to the cognizant engineering authority on behalf of the price challenger.

- **Addressing Acquisition Alternatives**

For NSN 5960-01-126-4506 the draft audit states "The Navy response explained the need for surcharges but did not discuss whether the challenger could purchase the part from another manufacturer. The second Navy response did not provide information on the short shelf-life or on whether the challenger could purchase the item directly from the manufacturer".

Concur. No record exists of this information being addressed. Corrective action currently in place explains the DFAR criteria for authorizing procurement of system stock outside normal requisitioning channels. The challenger's second letter appeared to raise the one year shelf-life issue for the item as a rationale for direct procurement. The Price Challenge Hotline has no record of having responded to the customer regarding shelf-life, and will take steps to do so. The Navy stocks large numbers of short shelf-life items and has a program to manage them.

- **Communicating Results of Price Challenge Evaluations**

Revised

The draft audit states "Of the 30 inadequate price challenge responses, two responses were inadequate because the Navy did not communicate the results of its price challenge evaluations to the challengers."

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For NSN 4810-01-041-2285 the draft audit states "Navy response ...did not inform the challenger that a should cost analysis performed by DCSC personnel showed that the part should cost $66."

Non-concur. A letter was sent to the challenger. This item is addressed in the **Analyzing Price Increases** section above.

For NSN 5340-01-063-1288 the draft audit states "The Navy response...did not state that the Navy evaluation of the price determined that the price was unreasonable. The response also did not tell the price challenger that, as a result of the price challenge, Industrial Supply obtained a voluntary refund from the contractor."

Non-concur. The closing response to the price challenger explained the rationale for the procurement price provided by the buying center. Also, the Price Challenge Hotline sent a letter back to the buying center (the same letter described in the **Soliciting Alternate Sources** section above) disagreeing with the determination because of the large price difference between the OEM and the authorized dealer. As stated earlier, a copy of this letter was sent to NADEP, Cherry Point.

RECOMMENDATIONS

A.1. We recommend that the Commander, NAVSUP, issue policy guidance that requires buying centers to evaluate price challenges received through the Navy Price Challenge Program and provide input for the price challenge responses that is accurate and responsive to all issues raised by the price challengers.

DON Comment

Concur. Long-standing policy guidance for Navy buying centers on the Price Challenge Program and other Project BOSS programs existed in NAVSUP Instruction 5400.11, Subj: Implementation of Project BOSS In the Naval Material Establishment, dated 16 October 1987. Letter guidance will be issued to reemphasize this policy by 30 September 1995 to ensure that Navy ICP personnel respond promptly and accurately to Hotline requests for information. The NAVSUP Memorandum of Agreement (MOA) with DLA will be amended during the next revision cycle to incorporate this requirement for processing of Navy pricing inquiries received by DLA ICPs.

A.2. We recommend that the Commanding Officer, FOSSAC, require the Navy Price Fighter Detachment to coordinate with the appropriate buying centers and:

a. Evaluate all issues raised in price challenges received. For challenges that concern contractor prices to the Government, the evaluation should determine whether or not the contractor prices were fair and reasonable and should identify the causes of any overpricing detected.

DON Comment

Partially concur. As discussed in the Price Challenge Hotline Operations Manual, the Price Challenge Hotline will evaluate all issues in price challenges received and respond to the challenger appropriately. However, as discussed in Appendix C of the draft audit and in the Federal Acquisition Regulations (15.802) the contracting officer is responsible for the determination of fair and reasonable prices. If in the course of responding to a price challenge, the Price Challenge Hotline, utilizing current information (which may not have been available to the contracting officer at the time of his determination) believes that the last procurement price of an item seems excessive, the Price Challenge Hotline will provide this information to the ICP for consideration in future contract awards or possible refund action.

b. Respond to all issues raised in each price challenge. The response should tell the price challenger whether or not the challenge was correct, should identify any overpricing found, and should clearly explain actions taken as a result of the price challenge. For price challenges that are not correct, the response should clearly explain the reasons that the challenge is not correct and the reasons that recommended actions were not taken.

DON Comment

Concur. As discussed in the Price challenge Hotline Operations Manual all issues raised in price challenges will be discussed in each response.

c. Forward price challenges that cannot be evaluated by the Navy Price Fighters Detachment and the buying centers to the appropriate authority for evaluation instead of returning the price challenge to the challenger. The price challenger should be notified that the price challenge was forwarded for evaluation.

DON Comment

Concur. Corrective action currently in place forwards all pricing related issues that cannot be evaluated by Price Fighters to the appropriate activity, via the buying center, on behalf of

the price challenger. Challengers will be made "copy to" recipients of this type of correspondence.

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Finding B. Pricing of Spare Parts Procurements

Revised

Of 45 price-challenged spare parts reviewed, DOD buying centers paid unreasonable prices to contractors on 89 procurements of 29 spare parts. The unreasonably priced procurements occurred because contracting officers did not properly analyze the proposed prices for the procurements. Specifically, contracting officers did not always:

- use available IGEs and field pricing support when determining whether contractor-proposed prices were fair and reasonable (6 parts),

- analyze price increases over previous procurements (5 parts), or

- solicit identified alternate sources (18 parts).

Revised

As a result, the DOD buying centers overpaid about $15.9 million on 89 procurements of 29 unreasonably priced spare parts, valued at $30.9 million. Of the 89 procurements, 8 procurements of 3 ASO parts, valued at $30.5 million, accounted for about $15.6 million of the overpricing. Overpricing of the spare parts made Government funds unavailable for other use.

DON Comment

Concur to the degree that the finding applies to the Navy.

Of the alleged overpricing attributable in the audit report to items included in contracts (Basic Ordering Agreement [BOA] orders) issued by ASO, the audit report cited failure to use available IGEs and field pricing support when determining whether contractor-proposed prices were fair and reasonable as the predominant finding. No instances were cited for failure to solicit identified alternate sources; and failure to analyze price increases over previous procurements was applicable only to a negligible degree.

The audit report cited five items attributable to ASO orders which were allegedly overpriced:

NSN 1560-00-761-7929	Forward Head Hub
NSN 1560-00-472-2722	Rudder Tip
NSN 1560-00-761-7899	Aft Head Hub
NSN 1560-00-073-1158	Link Assembly
NSN 3040-00-073-6915	Shaft and Carrier

As noted in the audit report, "The Defense Plant Representative Office, Boeing Defense and Space Group, Helicopter Division (DPRO, Boeing), negotiated the prices of five of the parts purchased by ASO."

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In fact, all of the ASO case files reviewed by the auditors, which formed the basis of their findings regarding ASO, involved orders which were issued by ASO on a ceiling priced basis, and which were subsequently definitized by DPRO, Boeing. Therefore, the prices for these items were negotiated and established by DPRO, Boeing contracting officers, who would have determined the prices to be fair and reasonable prior to issuing definitization modifications.

Accordingly, the Navy defers to DLA concerning the final definitized prices.

Nevertheless, the Navy acknowledges that it contributed to the failure to always utilize available should cost analyses conducted by the Price Fighter Detachment when negotiating prices for spare parts. Specifically, ASO did not always forward to the DPRO, Boeing contracting officers available should cost data from the Price Fighter Detachment for items whose prices were being definitized by DPRO, Boeing.

ASO acknowledges its responsibility, when delegating responsibility for price definitization, to forward to the definitizing activity all relevant information, particularly should cost data or other IGE data. This was, in fact, ASO policy. However, this was not explicit in formal written ASO policy guidance, with the result that the policy was not uniformly followed in practice. Additionally, ASO acknowledges its responsibility as the procuring activity, to obtain feedback when delegating pricing responsibility on utilization of should cost data and resolution of price challenges.

Since the audit findings, ASO has provided additional training on pricing to its contracting personnel, which specifically included utilization of should cost data from the Price Fighter Detachment. Also, ASO has issued a policy memorandum on should cost analysis, specifically. The handout used in the training and the policy memo are included as Attachments (B) and (C).

Recommendations

B.1. We recommend that the Commander, NAVSUP, and the Director, DLA, issue guidance to their respective buying centers that requires contracting officers to:

a. Obtain IGEs for negotiated procurements of spare parts as required by the Federal Acquisition Regulation and consider the estimates, including any Government-prepared should cost estimates, when determining fair and reasonable prices and establishing prenegotiation price objectives. Contracting officers should document in the contract files reasons for not adopting recommendations made in the independent estimates.

b. Obtain field pricing support, or provide written justification for not obtaining it, for negotiated procurements

expected to exceed $500,000 that require the contractor to submit cost or pricing data, and use the information to evaluate the contractor's proposal and establish prenegotiation price objectives.

c. Compare the price of the previous procurement to the proposed price and evaluate any price increase that common sense indicates is not reasonable. At a minimum, the contracting officer should evaluate proposed prices that increase 25 percent or more than the previous procurement price.

d. Include qualified alternative sources identified by price challengers in the source lists for the parts and solicit the new sources, as well as the other qualified sources, on future procurements of the parts.

DON Comment

Concur.

Regarding the specific items addressed in the audit findings, ASO also issues priced orders under the Boeing BOA, requesting the DPRO to provide the cost and price analysis and price negotiation. However, the Navy recognizes that in this situation, although the Navy buying activity may rely upon the in-house expertise of the DPRO contracting officers and price analysts, the ultimate responsibility for determining item prices to be fair and reasonable resides with the contracting officer executing the contract action which establishes the contract item prices. Accordingly, the policy guidance issued by the Commander, NAVSUP will emphasize this responsibility of contracting officers at Navy buying activities in addition to the elements cited in the recommendation.

Policy guidance will be formally issued no later than 30 September 1995.

B.2. We recommend the Director, Defense Construction Supply Center, and the Director, DISC, conduct audits of contractors participating in their automated purchasing systems who have not been audited recently and who have made overpriced sales of NSNs 2930-00-367-7375 and 4810-00-041-2285 to the Defense Construction Supply Center, and NSN 5330-00-103-2014 to DISC.

DON Comment

Defer comment to DLA.

No.	NSN	DOD CLASSIFICATIONS: 1	2	3	4	5	NAVY POSITION	NOTE	PAGES
1	1560-00-761-7929	X					CONCUR		7
2	1560-00-172-2722	X					CONCUR		7
3	1560-00-073-1158	X					CONCUR		7
4	3040-00-073-6915	X					CONCUR		7
5	2090-00-367-7375		X	X			CONCUR		8,9
6	5330-00-421-4849		X	X			CONCUR		8,9
7	4330-00-200-8095		X				NON-CONCUR	1	8
8	5306-00-059-3529		X				NON-CONCUR	2	8
9	5330-01-301-0076		X				NON-CONCUR	2	8
10	3110-01-319-2482		X				NON-CONCUR	2	8
11	5340-00-786-6469		X				NON-CONCUR	2	8
12	5365-01-255-5047		X				NON-CONCUR	2	8
13	5330-01-299-3160		X				NON-CONCUR	2	8
14	5330-01-320-2009		X				NON-CONCUR	2	8
15	5340-01-319-4264		X				NON-CONCUR	2	8
16	5365-01-227-9163		X				NON-CONCUR	2	8
17	5330-00-363-8211		X				NON-CONCUR	2	8
18	5315-01-304-9174		X	X			NON-CONCUR	2	8,9
19	5360-01-101-1956		X	X			NON-CONCUR	2	8,9
20	5360-01-166-6633		X	X			NON-CONCUR	2	8,9
21	4330-00-824-2327			X			CONCUR		9
22	5340-01-268-3618			X			CONCUR		9
23	4810-01-041-2285			X		X	NON-CONCUR	3	9,12
24	5330-00-103-2014			X			NON-CONCUR	4	10
25	1560-00-918-4601				X		NON-CONCUR	5	10
26	2835-01-109-2492				X		NON-CONCUR	6	10
27	5975-00-435-0133				X		CONCUR		11
28	5910-00-781-4797				X		CONCUR		11
29	5960-01-126-4506				X		CONCUR		11
30	5340-01-063-1288					X	NON-CONCUR	3	12

Class 1: Price Reasonableness not determined: Govt estimate not used.
Class 2: Price Reasonableness not determined: alt source not solicited.
Class 3: Price Reasonableness not determined: price increase not analyzed.
Class 4: All issues raised by challenger not answered.
Class 5: Results of evaluation not communicated to challenger.

Notes:

1 Price increase rationale provided to the challenger

2 Buying center price justification passed to challenger. However, Hotline letters to buying center requested prices be scrutinized further. Copy of letters sent to challenger.

3 Price Challenge Hotline provided correct response to challenger based on data provided by ICP at the time of the Challenge. Additional data regarding price reduction provided by ICP to DODIG as result of audit.

4 Price increase due to Small Business Set-Aside. Letter provided to challenger explained rationale for price increase.

5 Challenger's suggested price could not be substantiated without additional data. Letter to challenger requesting data not answered.

ATTACHMENT A

6	Detailed explanation why cheaper substitute was not acceptable provided to							
	challenger by letter.							

ASO TRAINING MODULE OF 23 MAY 1995

USE OF COST & PRICE ANALYSIS

Presented By Don McGettigan
May 23, 1995

PURPOSE: DETERMINE AWARD PRICE TO BE FAIR & REASONABLE

TWO WAYS TO DETERMINE ACCEPTABLE PRICE:

COST ANALYSIS	USE WHEN REQUIRED/APPROPRIATE
PRICE ANALYSIS	USE FOR ALL PROCUREMENTS

PRICE ANALYSIS IS THE EXAMINATION AND EVALUATION OF A PRICE WITHOUT EVALUATING THE SEPARATE ELEMENTS OF COST AND PROFIT.

THE PREFERRRED METHOD OF DETERMINING PRICES TO BE FAIR AND REASONABLE IS THE EXISTENCE OF ADEQUATE PRICE COMPETITION

- 2 OR MORE RESPONSIBLE OFFERORS SUBMIT OFFERS
- THEIR OFFERS ARE RESPONSIVE TO THE SOLICITATION
- THEY COMPETE INDEPENDENTLY FOR PRICE-BASED AWARD

OTHER TECHNIQUES FOR PRICE ANALYSIS:

COMMERCIAL ITEM, REGULAR SALES TO CUSTOMERS OTHER THAN GOVERNMENT, EXISTENCE OF CATALOG OR MARKET PRICE

PROCUREMENT HISTORY - SALES OF SAME/SIMILAR ITEM
- REVIEW OF PREVIOUS FOLDER
- HOW WAS PRICE DETERMINED TO BE FAIR & REASONABLE?

CONSIDERATION OF PRICING IMPACT OF:
- LAPSED TIME BETWEEN BUYS - IMPACT OF INFLATION
- QUANTITY DIFFERENCES - USE OF LEARNING CURVES

CITE/JUSTIFY PARTICULAR ESCALATION FACTOR UTILZIED
EXPLAIN PRICE ADJUSTMENT DUE TO QUANTITY DIFFFERENCES

AVAILABLE RESOURCES: BRANCH, DIVISION OR 0251 OFFICE
BUREAU OF LABOR STATISTICS PRODUCERS PRICE INDEX
DATA RESOURCES, INC. (DRI) PROJECTIONS

POSSIBLE COMBINATION W/ OTHER PRODUCTION
- NAVAIR, USAF, COMMERCIAL, FMS OR GFE BUYS

SHOULD COST ANALYSIS - NAVY PRICEFIGHTER DETACHMENT
- USE IT, DOCUMENT IT, PROVIDE FEEDBACK. IF NEGOTIATIONS ARE DELEGATED, PROVIDE "SHOULD COST" INFO TO NEGOTIATOR.

ATTACHMENT B

06/29/95 THU 11:31 FAX 717 790 1010 NAVSUPPDET MECH 006

ASO E-MAIL POLICY MEMO OF 6 JUNE 1995

MEMO

Subject: SHOULD COST ANALYSES

1. The DODIG performed an audit on the quality of responses and prices resulting from price challenges. As a result of the audit, the prices negotiated by the DPRO was questioned because the negotiators at the DPRO did not use a should cost analysis.

2. If a DPRO/DCMAO is negotiating a price for a procurement and a should cost is available, forward the should cost to the negotiator at the DPRO/DCMAO. Explain what the should cost is and where it came from. If the DPRO/DCMAO has any questions regarding the should cost, have the negotiator contact Price Fighters directly. The negotiator will also have to provide feedback regarding the should cost and its use.

ATTACHMENT C

06/29/95 THU 11:31 FAX 717 790 4040 NAVSUPPCT MECH 008

Defense Logistics Agency Comments

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

IN REPLY REFER TO DDAI

12 SEP 1995

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Draft Audit Report on Price Challenges on Selected Spare Parts (Project No. 4CH-8010.01)

We agree with the Inspector General that DLA must continue to improve the quality of price challenge reviews and the pricing of spare parts and supplies. We also agree that hotline and price challenge programs can be a valuable contributor to this effort because our customers may identify instances of overpricing that might not otherwise be apparent to logistical managers.

This audit dealt in large part with alternate nonmanufacturing sources identified and reviewed under our price challenge program and in-depth independent Government estimates sometimes performed in evaluating a price challenge. DLA wants to capitalize on the IG's efforts to highlight potential opportunities to leverage our administrative expenditures in order to reduce prices we pay. This scrutiny has spotlighted several opportunities for improving our use of such information in future procurements and needed improvements in reporting the results of price challenge reviews. We plan to address these "lessons learned" at our next Value Engineering Program Managers' Meeting and in follow-on letters to the field. We expect this to lead to greater customer satisfaction and help us drive down materiel costs to the warfighter.

We expect DLA personnel to fully consider indications of potential overpricing, and if they determine it occurred, to promptly seek price reductions or recoupments as applicable. This is especially important in a customer-oriented agency that makes over 1.25 million buys below the simplified purchase threshold annually, and where the acceptance of even moderate increases in prices is substantially magnified.

In Finding B, the IG concluded that the number of overpriced parts found was expected to be larger than would be found in a statistical sample of spare parts because the audit reviewed only spare parts already suspected of being unreasonably priced. Buys totaling $30.9 million on 29 of the parts reviewed were reportedly "overpriced." We have substantial concerns for the correctness of the audit decisions on which this "overpricing" was calculated. Accordingly, we reached a much different conclusion, i.e., about $21 thousand total overpricing on three parts, of which about one-fourth has been recouped. Revised

We appreciate the opportunity to offer comments and recommendations (Encls 1-6) in response to Finding B and the related recommendations. We did not include comments concerning Finding A as those recommendations were not addressed to DLA. However, we disagree, strongly, that it is either proper or necessary to review and furnish an opinion on the contracting officer's price reasonableness determination. A determination of overpricing furnished to the challenger should suffice, as it has for many years.

WILLIAM P. HALLIN
Major General, USAF
Deputy Director
Materiel Management

6 Encl

Federal Recycling Program Printed on Recycled Paper

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TYPE OF REPORT: DRAFT DATE OF POSITION: 12 SEP 1995

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Price Challenges on Selected Spare Parts (4CH-8010.01)

FINDING B: PRICING OF SPARE PARTS PROCUREMENTS

Revised

Of 45 price-challenged spare parts reviewed, DoD buying centers paid unreasonable prices to contractors on 89 procurements of 29 spare parts. The unreasonably priced procurements occurred because contracting officers did not properly analyze the proposed prices for the procurements. Specifically, contracting officers did not always:

o use available independent Government estimates and field pricing support when determining whether contractor-proposed prices were unfair and reasonable (6 parts),

Revised

o analyze price increases over previous procurements (5 parts), or

Revised

o solicit identified alternative sources (18 parts).

Revised

As a result, the DoD buying centers overpaid about $15.9 million on 89 procurements of 29 unreasonably priced spare parts, valued at $30.9 million. Of the 89 procurements, 8 procurements of 3 Naval Aviation Supply Office parts, valued at $30.5 million, accounted for about $15.6 million of the overpricing. Overpricing of the spare parts made Government funds unavailable for other use.

DLA COMMENTS: Partially concur.

A detailed discussion of each major element of the DoD Inspector General (IG) finding follows this recap of the DLA position regarding Finding B:

o DLA agrees that "contracting officers did not always ...use available independent Government estimates and field pricing support when determining whether contractor-proposed prices were fair and reasonable"

o DLA agrees that "contracting officers ...did not always analyze price increases over previous procurements"

o DLA agrees that "contracting officers ...did not always solicit identified alternate sources"

o DLA strongly disagrees that "[accordingly,] contracting officers did not properly analyze the proposed prices for the procurements."

Revised

o DLA strongly disagrees that "...DoD buying centers paid unreasonable prices to contractors on 89 procurements of 29 spare parts."

Revised

o DLA strongly disagrees that "As a result, the DoD buying centers overpaid about $15.9 million for the 29 unreasonably priced spare parts on 89 procurements valued at $30.9 million."

The IG evaluated procurements made over a 6 3/4 year period from January 1988 through September 1994

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on 45 spare parts for which allegations of overpricing had been lodged. The IG opined that "overpricing" occurred on 11 awards totaling $30.514 million on 4 of the 5 spare parts in question (all except the "Rudder Tip"---see Appendix D of the draft) as managed by the Naval Aviation Supply Office on which the DLA Plant Representative Office (DPRO) negotiated the contract prices; and on 77 awards totaling $0.397 million on 24 spare parts managed by DLA's Defense Supply Centers. Revised Appendix E

Most of the procurements in question for the Navy-managed parts were high-valued. Of these buys, 8 exceeded $1 million, 1 was for $45 thousand, and the remaining 3 were below the recently revised $25,000 small purchase threshold (i.e., became the $50,000 "simplified purchase threshold" effective 3 July 1995 as a result of partial implementation of statutory changes from the Federal Acquisition Streamlining Act of 1994 (FASA).) Conversely, all 77 (actually 75) of the buys on DLA-managed items were of low dollar value (i.e., all but 1 buy for $48 thousand and 1 for $56 thousand were below the former $25 thousand threshold. The value of each procurement substantially dictates the type and depth of analysis of price conducted by the Government. This is recognized in Government regulations and is why DLA contracting officers did not always use all of the 4 types of analyses cited in IG Finding B. A discussion of the DLA position regarding each of the aforementioned elements of Finding B follows: Revised

o "contracting officers...did not always use available independent Government estimates and field pricing support..."---DLA's concurrence with this element of the finding is solely because the statement itself is literally correct. However, these analytical techniques are generally relevant only on high dollar procurements such as some buys made by the DPRO on several of the Navy-managed items. These techniques were not relevant, not requested, and not used in price analyses of the low-dollar value DLA buys, where other, preferable means of determining price reasonableness were available for use as appropriate at the discretion of the contracting officer:

oo Independent Government estimates---The fifth column of the table in the draft report, Appendix D, shows that IGEs were the basis of the reported "overpricing," on all 5 (3 high dollar valued and 2 low valued) Navy-managed items and on 2 of the 24 (low-dollar) DLA-managed items. Appendix E

The draft IG report uses the words "cost estimate," "should cost estimate," and independent Government estimate" interchangeably, which can be confusing or misleading. [We use the phrase "independent Government estimate" and its acronym (IGE) in this DLA position only to refer to Government estimates based on in-depth engineering analyses of the various steps and costs involved in manufacturing an item.] Revised

An IGE is not required to be used on any Government purchase, regardless of the value of the buy. And, IGEs were not requested, made available, or used in connection with the DPRO awards on the 4 Navy-managed items ; nor in connection with 1of the buys in question concerning 1of the 2 DLA-managed items cited as "overpriced" on this basis.

FAR 15.805-2 states that the contracting officer is responsible for selecting and using whatever price analysis techniques will ensure a fair and reasonable price. It goes on to state that the comparison of proposed prices (and, in cases involving cost or pricing, the comparison of costs proposed by the offeror for individual cost elements) with independent Government cost estimates made by technical personnel (i.e., IGEs), is one of various techniques it lists that may be selected for analyzing proposed prices.

IGEs can be a useful primary or supplemental tool for contract cost/price proposal evaluations of certain high-valued procurements. There are, however, several drawbacks which generally serve to limit selection and use of IGEs for other than a small number of higher valued noncompetitive large purchases:

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(i) Like all estimates, their accuracy can vary widely from the reasonable cost plus profit the Government expects to pay its suppliers,

(ii) The time and cost necessary of skilled engineering resources to perform such an in-depth IGE may be substantial,

(iii) A sample item or drawings of the item, which are needed to develop a detailed and reliable cost estimate, may not be available, and

(iv) There are often more effective, or equally effective, alternatives available for selection by the contracting officer.

Revised

The first sentence of the Appendix C paragraph of the draft entitled "Independent Government Estimates" requires correction because it incorrectly state that "Contracting officers are required to obtain an independent Government estimate for negotiated procurements if feasible, and to use these estimates in setting prenegotiation objectives."

The first part of this statement appears to refer to the FAR language at paragraph 15.803(b), which states:

"Before issuing a solicitation, the contracting officer shall (when it is feasible to do so) [underlined for emphasis] develop an estimate of the proper price level or value of the supplies or services to be purchased. Estimates can range from simple budgetary estimates to complex estimates based on inspection of the product itself and review of such items as drawings, specifications, and prior data."

This is an incorrect FAR cite, as it is aimed at assuring adequate/accurate financial planning during acquisition planning. It does not establish any requirement regarding use of IGEs for the analysis of the offers which are ultimately received.

It has not proven feasible for DLA Centers to develop such individual estimates for budgetary purposes for the 1 1/4 million buys below the $50,000 simplified purchase threshold which they make annually. Instead, our automated systems generally use the most recent award unit price for purchase request budgetary purposes. Absent a prior buy, an estimate furnished by the prior inventory manager or the requisitioner, if any, may be used. This type of budgetary estimate would be of very limited value as a baseline for price proposal evaluation and award purposes, however, so it is not used for contract price evaluations within DLA.

Some cost estimates, including some IGEs, fail to provide even a "ball-park" indication of what the item "should cost." This is because IGEs often are prepared without knowledge of the prospective contractor (much less its proposal estimating methodology and the proper rates and factors). In such cases, the IGE is made to estimate the cost plus a reasonable profit for an average machine shop to produce an item. This, of course, will generally underestimate a fair price for an original equipment manufacturer (OEM) by a very sizeable percentage (perhaps as much as 250 percent). Furthermore, the technique becomes more unreliable for low-dollar value procurements where start up costs, minimum charges, or purchase from an OEM are more likely to overshadow the direct manufacturing costs of an economic order quantity placed with an average machine shop.

Although we have pointed these facts out in DLA responses to prior audits of reputed "overpricing," and did so again at our 18 May 1995 exit meeting with the auditors, the IG continue to espouse use of IGEs (and estimates of superficial depth, as in the case of DCSC's Orifice Disk) as accurate bases for determining "reasonable prices" and "overpricing."

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Despite these limitations, our contracting officers utilize IGEs where necessary and appropriate. This is consistent with FAR 15.807, Prenegotiation Objectives, which specifies that, when setting prenegotiation objectives, the contracting officer will analyze the offer's proposal, taking into account the field pricing report, if any, any audit and technical analyses, and other pertinent data, such as IGEs.

This does not mean, however, that the contracting officer is required to obtain an IGE. Only, that if one is requested and obtained (or a previously performed IGE is furnished to or received) by the contracting officer, it should be considered, along with other analyses, in setting prenegotiation objectives. Of course, IGEs are used in setting prenegotiation objectives only to the extent the contracting officer deems such estimate to be a reasonably reliable basis for price negotiations.

To be useful in contract negotiations, an IGE must be performed, and its basis and derivation reported, in sufficient depth and clarity to enable the contracting officer to (i) reach a conclusion as to its soundness for assessing the reasonableness of the proposed contract price, and to (ii) facilitate in-depth discussions demonstrating the merits of the Government's estimate and to refute the results of the offeror's pricing approach during contract price negotiations. We note that an IGE is rarely, if ever, used as the sole basis for setting negotiation objectives and determining a fair and reasonable price. The contracting officer decides how much reliance, if any, to place on such estimate, as well as any other available information provided by pricing team specialists.

In summary, inasmuch as contracting officers are not required "to obtain an independent Government estimate for negotiated procurements if feasible" and are not required "to use these estimates in setting prenegotiation objectives," the aforementioned IG statement in Appendix C requires revision. If the IG still desires to refer to the FAR 15.803(b) budgetary planning requirement, the citation should be included along with the explanation provided above. Revised

oo Field pricing support---Appendix C ("Requirements for Determining Price Reasonableness") of the draft report seeks to present the relevant regulatory requirements in separate subsections entitled "Small Purchase Requirements" and "Large Purchase Requirements." Although the Appendix includes a paragraph entitled "Field Pricing Support" properly under the caption "Large Purchase Requirements," the distinction that this technique is not applicable to simplified purchases is not made. This should be explicitly clarified therein and more importantly, in the writeup of Finding B, which implies that such techniques were not employed, but should have been, in connection with all the buys, simplified as well as large purchases, which the report deems were "overpriced." These facts should be reflected not only in Finding B, but also in Recommendation B.1.b., and in the paragraph of Appendix C where this analytical technique is discussed. Specifics are as follows: Revised

The first sentence of this paragraph of Appendix C of the draft report states "Contracting officers are required to obtain field pricing support for negotiated procurements expected to exceed $500,000 that require the contractor to submit cost or pricing data." This is incomplete and should be corrected. DoD FAR Supplement (DFARS) paragraph 215.805-5(a)(1)(A) restricts the requirement at the $500,000 level to fixed price proposals and cost-type proposals from offerors with significant estimating system deficiencies. More importantly, the paragraph should cite the exception in DFARS 215.805-5(a)(1)(B) that "Contracting officers may, with adequate written justification, waive the requirement for these reports." Revised

This IG paragraph does correctly point out that the requirements for field pricing are relative to instances where the offeror is required to submit cost or pricing data. However, this qualification should also be added to the first sentence of the preceding paragraph of Appendix C, entitled "Cost Analysis and Technical Analysis." Revised

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To recap, field pricing support is not permitted, and IGEs were neither required nor requested in connection with any of the low-dollar buys in question in this report. The report cited no instance where field pricing was required but not obtained on any buy made by either the DPRO or a DLA Center. Accordingly, we disagree, strongly, with the implicit IG conclusion that:

(i) use of these analytical techniques in connection with the full dollar range of spare parts procurements reviewed in this audit is, or should be, required by regulation,

(ii) use of these techniques is cost-effective or otherwise generally warranted in contracting for spare parts,

(iii) "overpricing" purportedly occurred on the buys in question, and that

(iv) the purported "overpricing" would have been averted through use of these types of pricing support.

Corrections and/or amplification of the relevant paragraphs in Appendix C is clearly required. Furthermore, elimination of applicability to DLA of this element of the finding and of the related recommendations B.1.a. and B.1.b., is warranted. If retained, the wording in Finding B, Appendix C, and Recommendations B.1.a. and B.1.b. should, as a minimum, be corrected for consistency with the applicable FAR and DFARS policies.

o "contracting officers ... did not always analyze price increases over previous procurements"---We do not take exception with this statement because it is likely to be factually correct. However, except for large purchases, such analysis is not generally required on either a preaward or postaward basis (by either FAR or DFARS). Nor is it necessary in accordance with best Government procurement practices, which increasingly rely on the reasonable pricing normally resulting from use of competitive procurement processes. At our Centers, these types of reviews occur on both preaward and postaward bases, as discussed below.

oo Preaward analysis:

ooo Under large purchase procedures, the contract file for buys by our Centers would include price history and the documentation would likely address any unexplained increases from prior prices paid This is because FAR Parts 14 ("Sealed Bidding") and 15 ("Contracting by Negotiation") both require a price reasonableness determination for all large purchases based on some form of price analysis (cost analysis when cost or pricing data is required).

ooo For simplified purchases (formerly "small purchases") not exceeding $2,500, Appendix C points out that such documentation is not required (i.e., now known as "micro-purchases" with the same $2,500 ceiling, due to the implementation of FASA by promulgation of interim rule revisions to the FAR on 15 December 1994, entitled "Micro-Purchase Procedures").

Our automated procurement system for these buys notifies the buyer when the current price exceeds the lowest price paid for the item over the past year. If no such recent buy had been made, the system automatically compares with the most recent price of record escalated to the current date. DISC uses a 10 percent price increases trigger for buyer review, as pointed out in the first paragraph under the heading "Automated Procurements."

Revised

The paragraph needs to be corrected, however, to reflect that all our Centers addressed in the report use this procedure. DCSC is currently using a 20 percent trigger (not 25, as reported). A 25 percent trigger was used

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until its reduction to 20 percent in March 1995. (DESC recently advised that it had reduced its trigger from 10 percent to 5 percent.) DLA has initiated a review of the preaward price variance procedure used at each Center in an effort to identify systemic improvements to enhance the utility of the process and in the interim, to determine the appropriate percentage for the automated purchase system at each individual Center to trigger a preaward buyer price review.

Regardless of the outcome, it is generally unreasonable and impractical to spend inordinate additional time in an effort to confirm whether or not a price is fair and reasonable on a one-time or low demand micro-purchase. And even in a particular instance where we can substantiate overcharging, the Government may well be unable to negotiate a lower price, or the cost the reverse engineer the item may far exceed the potential savings or recoupment. This may help to explain why the FAR is written so as not to require unreasonable efforts by contracting officials to assure that every purchase, small as well as large, is reasonably priced and does not preclude award in the absence of such assurance.

ooo For simplified purchases (formally "small purchases) above the $2,500 threshold, the limitation of the documentation requirement to other than competitive simplified purchases should be stated in the "Small Purchases of More Than $2,500" paragraph of Appendix C. We recommend it be added and the language updated based on the new FASA final rule coverage promulgated in the Federal Register on 3 July 1995, entitled "Simplified Acquisition Procedures/FACNET." Revised

Throughout the report, the IG points out very sizeable price "increases" which appear to evidence a failure to properly perform the procurement function. We strongly disagree with "worst case reporting," particularly because most of the price changes addressed in the report were not overpriced. Further, these writeups do not generally demonstrate the relatively small amounts of these individual buys being challenged nor the fact that they occurred over a 6 3/4 year audit period, which tends to increase the amounts reported.

For example, in the subsection entitled "Analysis of Price Increases Over Previous Procurement Prices," it is reported that "5 [parts] were unreasonably priced because the contracting officers did not identify and analyze price increases that ranged from 59 percent to 1,233 percent more than the prices paid on the previous procurements of the parts This "overpricing," as reported in Appendix D to the draft report ("Summary of Parts Unreasonably Priced"), is recapped below, along with the results of our review, which disclosed that most of the reported "overpricing" was non-existent: Appendix E

Revised

Part Name	Actually Paid	IG reported Overpricing	DLA Confirmed Overpricing
Orifice Disk	$2,560.67	$2,029.31	$1,126.75
Assy, Elevator Tab Fitting	21,962.00	9,596.92	9,596.92*
Wire Rope Terminal	129,383.51	105,258.51	10,570.00
Butt Hinge Leaf	6,502.38	2,422.38	0.00
Preformed Packing	4,550.40	2,167.20	0.00
Total	$164,958.96	$121,474.32	$21,293.67
Cumulative % of Overpricing (Period audited = 6 3/4 years)		73.6%	12.9%*

*Net cumulative overpricing over the entire audit period after a $4798.46 recoupment is less than 10.0%.

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Appendix E Revised

In addition to these 11 buys questioned on 5 DLA-managed items, Appendix D identified the "failure" to do this analysis as a collateral cause of "overpricing," along with a failure to use Government estimates or field pricing support, for 3 buys negotiated by the DPRO of 1 Navy-managed; and for 9 buys on 1 additional DLA-managed; and collateral, along with a failure to consider an alternative source from a price challenge, on 19 (correctly, 17) buys of 6 additional DLA-managed items.

Most of the buys were small valued purchases, where any such documentation is rarely required. Specifically, 16 of the DLA-managed item buys were Blanket Purchase Agreement (BPA) calls below the $2,500 threshold requiring competition or documentation; 4 of the 6 manually awarded purchase orders were competed or below the noncompetitive threshold, so documentation was not required; 4 more were Indefinite Delivery Type Contract (IDTC) orders not requiring a further price reasonableness review because reasonableness of the prices had been validated and documented at time the IDTCs were awarded; and the remaining 11 were orders under Basic Ordering Agreements (BOAs), which required documentation.

Prices fluctuate but generally exhibit an upward trend over time for many reasons. Often we, as well as our suppliers, face minimum charges from manufacturers or other suppliers that are passed on to our source of supply. In other situations, the prior source is no longer interested in small value purchases, out of business, or for other reasons, a new source must be found. Often we may be buying spare parts from the manufacturer of a weapons system because we don't own manufacturing drawings which would enable us to seek out other potential manufacturing sources. Weapons system manufacturers may not be able to produce or supply parts as economically as other potential suppliers might, if they had access to manufacturing drawings.

Absent competition, some sole source suppliers may lack the motivation to control costs and prices. As a result of these various situations, sometimes our supplier and/or the Government pays more than it might otherwise, under different circumstances. In some cases the charge is so unreasonable as to no doubt represent overcharging. Determining whether this is the case on an individual buy and whether it is costeffective to correct are difficult decisions.

Regardless, the IG conclusion that overpricing was "caused" by a failure to analyze large price increases is flawed. And, this conclusion is inconsistent with existing Government policies. Further, knowledge of a price increase over a prior buy does not corroborate that either the current, a prior buy, or both buys were overpriced.

oo Postaward analysis:

In spite of DLA's nonconcurrence with this element of the finding, there are some additional analyses of price which are accomplished by each of our Centers on a postaward basis in an effort to assure that the prices we pay continue to be reasonable.

The 4 Defense Supply Centers addressed in this audit monitor overall trends in prices they pay, as well as price fluctuations and trends for individual buys, suppliers, and commodity groups, on a continuing basis.

These Centers utilize our automated systems to place calls with to BPA holders on a rotational basis up to the micro-purchase threshold. In addition, DCSC places automated IDTC orders up to the former small purchase threshold. These Centers perform postaward price reviews of the automated awards to individual suppliers on a periodic, rotational basis. The Centers utilize summary listings of awards by vendor along with other reports and past experiences with individual suppliers in initiating new and followup reviews. Since the awards volume far surpasses available resourcing and the cost effectiveness does not support review of all suppliers, the Centers restrict their efforts to in order to maximize the return on investment. They concentrate on the highest dollar volume suppliers plus any where past experience or other indicators suggest such a

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review should be initiated. The reviews are accomplished by contract pricing personnel, except that DISC pricing personnel obtain assistance as required from the Defense Contract Audit Agency.

Such vendor-wide reviews by DCSC and DISC were briefly addressed in the second of two paragraphs under the heading "Automated Procurements." Vendors supplying several of the items in question to these Centers were targeted therein and in Recommendation B.2. as requiring audit because the contractors reportedly hadn't recently been audited. If comments on these reviews and the recommendation are retained, the Centers' programs should be more fully explained, along with why the IG believes that the suppliers for the 3 items cited in Recommendation 2 should be singled out for review

Revised

To recap, DLA disagrees, strongly, with the implicit IG conclusion that:

(i) the analysis of price increase over prior procurements is required, or should be required by regulation, in connection with the full dollar range of spare parts procurements reviewed in this audit,

(ii) such analysis should have been accomplished in connection with the full dollar range of spare parts procurements reviewed in this audit,

(iii) "overpricing" occurred as a result of failure to perform such analysis, and that

(iv) the purported "overpricing" would have been averted through such use.

Corrections and/or amplification of the relevant paragraphs in Appendix C is clearly required. And as further explained herein, elimination of applicability to DLA of this element of Finding B and of recommendations B.1.c. and B.2., is warranted. If retained, the wording in the Finding, Appendix, and Recommendations should, as a minimum, be corrected for consistency with the applicable FAR and DFARS policies.

o "contracting officers ... did not always solicit identified alternate sources"--This element of the finding is factually correct but inconsistent with existing regulations applicable to the DLA small purchases in question, which at most, only require that a reasonable number of sources be solicited. Neither has this been found beneficial under best Government procurement practices.

Appendix D to the draft report identifies the failure to consider an alternative source from a price challenge as the "cause of overpricing" on 36 buys questioned on 12 DLA-managed items. And, this is identified as a collateral cause, along with a failure to question a large increase over previous prices on 19 (correctly, 17) additional buys on 6 other DLA-managed items. The Appendix further shows that the lower price from the alternative source was the basis of the IG's calculation of a "reasonable price" for the total of 57 buys questioned by the IG for all 18 of these items. The IG labels the entire difference between the lower price from the alternate source and the prices paid on these 57 (correctly, 55) buys as "overpricing."

Appendix E

Revised

FAR competition requirements, which stem from the Competition and Contract Act, are as follows:

(i) " . . with certain limited exceptions ... contracting officers shall promote and provide for full and open competition in soliciting offers and awarding Government contracts." (FAR 6.101)

(ii) " ... full and open competition is the process by which all responsible offerors are allowed to compete." (FAR 6.000)

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(iii) FAR 6.001 ("Applicability"), points out that exceptions for which these requirement do not apply include:

(a) contracts awarded using simplified acquisition procedures (vice "small purchase procedures" prior to the aforementioned FASTA changes which became effective 3 July 1995) and

(b) orders placed under indefinite-quantity contracts when the contract was awarded under full and open procedures and all responsible sources were realistically permitted to compete [i.e., applicable to 4 of the 55 buys questioned on this basis].

(iv) FAR 13 procedures for simplified acquisitions specify that:

(a) "Micro-purchases may be awarded without soliciting competitive quotations if the contracting officer determines that the price is reasonable." (FAR 13.603(a)).

(b) Unless dissolved or canceled,..."each acquisition...of supplies or services that has an anticipated dollar value exceeding $2,500 and not exceeding $100,000, is reserved exclusively for small business concerns and shall be set aside..."(FAR 13.105(a)) [i.e., applicable to 38 of the 55 buys questioned on this basis].

(c) "...contracting officers shall solicit a reasonable number of sources to promote competition to the maximum extent practicable and to ensure that the purchase is advantageous to the Government ... " (FAR 13.106-1(a)(1)) [i.e., applicable to 13 of the 55 buys questioned on this basis]

Revised

As indicated above, there was no requirement for contracting officers to solicit any other source on 42 of the 55 buys questioned. The remaining 13 simplified purchases exceeded $2,500 and would be subject to the requirement to solicit a reasonable number of sources (i.e., normally 3 suffices). However, only 4 of these buys questioned occurred following the notification to the cognizant Center in early 1993 that an alternate source existed. The other 9 were awarded in the 1988-1991 time frame. Furthermore, all 55 of the buys on these 18 items were deemed by the IG to have been "overpriced" due to the prices reportedly available from the same alternate source. However, as further explained below, the 2 Centers responsible for these items have historically been unable to interest this particular supplier in participating in their automated awards program because the supplier has reportedly been disinterested in furnishing in accordance with their standard requirements---i.e., for military standard packaging, barcoding, and marking, plus pricing on an FOB destination basis For these reasons, the IG has failed to substantiate that "overpricing" occurred on any of these items.

Deleted

The subsection entitled "Soliciting Alternate Source" (page 6) of the draft section entitled "Finding A. Responses to Price Challenges" states that "The Navy responses for the 16 parts stated that the source identified by the challenger would be added to the solicitation list for future procurements of the parts. However, the buying centers did not solicit the new source on the 8 parts that were subsequently procured." Taken together, this implies that the additional source should have been, but was not, solicited. This should be revised to eliminate the resulting misunderstanding, and perhaps a cross-reference added to the further discussion of the matter contained under "Finding B. Pricing of Spare Parts Procurements."

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The elaboration in second paragraph (page 20) under the report subsection of "B" entitled "Soliciting Alternative Sources," also requires revision for the 4 reasons discussed in the succeeding paragraphs.

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First, the IG uses a similarly deficient statement that "...[DLA] contracting officials...did not solicit the alternate source for 10 procurements of 8 of these 18 parts ... after receipt of the price challenges." The report wording should be clarified and the numbers revised accordingly: Revised

(i) to recognize that the Center must first make a technical review to determine whether or not the additional supplier is a valid alternative source for the identical item, and if validated, enter the source into the source list for such item,

(ii) to state thereat that soliciting these individual sources on all subsequent buys is not required by regulation (see previous discussion)for large purchases, much less for buys using small (now simplified) purchase procedures, and

(iii) to state that, consistent with the applicable regulations, DLA systems solicit 3 or more sources (required on buys over the micro-purchase threshold) and places automated calls on a rotational basis for procurements under the $2,500 threshold.

Second, the succeeding statement in this same paragraph states that "The alternate source was not entered in the Construction Supply and Industrial Supply automated purchasing systems" should be revised to eliminate the implication of a failure to follow procedures. The succeeding sentences in this paragraph provide some indication that the Government and the Centers had not entered into the requisite Blanket Purchase Agreement (BPA) with the alternate source. However, this wording needs to be revised and updated, along with some background on our automated procedure, as discussed below. Deleted

These two Centers have on several occasions contacted or written the alternate source used by the IG as the basis of its "overpricing" calculations, about participating in their automated procurement systems. However, we understand that the company has consistently declined because of its unwillingness to either furnish the materiel with the necessary military packaging, barcoding, and marking, and to price on an FOB destination basis. The requirements for military packaging, barcoding, and marking are universally applied in automated BPAs used by our Centers and significant changes to these systems would be required to enable conversion of buys to a different basis for this or any other supplier. However, we were advised by a representative of DCSC that this matter was again discussed with a member of the company who expressed a willingness to look over the Center's standard BPA. We understand that it was mailed to the company on 8 September 1995. The Center will be following up with the Company on this matter in the near future. Revised

The report should note that DLA developed its automated procurement systems as a means of placing BPA calls and IDTC orders with the lowest possible administrative expenditure to the our customers and the taxpayer. However, because there is a built-in administrative cost to vendors and the Government of developing and maintaining these contractual instruments, use of these techniques is not beneficial to both parties unless a substantial volume of business results from using these instruments in a standardized manner.

Third, this same paragraph states that "the contracting officer for 1 of the 3 manual procurements stated that she was not made aware of the alternate source." Further, that "The contracting officers for the other two manual procurements were not available to discuss the procurement." These comments appear to contribute little to the thrust of the paragraph. Suggest they be dropped. If the former sentence is retained, an explanation should be included to indicate whether this appears to be an isolated instance. Revised

Fourth and last, this paragraph also states that "Industrial Supply management officials stated that, starting in February 1995, contracting officers making manual procurements would be made aware of the alternate source." Apparently this comment refers to the Center's longstanding, not newly established, practice of

furnishing a copy of results of reviews resulting in the addition of an alternate source of supply, to alert the commodity buying group and/or the automated procurement group of the additional source.

In summary, contracting officers are not generally required nor expected to solicit the potentially lowest priced source in connection with every buy, much less the low dollar type DLA buys in question in this report. Further, use of the particular alternate source in question would necessitate change in a very substantial number of NSNs to utilize administratively more costly non-automated buying procedures whenever any other supplier is identified that might offer a lower purchase price. The administrative cost to award automated vice manual awards at these 3 Centers are:

Center	Automated Award Cost	Manual Award Cost	Cost Difference
DCSC	$15.86	$70.57	$54.71
DGSC	13.45	75.34	61.92
DISC	16.43	71.37	54.94

Source: Draft results of a current DLA Operations Research study of the cost and other considerations of the various current and potential improved buying methodologies.

As can be seen, pursuit of the lowest possible purchase price could have a significant impact on our operations. The increased administrative costs would be substantial (especially if the costs of canceling or dissolving setasides in pursuit of such lower costs were considered). Other repercussions must also be considered, such as the adverse impact on administrative and production lead times (manual is 26-28 days longer, depending on the Center), achievement of goals for awards to small and small disadvantaged businesses, etc if implemented across the board or to any sizeable degree.

Accordingly, we disagree, strongly, with the implicit IG conclusion that---

(i) that alternate sources are required to be solicited, or should be required to be solicited, by regulation, across the full dollar range of spare parts procurements reviewed in this audit,

(ii) this particular alternate source should have been solicited in every buy,

(iii) "overpricing" occurs whenever an item from an alternate source reported to be available at a lower price was validated as acceptable but not solicited on every subsequent buy, regardless of dollar value, method of procurement, or other salient considerations, and that

(iv) the purported "overpricing" would have been averted through such full and open competition.

A lower price from another source criterion may represent potential opportunities for savings in future buys after the Government has confirmed that a suggested additional supplier is a valid alternate source for an item. However, this does not mean that such source should be solicited on future requirements of the item. Contracting officers are granted considerable latitude to exercise the requisite judgment in the interests of the Government. No such failure has been suggested in the report to have occurred. Accordingly, corrections and/or amplification of the relevant paragraphs in Finding A, Finding B, and in Appendix C is clearly required. Additionally, elimination of applicability to DLA of, this element of the Finding and of Recommendation B.1.d. is warranted. If retained, the wording in the finding and recommendations should, as a minimum, be corrected for consistency with the applicable FAR and DFARS policies.

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o "... [Accordingly,] contracting officers did not properly analyze the proposed prices for the procurements."---For the reasons discussed above, independent Government cost estimates, field pricing supp''ort, price comparisons with prior prices, and soliciting alternate sources are techniques for selective application to large purchases, but are generally inapplicable to most of the DLA small dollar purchases such as those questioned in this audit. Accordingly, the audit conclusion as written is substantially flawed and requires the aforementioned changes to correct misstatements and inconsistencies with Federal and Defense policies and good business practices. Failure to makes these correction will likely result in misconceptions on the part of recipients of the report.

o " . . DoD buying centers paid unreasonable prices to contractors on 89 procurements of 29 spare parts"---The IG continues to use the longstanding approach of viewing any lower prior or subsequent price estimate, quote, or award as confirmation that a higher contract price was unreasonable. This is patently incorrect. Due to the seriousness of the audit allegations, our Defense Contract Management Command (DCMC) formed a team to evaluate the reasonableness of the negotiated prices and determine whether the pricing actions taken by the DPRO negotiators were compliant with the applicable regulations and adequate to assure that the prices paid were fair and reasonable. The DLA Headquarters and Center staffs performed oversight review on a coordinated basis covering the Centers's buys in question. Revised

As we have pointed out in response to several prior audits involving reported "overpricing," a range of prices can be fair and reasonable and reflect best value to the Government considering the circumstances of the specific contracting situation.

Contracting officers exercise considerable judgment in making price reasonableness determinations in connection with each individual buy. Many considerations go into reaching that decision, which is time-specific, and based on the information that is available to the contracting officer at the time the determination is made and the buy awarded. Information on an alternate source, lower priced subsequent buy, or an in-depth cost estimate may become available. But a higher price on a previous or subsequent buy does not by any means confirm that another buy was unreasonably priced or that overpricing occurred. Indeed, with growing emphasis on basing awards on considerations of quality, item performance, past performance by the contractor, and other factors, clearly a range of prices may be fair and reasonable in the circumstances. However, unless it is learned that the price paid to the contractor is attributable in part to erroneous and misleading information furnished by the prospective supplier and/or the contracting officer's price reasonableness determination was unsupported and/or otherwise unfounded and should have been substantially lower, then the price reasonableness determination made at the time of the buy was correct.

The award at a price deemed to have been unreasonable does not mean that overpricing occurred. Of course, the converse is also true, i.e., the award at a fair and reasonable price does not mean that overpricing did not occur. Further, overpricing is not synonymous with overcharging. Overpricing occurs when the contract price is so excessive as to be unconscionable. Overcharging occurs when the resulting payments to the contractor are so excessive as to be unconscionable. The Government should pursue recoupment of overcharging resulting from such overpricing, and in addition, in instances where major changes in conditions and/or plans for contract performance change which result in a substantial cost underrun (i.e., a windfall to the contractor).

To recap, we disagree with the audit conclusion that most of the awards in question were unreasonably priced. As of the date of this position, we have been unable to confirm the finding of "unreasonable" pricing in connection with other than 7 of the buys on 3 of the parts questioned by the IG. We note that our review is ongoing concerning 5 of the DISC-managed items, as identified in the Attachment to this Finding B.

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Revised

o "As a result, the DoD buying centers overpaid about $18.1 million for the 29 unreasonably priced spare parts on 89 procurements valued at $30.9 million"---The "overpricing" attributable to DLA reportedly occurred on 11 awards totaling $30.514 million on 4 of the Navy-managed items which the DLA Plant Representative Office (DPRO) negotiated the contract prices; and on 77 awards totaling $0.397 million on 24 spare parts managed by DLA's Defense Supply Centers.

This reported "overpricing" is substantially overstated for several reasons:

Revised

(i). First, as noted in the paragraph entitled "Soliciting Alternate Sources (pages 19-20 of the draft), the IG reported that "The amount of overpricing is overstated by an undeterminable amount because the alternate source, to sell to Construction Supply or Industrial Supply, would have to add to the catalog price the costs of barcoding, military packaging, and shipping. Neither Industrial Supply nor the alternate source could provide an estimate of the costs." This comment applies to all 18 of the 29 items reported which were reported as "overpriced" based on an "alternate source." All 18 were prices reportedly available from the same alternate source, long after most or all of the buys in question were made. This statement requires updating, inasmuch as we have included in our discussion of the individual items deemed "overpriced" by the IG, an estimate of these amounts.

(ii) Second, in addition to the overstatement in the IG's calculations which it reported, there are two other types of overstatements of the amount the IG deemed "overpriced" which went unreported because---

Revised

(a) The prices from the alternate source used as the basis of the IG's calculation of "overpricing" on all 18 of these items are Free On Board (F.O.B.) origin, whereas most of the buys in question were destination, i.e., F.O.B. to the Government depot or the Government customer. We have included estimates of these amounts in the following discussions, so the IG report should update this comment accordingly.

Revised

(b) Second, the amount of reported "overpricing" is overstated due to inadvertent miscalculations pointed out in our discussion of 2 of the items (Attachment to this DLA position paper).

The cognizant Centers (DCSC, DGSC, and DISC) and this Headquarters have reviewed the circumstances of the DLA buys in question as reported in the draft. Notwithstanding the review conducted by the IG, DLA's reviews disclosed that of the buys in question, DLA paid a total of $21,293.67 too much as a result of overpricing on 3 of the items (identified above in the table within the discussion of price increases over previous procurements) (However, the Center has recovered $4798.46 of this amount from the contractor on 1 of the items.) The basis of the IG and DLA position on each item in question is explained in the Attachment.

We note that in the "Conclusion" paragraph of this finding, the IG stated:

"...the audit results should not be interpreted as indicative of widespread overpricing at the buying centers within DoD. The audit reviewed only the pricing of spare parts that were already suspected of being unreasonably priced. Nevertheless, the audit results indicate that the quality of spare parts pricing can be improved. The number of unreasonably priced spare parts procurements should decrease if contracting officers solicit all known qualified sources and use independent Government estimates, field pricing support, and price comparisons, when applicable, to evaluate proposed prices for the parts."

This audit conclusion, which served as the basis for the accompanying recommendations B.1.a. through B.1.d. and B.2., is flawed. DLA has fully implemented the requirements of FAR and DFARS and our contracting officers have fully followed these policies. The report failed to demonstrate any instances where there has been a failure to follow such policies. Nevertheless, the IG has drafted recommendations worded so

as to imply that there has been failure to follow these policies. This is not the case. Therefore, there is no need for further policy implementation or management reemphasis of these policies. And, there should be no expectation that the quality of pricing of the spare parts in question nor any other spares would improve if implemented and followed beyond the extent specified in current regulations.

INTERNAL MANAGEMENT CONTROL WEAKNESS: Not Applicable
(x) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. A lower price from another source criterion may represent potential opportunities for savings in future buys after the Government has confirmed that a suggested additional supplier is a valid alternate source for an item. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur: weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Jerry Gilbart, MMPPP, 11 September 95

REVIEW/APPROVAL: MARGARET J. JANES, Assistant Executive Director (Policy & Oversight), Directorate of Procurement, 11 Sep 95

COORDINATION: JILL PETTIBONE, Assistant Executive Director (Operations/Policy Group), Directorate of Contract Management, 11 Sep 95

EILEEN SANCHEZ, Internal Management Control Program Manager, Management Control Improvement Group, 11 Sep 95

DLA APPROVAL: Maj Gen WILLIAM P. HALLIN, USAF, Deputy Director, Materiel Management, 12 September 1995

1 Attachment
DLA Position---29 "Unreasonably" Priced Spare Parts

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DLA POSITION---29 "UNREASONABLY PRICED" SPARE PARTS

Revised

Due to the seriousness of the audit allegations ($15,817,764.70 total DLA overpricing) (actually $15,815,545.65 as explained below), DLA has performed comprehensive reviews of the individual buys in question. Our Defense Contract Management Command (DCMC) formed a team including representatives from the cognizant Defense Plant Representative Office (DPRO). The team evaluated the prices negotiated for the 8 buys for 3 of the 4 Navy-managed items (i.e., all except the Link Assembly) which had been made by the DPRO on behalf of the Navy [The Navy contracted for the remaining item, i.e., the Rudder Tip.], which accounted for virtually all of the purported overpricing on the DPRO awards. The 77 awards (actually 75) in question on the 24 DLA-managed items were reviewed by personnel of this Headquarters and the cognizant Defense Supply Centers (i.e., the Defense Construction Supply Center (DCSC), the Defense General Supply Center (DGSC), and the Defense Industrial Supply Center (DISC)) on a coordinated basis..

The objective of the DLA reviews was to determine whether the pricing actions taken by the DPRO negotiators and the Center contracting personnel were compliant with the applicable regulations and adequate to assure that the prices paid were fair and reasonable; and in retrospect, to attempt to ascertain, whenever possible, whether overpricing occurred; otherwise, the likelihood of its occurrence.

Notwithstanding the IG's conclusion of substantial overpricing, DLA's reviews disclosed a much different result. We have found that the IG's conclusion of overpricing has not been substantiated to have occurred on the DPRO awards for the 4 Navy-managed items. For 19 of the 25 DLA-managed items, we have concluded that DLA paid a total of $21,293.67 too much as a result of overpricing on 3 items. Of this amount, $4,798.46 has been recouped on 1 of the contracts in question. We have not yet reached a conclusion on 5 of the items comprising a very minor portion of the reported "overpricing." An explanation of the IG finding and the DLA position regarding each item in question follows (in the same sequence as reported in Appendix D to the draft IG report):

Revised Appendix E

- o Navy managed items (but negotiated by the DPRO):

  - oo Forward Head Hub ($6,632,655.32 total overpricing per IG; $0.00 per DLA) & Aft Head Hub ($6,640,168.91 total overpricing per IG; $0.00 per DLA)--The DCMC review team focused its efforts on the prices negotiated for the Head Hubs since about $13.3M (84%) of the DoD IG's $15.9M overpricing is assignable to 7 procurements over a 5 year period for these 2 similar parts. The negotiated prices for all 7 procurements are consistent.

The team reviewed the contract files for 2 of the most recent procurements of the Head Hubs under BOA N00383-91-G-K512, Delivery Orders 0165 and 0166. The prices negotiated by the DPRO were based upon the results of both price and cost analyses. As mentioned above, price analysis indicated that the negotiated prices were reasonable. The DPRO negotiator had also performed a cost analysis which necessarily included a review of the proposed subcontract costs in accordance with the acquisition regulations (the manufacture of the Head Hubs is almost entirely a subcontracted machining effort). The DPRO negotiator's review of prior purchase orders for these parts supported the determination of subcontract cost reasonableness. The DPRO negotiator had also reviewed the subcontractor cost or pricing data submitted to the Government by Boeing and its analysis thereof. The subcontractor's estimated costs were based primarily upon actual labor cost history for 624 nearly identical parts completed during 1991-93 which had been audited by the Boeing analyst. The Boeing subcontract analysis and negotiation memorandum were thorough, logical, and well documented.

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Given the abundance of prior purchasing information, the fact that the subcontractor's proposed labor cost was based primarily on audited historical cost data, and the quality of the prime's analysis, all of which suggested that the subcontract costs were reasonable, the DPRO negotiator had determined that a Government subcontract analysis was not necessary.

We note that the DPRO negotiator learned by virtue of the DoD IG audit conducted after these awards had been negotiated, of the existence of an Independent Government Estimate (IGE) forming the basis of the IG finding of "overpricing" on these items. The IGE had been performed within the Navy for evaluation of a price challenge on these items. The DoD IG, despite access to all of the information presented above which indicates price reasonableness, concluded that "the overpricing ...could have been prevented had the contracting officer obtained field pricing support to analyze the contractor's proposal, including subcontractor costs." Given the persuasive cost and pricing information in the contract file, we do not believe that subcontract cost analyses over and above that performed by the prime contractor was warranted nor justifiable.

The difference between the negotiated price and IGE is due to the direct labor hours estimated for machining the Hub forgings. The IGE is about 6 times lower than that estimated by the subcontractor. As mentioned above, the subcontractor's estimate was based on historical experience for 624 prior units. The DoD IG apparently never questioned the basis for the IGE. Instead, the estimates were apparently accepted as the fair and reasonable price, notwithstanding that the report of the IGE clearly state that it was based on drawings only and that the drawings were illegible. Considering all the historical cost and pricing information available for the Head Hubs, we do not believe that the IGE suffices as a valid basis for the DoD IG to claim of overpricing.

oo Link Assembly ($10,475.41 total overpricing per IG; $0.00 per DLA)---The purported overpricing of this item occurred on 3 different delivery orders over a 5 year period. The auditors' primary basis for alleging that the part was unreasonably priced is a Navy Price Fighter estimate which also serves as the DoD IG's criterion for quantifying the total amount of "overpricing." The DoD IG also considers the increase in the price of the part on the most recent order from that paid on the 2 prior delivery orders to be further proof of "overpricing" (although the DoD IG considers all 3 orders "overpriced"). Due to the relative insignificant of the "overpricing" attributed to this item, the DCMC review team did not evaluate its pricing. Revised

In order to ascertain price reasonableness, according to the documentation in the contract file for the most recent delivery order, the DPRO negotiator conducted both a price analysis and cost analysis. It should be understood that the total price for the last order was only $8,841. Neither acquisition regulations, DCMC policies, nor prudent business practices suggest that detailed rationale (e.g., a price negotiation memorandum) be prepared and maintained in the contract file for awards of such a relatively low dollar value.

The DoD IG, having "proved" overpricing by comparing the negotiated prices to the IGE, is also critical of the price analysis conducted. The DoD IG states that the DPRO negotiator, in pricing the last delivery order, failed to question the large price increase over the previous price for the part. This assertion by the DoD IG is highly speculative; since the justification in the contract file states that the proposed price was reviewed in relation to prior prices paid. The logical assumption is that the difference was adequately justified to the negotiator responsible for establishing the contract price. The DoD IG also states that price differential can not be explained by quantity variances since the quantities procured on each of the 3 orders are similar. This conclusion may also be incorrect since the 2 earlier orders, placed only about 2 months apart, were scheduled for production on the same work order. By consolidating the 2 orders, the quantity difference becomes 58 versus 27 which may indeed be significant on the factory floor.

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Variance from the Navy Price Fighter estimates is not evidence that an item is overpriced as demonstrated by our review of the Head Hub and Shaft and Carrier pricing. The DoD IG criticism of the price analysis for the Link Assembly is founded upon a superficial review of the acquisition. Accordingly, the DoD IG has not made a convincing argument that the prices negotiated for the Link Assembly are unreasonable

oo Shaft and Carrier ($2,338,334.88 total overpricing per IG; $0.00 per DLA)---The DoD IG's sole basis for both alleging that the parts were unreasonably priced and calculating the amount by which overpriced is an IGE.

The team reviewed the contract file for the procurement of the Shaft and Carrier under BOA N00383-87-G-K503, Delivery Order 0608 and found that the prices negotiated by the DPRO were based upon the results of both price and cost analyses. The prior purchase price for this part (similar item but a different dash number) of $29,283/unit in 1987 for a similar quantity compares favorably with the 1994 unit price of $36,033 challenged by the DoD IG; these prices differ by less than 4.5% after adjusting for the effects of inflation (using the index for Industrial Commodities).

The manufacture of the Shaft and Carrier is a subcontracted effort which was awarded competitively to the lowest priced bidder. Since the subcontract price was determined to be based upon adequate price competition, no further evaluation of this cost element was conducted during the cost analysis. The review team finds the pricing actions taken by the DPRO negotiator to be compliant with the applicable regulations, in accord with Government contract pricing practices, and adequate to reasonably assure that the prices paid were fair.

o DCSC-managed Items:

Revised

oo Engine Radiator ($6,125.69 total overpricing per IG; $4,641.74 per IG as corrected; $0.00 per DLA)---The IG reported that the last 5 buys through 30 August 1995 for this item (actually, the last 4 buys---2 in 1989 for $810.00 ea/qty of 3 and $810.05 ea/qty of 15 plus 2 in 1990 for $868.42 ea/qty of 11 and $896.87 ea/qty of 19---due to IG double-counting the second 1989 buy) were overpriced based on subsequent advice forwarded in February 1993 (2 1/2 years after the last buy) from a user of the item that reportedly, it could be bought for $755.72 from a different authorized distributor of the original equipment manufacturer (OEM) and all 17 of the other items deemed "overpriced" on this basis. Further, we note that the vendor for these buys was also targeted by the IG for a postaward review (Recommendation B.2.).

[An OEM is a firm that manufactures and/or assembles the end item (or a major component) from individual parts and/or components which it manufactures or are produced to specifications and drawings which it developed, owns, and which are necessary to manufacture the piece of equipment or component.]

DLA has determined that these orders to a small business dealer were priced in accordance with the terms of the automated Indefinite Delivery Type Contract (IDTC) (which had been competitively awarded to the supplier offering the most advantageous prices to the Government), that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing on the buys in question has not been substantiated.

The IG did not consider that the alternate source, an authorized distributor for the OEM, will not furnish the item via other than the OEM's normal commercial packaging, marking, and F.O.B. origin pricing. The awards in question provided for military packaging, barcoding, and marking. The 1990 buys also provided for delivery F.O.B. destination. Therefore, any price comparison with the alternate source requires the inclusion of an estimate of these packaging, marking, and shipping costs to the destination (Tracy, CA).

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In the absence of knowledge of whether the alternate could arrange for the manufacturer to drop ship the items with a commercial packager for repackaging and shipment to the depot, or even the location of the shipment point, the Center obtained estimates for these charges based on shipment from a mid-U.S. location (Columbus, OH) to the receiving depot for the buys in question (Tracy, CA).

A local packager in Columbus, OH has a minimum charge of $25.00 for this repackaging and barcoding. However, the charge for this outsized item (unit weight and cube of 103 lbs and 6.0 cubic feet) would be $15.00 each radiator. The Center Transportation office estimated that the cost in 1990 to ship the most recent 1990 buy was $50.44 - $50.49 each, depending on the quantity. Accordingly, including these add-ons (totaling about $65.45 each) with the $755.72 unit price of the alternate source produces a $821.17 price which is comparable to the $852.42 average price paid by the Center.

There is one additional difference between these buys and the alternate source which should be considered. The buys in question were made via orders placed under automated Indefinite Delivery Type Contracts (IDTCs) that had previously been awarded on a competitive basis. This will no longer be the case for this item. The Center became aware of a different alternate source in July 1991. This source was validated on 16 July 1992 (i.e., which was 8 months prior to receiving knowledge of the possible existence of an additional alternate source) the Center had recoded the item for exclusion from its automated IDTC procurement system. As a result, these small business distributors can be given the opportunity to compete with other approved suppliers on any subsequent buy, which should help assure that any potential improvement in prices can be realized. (We note, however, that as of the current date, the Center has not been required to repurchase this item.)

oo Orifice Disk ($2,029.31 total overpricing per IG; $1,126.75 per DLA)---The IG reported that the last 3 buys through 30 August 1995 (from three different dealers---in 1991 for $284.25 ea/qty of 3, in 1992 for $334.10 ea/qty of 3, and in February 1993 for $352.81 ea/qty of 2) were overpriced based on a estimate than had been misidentified as a "should cost" estimate (i.e., an IGE), accomplished subsequently by the Center in September 1993 for purposes of evaluating a price challenge that the item seemed overpriced. Further, we note that the 3 dealers were also targeted by the IG for a postaward review (Recommendation B.2.). Revised

The IG was told by Center technical personnel that this was not a detailed IGE based on manufacturing processes, time, material, quantity, etc, but rather a "best guess" based on similar items in a production run environment, i.e., several hundred or an item routinely manufactured. Accordingly, the IG was cautioned that the Center could not use this estimate as a basis for a fair and reasonable price for this proprietary item

The buys in question were provided through small business dealers who resold the item to the Government. In 1991, the price from the OEM for the item was raised from $48.00 in 1990, due to imposition of a $750.00 minimum order charge. As a result, the OEM charged the Center's supplier this amount for the quantity of 3 units it furnished, with a reasonable markup, on the first buy in question. Subsequently, the OEM was bought out, along with remaining stocks of the item, which were furnished on the 2 subsequent buys. The successor OEM apparently adopted the $250.00 price as a baseline, since it charged the subsequent 2 vendors $257.00 each and $267.00 each, respectively.

DLA agrees with the IG that the higher prices charged the dealers for these 3 buys was excessive and that overpricing occurred. In July 1995, the Center obtained an independent should cost estimate from the Navy. This estimated a price of $90.68 each for a quantity of 3 based on review of the proprietary drawing. The Center technical personnel in turn formulated a 1995 should cost estimate using the Navy's pricing factors. The resulting $85.49 estimate was been placed in the Procurement Guidance Field on 27 July 1995 for buyer use in future procurements. However, manufacturers often impose some minimum order or minimum

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quantity charge to cover the administrative costs of filling small orders. We believe a minimum order charge of up to $250 would not be unreasonable. We have therefore used the $85.49 and a $250.00 per order charge to calculate an upper amount that should be considered reasonable for the 8 units purchased on the 3 buys ($1,433.92 vice $2,560.67 actually paid). The overage constitutes overpricing ($1,126.75).

It must be recognized, however, that because the item is proprietary and the suppliers have no alternative to paying the sole source's price, the overpayment cannot be recouped. The Center will likely be obliged to procure at the excessive rate in the event of a further buy, unless the requirement is sufficient to warrant the substantial investment needed to reverse engineer the part to enable procurement using Government-developed data.

However, the Center has now blocked the item from future procurements via the automated Blanket Purchase Agreement (PBA) procurement system. Accordingly, if the need for a further buy arises, instead of a the automatic placement of an award, the manufacturer can be contacted to determine the least costly source of supply.

Revised

oo Fluid Filter Element ($861.72 total overpricing per IG; $0.00 per DLA)---The IG reported that the last 3 buys (3 in 1991, all at $10.07 ea/qtys of 46, 22, and 33, and 1 in June 1993 for $5.00 ea/qty of 34) during the 6 3/4 year period ended 30 September 1994 covered by the audit were overpriced based on advice forwarded in early 1993 from a user of the item (after the first 2 buys), that reportedly, it could be bought from a distributor of a different OEM (the same alternate source suggested for the Engine Radiator discussed above and all of the 17 other items deemed "overpriced" on this basis), for $2.41 each.

DLA has determined these calls to small business dealers were fair and reasonably priced in accordance with the terms of the automated BPAs, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing on the buys in question has not been substantiated.

The awards in question were to dealers on the basis of military packaging, marking, barcoding, and F.O.B. destination. As in the case of the Engine Radiator above, the IG did not consider that the alternate source, an authorized distributor for the OEM, will not furnish the item via other than the OEM's normal commercial packaging and marking, and F.O.B. origin pricing. Therefore, any price comparison with that available from use of the alternate source requires the inclusion of an estimate for these packaging, marking, and shipping cost to the destination for these buys (Tracy, CA).

As in the case of the Engine Radiator, the Center obtained estimates for these charges based on shipment from a mid-U.S. location (Columbus, OH) to the receiving depot. The local packager's $25.00 minimum charge would be applicable for repackaging and barcoding each of these 4 buys. The Center Transportation office estimated that the cost to ship these buys (unit weight and cube of 2.0 lbs and .05 cubic feet) would be about $0.85 each. Accordingly, including these add-ons (4 calls X $25.00/call + 135 each X $0.85 each average) offsets about $214.75 of the "overpricing," or about $1.59 per unit.

An additional consideration applicable to these automated buys from small business dealers is the extra administrative costs that would have resulted if each of the buys had been converted to a manual award process. As noted in the writeup of the finding concerning use of alternate sources, this latter factor amounts to an additional cost of about $ 55 per manual buy by the Center.

The subsequent knowledge of the existence of a potential alternate source of supply does not confirm that a prior buy was made from among sources then known to exist. We have confirmed that proper procedures were followed on the first 2 awards in question, and that they were made at prices which were fair and

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reasonable. Accordingly, absent more definitive information, there is no basis to conclude overpricing occurred thereon due to failure to consider the price of an alternate source not then known to exist.

The knowledge that an alternate OEM existed did enable the Center to confirm part interchangeability and to promptly load the alternate into its automated source list (March 1993). This resulted in the subsequent 1993 award at a reduced price to an independent supplier (vender) of that OEM's part at a more reasonable price, i.e., the OEM's list price of $4.44 (which provides a reasonable markup from the OEM's dealer net price of $2.41) to cover their operating costs and profit) plus amounts for transportation to destination and the military packaging, marking, and barcoding costs. Assuming the vendor's price was based on the retail list price of $4.44, the total amount included in this 1993 buy of 34 at $5.00 each to cover these additional costs would be $22.44, which is clearly not unreasonable.

There has been only 1 buy subsequent to the audit period through 30 August 1995, a manual award on 10 August 1995 at $9.56 ea/qty of 64. As a result of further review in an effort to learn how this could have resulted, it was learned that the preceding supplier had again submitted a price of $5.00 each but subsequently withdrew it on 20 July 1995 after being asked to verify the manufacturing source of the item. The firm said it would only bid on another manufacturer's item (i.e., that has not been validated as an authorized alternate item). The buyer then sent out a request for quote to the original OEM, resulting in the manual award for at a total price of $611.84.

In an attempt to assure that holders of automated contractual instruments that supply the second, more advantageous OEM's parts will have the opportunity not just to be considered for manual awards, but also to receive automated orders/calls for subsequent demands for this item that may arise in the future, the Center submitted a cataloging change through the Defense Logistics Services Center When DLSC downloads the updated information back to the Center, our system will automatically establish the necessary cross-reference in the DCSC files for this to happen.

In addition, on 8 September, as a result of a further follow-up with the alternate supplier on which the IG's finding is based, that firm agreed to given further consideration to the possibility of participating in the Center's automated BPA program. The necessary information was accordingly mailed out that same day

o DGSC-managed Items:

oo Junction Box Cover ($30,664.45 total overpricing per IG; $0.00 per DLA)---The IG reported that 8 of the last 9 buys through 30 August 1995 for this item (2 in 1989 at $225.94 ea/qty of 17 and $226.56 ea/qty of 15, 2 in 1991 for $255.60 ea/qty of 67 and $284.25 ea/qty of 25, 2 in 1992 for $250.00 ea/qty of 33 and $327.46 ea/qty of 23, 2 in September 1993 for $231.94 ea/qtys of 60 and 82, and 1 in October 1994 for $347.00 ea/qty of 139) were overpriced based on an "adjusted should cost" of $212.04 each. Revised

DLA nonconcurs in the assertion that the should cost analysis or that the price as adjusted by the IG demonstrates that these procurements were overpriced, or that overpricing occurred on any of the buys in question for this proprietary item, which were all placed with the OEM, a major supplier of aircraft and related items.

An IGE dated April 1993 was performed in early 1993. Although we could not determine the requestor or purpose of the review, it may have been needed in support of an internal review by the Navy of a suggestion to manufacture the part from a different material. There was no indication in the procurement files for the 2 September 1993 buys of knowledge of the should cost. Neither was there any indication that the Center had

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been furnished the should cost until 1994 when the IG audit was underway. A review of the 1993 award files revealed that the contracting officer evaluated the proposed price using a cost breakdown from the offeror and the current Government recommended forward pricing rates.

The should cost review was considered in evaluating the contractor's proposal supporting the 1994 buy, along with current and prior contract cost data. The direct materials cost included in the should cost estimate was quite comparable to the offer's proposed amount and recent actual costs, which was used in formulating the Government's negotiating position. The direct labor hours included in the should cost estimate coincided with the OEM's proposed hours, but substantially exceeded the supplier's historical experience, which was used in formulating the Government's position. The principal point of departure from the should cost estimate, however, is the fact that it used nationwide average rate estimated for labor and indirect expense pools, which underestimates the proper price level for this high-cost producer by a very substantial margin.

The Government position was accordingly based on forward pricing rates recommended by the cognizant DPRO, which are used in negotiating contracts with this OEM. The report of analysis included in the contract file acknowledged the consideration of the should cost estimate and explained why the recommended negotiation position was based instead on other information as discussed above. A fair and reasonable price for the contractor and the Government was negotiated.

Revised

The IGE is clearly not a reasonable estimate for procurements of this proprietary item from this high cost producer. This was recognized by the IG, and led to its calculation of an "adjusted should cost" using the then current forward pricing rates. However, the calculations were incomplete as they did not include amounts for any of the 5 applicable direct support labor factors (i.e., manufacturing support, quality labor, tool maintenance, etc). Additionally, it utilized the estimated material costs vice an amount consistent with the contractor's actual experienced material costs. If these shortcomings were eliminated and the applicable markups for these amounts added to the IG's adjustments, the result would have been comparable to the amount negotiated, which demonstrates that such price was fair and reasonable.

In summary, our review disclosed no indication that the determination that the award price was erroneous or that overpricing occurred on any of the procurements in question.

We note 2 other statements in the draft report related to this item require correction or elimination. First, the statement that "the General Supply Contracting officer for NSN 5975-00-435-0133 failed to question the large price increases over the previous procurement prices for the parts" was included in the third paragraph (page 16 of the draft) of the subsection entitled "Field Pricing Support," but it should be corrected or deleted. Second, the statement in the second paragraph of the subsection entitled "Government Estimates" at the bottom of page 14 that "...the contract file for NSN 5975-00-435-0133 does not show use of the should-cost estimate." requires correction.

The initial proposed price of $424.88 for the most recent procurement was questioned, as substantiated by the fact that the cost/price analysis element was tasked to review the proposal event though the proposed $59 thousand value was well below the normal threshold for this type of review. The cost/price analyst had the should cost in evaluating the 1994 buy and commented on it in the pricing report, which is a part of the contract file. However, the analyst utilized preferred methods in arriving and the recommended negotiation position, which was used in contract negotiations.

oo Assembly of Elevator Tab Fitting ($9,596.92 total overpricing per IG; $9,596.92 per DLA, of which $4,798.45 has been recouped)---DLA agrees with the IG conclusion concerning this item. The Center was alerted through a price challenge received in 1994 that the price paid on its only buy through 30 August 1995 (1990 for $217.26 ea/qty of 79) for this then-noncompetitive item may have been excessive.

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The Center contacted the contractor for the buy in question, a major weapons system manufacturer, and requested substantiating cost information. The contractor advised of a substantial cost underrun it attributed to the subsequent phase-out of the planned facility and completion of the order at a lower costing facility at a price $9,596.92 below the contract price. Although the Center was only able to secure a voluntary refund on the basis of an equal sharing with the contractor of the $9,596.92 underrun. DLA concurs with the IG that the initial award price exceeded a reasonable price. Furthermore, this full amount constituted overpricing which existed at the time of initiation of the audit.

During the course of the review, the Center learned through accessing a commercially available database, that the item had previously been bought in 1986, prior to transfer of item management responsibility to DLA, from a previously unknown source (a machine shop), at a substantially lower price. On following up with the machine shop, the Center was able to substantiate that it was a valid manufacturing source. Accordingly, the Center was able to recode the item as competitive and add the additional source to the Procurement Guidance Information for use in the event of any future procurements. DLA recommends that this information on additional DLA corrective actions be added to the writeup in the first paragraph under the subsection entitled "Manual Procurements" (page 17 of the draft) regarding this item. Revised

o DISC-managed Items:

oo Gasket ($46.00 total overpricing per IG; $0.00 per DLA)---The IG reported that only buy for this item (1 in June 1989 at $2.25 ea/qty of 25) during the 6 3/4 year period covered by the audit was overpriced based on subsequent advice forwarded in early 1993 (over 3 1/2 years after the last buy) from a user of the item that reportedly, it could be bought for $0.41 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis. Revised

DLA has determined this purchase from a small business dealer was fair and reasonably priced, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that overpricing did not occur on the award.

Unlike the $0.41 unit price from the alternate source, the price paid on the buy in question included military packaging, marking, and barcoding, and was F.O.B. destination. Since the alternate source will not sell to the Center on this basis, purchase from this source would require the additional administrative effort and cost to the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government depot. Most packagers have a $30.00 - $50.00 minimum charge, and due to the unit packaging required for gaskets, charge $2.00 - $3.00 per gasket. Forgetting for a moment the add-on for transportation to the Government depot for these buys, a packager's charge alone would increase the price for these 2 purchases from the alternate source well above the prices paid.

This notwithstanding, the Center included the distributor as an alternate source in the contracting guidance field in June 1993. This information would be available for use in a subsequent competitive procurement as appropriate, which should be useful to the contracting officer in helping to assure that a fair and reasonable price continues to be paid for the item. Although there has not been a subsequent major buy of the item through 30 August 1995, we note that in August 1995, the Center made a micro-purchase (BPA call) for 110 at $0.61 ea. This price is below the unit price recommended by the IG, after appropriate adjustments have been made as discussed above. Revised

oo Machine Bolt ($6,539.90 total overpricing per IG; DLA review is ongoing)---The IG reported that the most recent 2 buys through 30 August 1995 for this item (1 in 1989 at $4.73 ea/substantial qty of

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1,100 and 1 in May 1994 for $8.96 ea/much small qty of 270) was overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $0.79 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis.

DLA disagrees with the IG's rationale of calculating "overpricing" based on the price of another supplier identified nearly 4 years after the first buy in question, and especially when that source is unwilling to supply the item in accordance with the Government's requirements for military packaging, barcoding, and marking, and on an F.O.B. destination. However, we agree that the 2 buys in question reflected substantial price increases from the prior buys which warrants further in-depth effort to resolve whether overpricing occurred on these buys. This review is continuing as of the date of this response. In the event that overpricing is substantiated, the Center will pursue a recoupment from the dealers as appropriate.

Deleted Appendix E

Added Appendix F

oo Special Key ($38.25 total overpricing per IG: $0.00 per DLA)---The IG reported that all 3 buys for this item (1 in 1989 at $3.00 ea/qty of 3, 1 in February 1993 for $0.31 ea/qty of 50, and 1 in December 1993 for $0.79 ea/qty of 50) through the end (30 September 1994) of the 6 3/4 year period covered by the audit were overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $0.25 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis.

DLA has determined that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed and that the occurrence of overpricing on the buys in question has not been substantiated.

Amounts for military packaging, barcoding, and marking, nor transportation charges to destination must be added to the price of the alternate source to enable a proper price comparison. with these automated BPA purchases from 3 different small business dealers. The cost of a third party packager alone for just 1 of these awards exceeds the total overpricing claimed for all 3.

Additional considerations applicable to these automated buys from small business dealers is the cost of F.O.B. destination and the additional administrative costs that would have resulted if each of the buys had been converted to a manual award process. As noted in the writeup of the finding concerning use of alternate sources, this latter factor would have amount to an additional amount of about $ 55 per buy by the Center.

The cost of these add-ons likewise exceed the "savings" if the item had been purchased from the alternate source. Accordingly, these buys were unquestionably awarded at reasonable prices.

We note that a stock replenishment buy was made in August 1995 ($0.96 ea/qty of 80). For the same reasons, this buy was likewise reasonably priced, considering the price of the alternative source, with appropriate adjustments.

Revised

oo Plain Encased Seal ($1,643.70 total overpricing per IG: $0.00 per DLA)---The IG reported that all 14 buys for this item through the period covered by the audit (10 in 1992 for $37.02 ea/qtys of 2, 1, and 1, $24.77 ea/qty of 1, $22.02 ea/qty of 1, $35.79 ea/qty of 1, $18.91 ea/qty of 1, $23.41 ea/qtys of 10 and 15, and $23.76 ea/qtys of 40 and 17; 1 in April 1993 for $31.09 ea/qty of 10 and in May 1993 for $23.15 ea/qty of 61; and 1 in 1994 at $28.28 ea/qty of 70) were overpriced based on advice forwarded to the Center after in early 1993 from a user of the item that reportedly, it could be bought for $18.39 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis

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DLA has determined these calls to small business dealers were fair and reasonably priced in accordance with the terms of the automated BPAs, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing on the buys in question has not been substantiated.

Unlike the unit price from the alternate source, the prices paid on to the 7 different small business dealers on the 14 automated BPA calls in question included military packaging, marking, and barcoding, and was F.O.B. destination. The first 7 buys were shipped directly to the military customer because they occurred before a sufficient demand pattern had occurred to determine a stockage objective. Subsequently, after the item was recoded for depot stockage, more economic order quantities were bought and prices generally declined.

Since the alternate source will not sell to the Center on this basis, purchase from this source would require the additional administrative effort and cost to the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government depot. This alone would result in an increased cost of each buy $30.00 - $50.00. The additional costs of F.O.B. destination and the administrative costs of a manual award (about $55 at this Center) are other considerations.

We note that in April 1995 on the single buy of the item since the 6 3/4 year period covered by the audit, the Center was able procure the item from an additional supplier at $19.90 ea/qty of 79, again inclusive of military packaging, barcoding, marking and F.O.B. destination. This price equates to the price deemed reasonable by the IG after it's upward adjustment with these additional costs, as necessary to achieve comparability of terms and conditions of sale.

This notwithstanding, the Center has included information in the Contracting Guidance Data for this item identifying the alternate source for use in the event of a subsequent purchase requirement which exceeds the micro-purchase threshold, to enable its consideration as appropriate.

oo Annular Ball Bearing ($51.77 total overpricing per IG; $0.00 per DLA)---The IG reported that all 3 buys through 30 August 1995 for this item (2 in 1989 at $45.00 ea/qty of 1 and $16.81 ea/qty of 1 and in May 1994 for $11.72 ea/qty of 2) were overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $8.37 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis.

Deleted Appendix E Added Appendix F

DLA has determined that the IG's rationale of calculating "overpricing" based on the price of a supplier identified 4 years after the first 2 buys is flawed and that the occurrence of overpricing on all 3 of these manual buys from small business dealers has not been substantiated.

Unlike the unit price from the alternate source, the price paid on the buy in question included military packaging, marking, and barcoding, and was F.O.B. destination. Since the alternate source will not sell to the Center on this basis, purchase from this source would require the additional administrative effort and cost to the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government depot. There would be an increased cost of $30.00 - $50.00 per order assuming the alternate source would have been willing to provide the item to these specifications. The cost of a third party packager alone for just 1 of these awards exceeds the total overpricing claimed for all 3. Accordingly, based on the IG's conclusion that a price of $8.37 (exclusive of these aforementioned add-ons) is fair and reasonable, it should be concluded that the IG has substantiated that the prices the Center paid were fair and reasonable.

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Revised

oo Anode ($19,510.70 total overpricing per IG; DLA review is ongoing)---The IG reported that the only 2 buys through 30 August 1995 for this item (in 1988 for $74.10 ea/qty of 150 and in 1989 for $41.10 ea/qty of 235) were overpriced based on advice forwarded over 4 years later, in early 1993, from a user of the item that reportedly, it could be bought for $3.28 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis

DLA disagrees with the IG's rationale of calculating "overpricing" based on the price of another supplier identified 4 years after the first buy in question, and especially when that source is unwilling to supply the item in accordance with the Government's requirements for military packaging, barcoding, marking, and shipment F.O.B. destination.

Unlike the unit price from the alternate source, the price paid on the buy in question included military packaging, marking, and barcoding, and was F.O.B. destination. Since the alternate source will not sell to the Center on this basis, purchase from this source would require the additional administrative effort and cost to the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government depot. There would be an increased cost of $30.00 - $50.00 per order. An additional amount covering transportation F.O.B. to destination is also required. Notwithstanding these additions, however, the remaining difference are still substantial and warrant a further in-depth effort on the part of the Center.

Due to the age of the buys in question, it is likely that the Government's contract file has been destroyed by the records center and it is doubtful that the contractor's award folder and cost records still exist for this noncompetitive item. Furthermore, the Center lacks sufficient drawings and other technical data normally used in reviews of potential overpricing. These documents may prove necessary to resolve unequivocally whether overpricing in fact occurred.

We do know that the data rights to the product line which includes this item were sold by the OEM to another OEM immediately preceding the two buys in question from the new sole source supplier. The alternate source suggested in 1993 was a distributor for the prior OEM's parts. We understand, however, that the distributor is an authorized supplier of the new OEM.

The Center's review is ongoing as of the date of this response. In the event overpricing can be substantiated, the Center will pursue a recoupment as appropriate. In then interim, we note that the Center had annotated the Contracting Guidance Data with advice to contact the alternate source. This should enable the Center to assure a more advantageous price is paid in the event of a further requirement for this item, for which there are no issuable assets on hand.

Revised

oo Sleeve Spacer ($2,501.25 total overpricing per IG; DLA review ongoing)---The IG reported that the only 2 buys through 30 August 1995 for this item (1 in 1992 at $24.22 ea/qty of 111 and 1 in March 1994 at $15.89 ea/qty of 60) were "overpriced" based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $6.67 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis.

DLA disagrees with the IG's rationale of calculating "overpricing" based on the price of another supplier identified after the first buy in question, especially when that source is unwilling to supply the item in accordance with the Government's requirements for military packaging, barcoding, marking, and shipment F.O.B. destination. The occurrence of unreasonable pricing or of overpricing on these buys has not been substantiated.

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The Center reports that the OEM's net price to its dealers for this item is $13.62 each. Accordingly, the $6.67 price reported, which had not previously been validated, appears suspect.

Since the price from the alternate source does not include military packaging, marking, and barcoding, and was F.O.B. origin, amounts must be added to the IG's figure for purpose of comparison. There would be an increased cost from a third party packager of at least $30.00 - $50.00 per order. An additional amount covering transportation F.O.B. to destination is also required. Finally, the administrative costs of a manual award (about $55 at this Center) must also be considered. Notwithstanding these additions, however, the remaining differences are still substantial for the earlier buy and warrant a further in-depth effort on the part of the Center.

The Center's review is incomplete as of the date of this response. In the event overpricing can be substantiated, the Center will pursue a recoupment as appropriate.

oo Gasket ($361.55 total overpricing per IG; $0.00 per DLA)---The IG reported that the 2 buys through 30 August 1995 for this item (1 in 1990 at $3.80 ea/qty of 50 and 1 in January 1994 for $2.35 ea/qty of 155) were overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $0.94 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis. Deleted Appendix E Added Appendix F

DLA has determined the manual and the automated awards were fair and reasonably priced in accordance with the terms of the automated BPAs, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing on the buys in question has not been substantiated.

Since the price from the alternate source does not include military packaging, marking, and barcoding, and was F.O.B. origin, amounts must be added to the IG's figure for purpose of comparison. There would be an increased cost from a third party packager of $2.00 - $3.00 per gasket. An additional amount covering transportation F.O.B. to destination is also required. Finally, the administrative costs of a manual award (about $55 at this Center) must also be considered. The cost of the special packaging and marking alone totally offsets the reported "overpricing," not to mention these additional considerations.

We note that there have been no rebuys of this item through 30 August 1995. Accordingly, no further review of pricing of this item is deemed needed.

oo Latch Spring ($39.33 total overpricing per IG; $0.00 per DLA)---The IG reported that the 3 buys occurring during the 6 3/4 year period covered by the IG audit (1 in 1988 at $4.058 ea/qty of 5, 1 in 1991 for $15.36 ea/qty of 2, and 1 in July 1993 for $5.76 ea/qty of 2) were overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $2.60 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis. Deleted Appendix E Added Appendix F

DLA has determined the 2 BPA calls to small business dealers and the subsequent manual purchase from a different distributor of the OEM were reasonably priced, that the IG's rationale of calculating "overpricing" based on the price of an alternative source identified several years after the first 2 buys is flawed, and that the occurrence of overpricing on the buys in question has not been substantiated.

Unlike the unit price from the alternate source, the price paid on the buy in question included military packaging, marking, and barcoding, and was F.O.B. destination. Since the alternate source will not sell to the Center on this basis, purchase from this source would require the additional administrative effort and cost to

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the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government depot. There would be an increased cost of $30.00 - $50.00 per order for the required packaging and marking. There would be additional increases for F.O.B. destination and about $55 per call (the additional cost for the Center to make a manual buy) for the first 2 (automated) buys. Since the total combined "overpricing" reported on all 3 buys totals only $39.33, clearly no overpricing occurred.

We note that in June 1995 the Center made an further manual buy of this item ($6.10 ea/qty of 3). For the aforementioned reasons, the buy was likewise reasonably priced.

Deleted
Appendix E
Added
Appendix F

oo Encased Plain Seal ($55.50 total overpricing per IG; $0.00 per DLA)---The IG reported that the only buy for this item (in 1990 at $18.69 ea/qty of 6) made during the period covered by the IG audit (1988 through September 1994) was "overpriced' based on advice subsequently forwarded in early 1993 from a user of the item that reportedly, it could be bought for $9.44 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis.

DLA has determined this call to a small business dealer was reasonably priced, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing has not been substantiated.

There would have been an increased cost of $30.00 - $50.00 per order for the required packaging and marking to use the alternate source. Furthermore, there would have been additional increases for F.O.B. destination and about $55 if the call had been converted to a manual award. Since the total "overpricing" reported is only $55.50 exclusive of these additional amounts, clearly no overpricing occurred.

Although the suggested alternate does not appear to be the most cost-effective alternative for small valued orders, we note that the Center has made 5 subsequent automated awards for a total of 90 units at an average unit price of $11.01, inclusive of military packaging, barcoding, marking, and F.O.B. destination shipment. The range of prices (from $14.28 ea/qty of 10 down to $9.79 ea/qty of 37) demonstrates the sensitivity of the price to quantity variations when the item is purchased in small quantities. Further, these prices confirm that the buy in question was not overpriced.

Revised

oo Angle Bracket ($102.90 total overpricing per IG; $0.00 per DLA)---The IG reported that the only buy through 30 August 1995 for this item (1 in 1990 at $7.08 ea/qty of 21) was overpriced based on advice forwarded nearly 4 years later (early 1993) from a user of the item that reportedly, it could be bought for $2.18 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis.

DLA has determined the $148.68 actually paid on BPA call to a small business dealer was reasonably priced in accordance with the terms of the automated BPA, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing on the buy has not been substantiated.

Since the alternate source will not sell to the Center on this basis, purchase therefrom would have required the additional administrative effort and cost to the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government depot. There would be an increased cost of $30.00 - $50.00 for the packager alone. Furthermore, there would have been additional increases for F.O.B. destination and about $55 if the call had been converted to a manual award. Since the total "overpricing" reported is only $102.90 exclusive of these additional amounts, it is apparent that no

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overpricing occurred. This notwithstanding, the Source of supply was contacted to obtain pricing information for the bracket. This enabled the Center to determine that the price was fully supportable.

oo Retaining Ring ($1,169.80 total overpricing per IG; $1,166.00 per IG as corrected; DLA review is ongoing)---The IG reported that the 3 buys (1 in 1988 at $10.79 (not $11.07 as mistakenly used in the IG's calculations) ea/qty of 38 and 2 in 1989 for $17.17 ea/qtys of 15 and 75) made during the period covered by the audit, were overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $6.22 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis. Revised

DLA disagrees with the IG's rationale of calculating "overpricing" based on the price of another supplier identified 4 years after the buys in question, especially when that source is unwilling to supply the item in accordance with the Government's requirements for military packaging, barcoding, marking, and shipment F.O.B. destination. The occurrence of unreasonable pricing or of overpricing on these 3 automated BPA calls placed with 2 small business dealers has not been substantiated.

Since the price from the alternate source does not include military packaging, marking, and barcoding, and was F.O.B. origin, amounts must be added to the IG's figure for purpose of comparison. There would be an increased cost from a third party packager of at least $30.00 - $50.00 per order. An additional amount covering transportation F.O.B. to destination is also required. Finally, the administrative costs of a manual award (about $55 at this Center) must also be considered.

The Center noted in an 8 June 1993 response on the price challenge, which presumedly was available to and reviewed by the auditor, that "Prior to your challenge, this office conducted an audit of the source of supply under our F-108 Program [i.e., postaward review for potential overpricing on automated buys]. Based on our negotiations, an adjustment was agreed upon between the contractor and DISC which included this award [sic, these awards]. As a result of these negotiations, all future procurements with this contractor should result in pricing which is more within the guidelines of this Center's Blanket Purchase Agreements." The Center recouped a total of $25,000.00 on all 288 awards ($173.01 on a pro rata basis for these latter 2 buys) Due to the volume of buys reviewed the Center has followed a practice of not posting the recoupment made on an overall basis against the individual buys. However, this amount is properly an offset against the initial award price, and substantially reduces the amount of reported "overpricing."

The Center noted that prior to receiving advice of the alternate source, the item had been listed as sole source to another OEM. The alternate source was added to the computerized information in June 1993.

Notwithstanding these additions to achieve comparability, the remaining differences are still substantial and warrant a further in-depth effort by the Center. Accordingly, the Center's review is ongoing as of the date of this response. In the event overpricing can be substantiated, the Center will pursue a recoupment as appropriate.

oo Bracket ($979.30 total overpricing per IG; $394.00 IG as corrected; $0.00 per DLA)---The IG reported that the most recent 2 buys through 30 August 1995 for this item (in 1989 at $2.56 ea/qty of 80 and $10.72 ea/qty of 110 (later corrected to $1.72 ea/qty of 110)) were overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $2.13 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis Revised

As a result of receiving the alternate source, the Center followed up with the contractor on the second buy for cost data supporting its price. The contractor responded that the price was incorrect, and should have been

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$1.72 each. The resulting unit price reduction to $1.72 produced an overall $990.00 savings on this particular award, which is more than the total "overpricing" claimed by the IG.

The IG's calculation of "overpricing" is patently wrong because it reports the second buy as "overpriced" even though a $990.00 correction had been recouped a year before the IG even announced initiation of this audit, through the normal operation of the Navy's and DLA's long-standing price challenge programs. The IG was aware of this price revision because it had been posted back into the procurement history reviewed by the IG. This knowledge was in fact acknowledged in the Finding A section entitled "Communicating Results of Price Challenge Evaluations", i.e., "...as a result of the price challenge, Industrial Supply obtained a voluntary refund from the contractor."

Given the IG's rationale, it should have calculated "overpricing" using the corrected price the Center ultimately paid for this buy. However, this would eliminate "overpricing" on this item, since the corrected price is substantially less than the $2.13 unit price the IG deems reasonable.

This notwithstanding, DLA has determined that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is also flawed, that both awards were reasonably priced, and that overpricing did not occur on the other as well.

Since the alternate source will not sell to the Center on this basis, purchase from this source would require the additional administrative effort and cost to the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government depot. There would be an increased cost of $30.00 - $50.00 per order. Furthermore, there would have been additional increases for F.O.B. destination and about $55 if the call had been converted to a manual award. Since the total "overpricing" reported on the first buy is only $34.40 (i.e.,($2.56 each - $2.13) X 80 units) exclusive of these additional amounts, clearly no overpricing occurred on this buy either.

This notwithstanding, we note that the Center has included a comment in the Contracting Guidance Data identifying the distributor as a potential alternate source in the event of a subsequent manual buy of this item

Revised

oo Sleeve Spacer ($688.65 total overpricing per IG; DLA review ongoing)---The IG reported that the only 2 buys through 30 August 1995 for this item (1 in 1990 at $156.66 ea/qty of 2 and 1 in 1991 for $82.50 ea/qty of 5) were overpriced based on advice subsequently forwarded to the Center in early 1993 from a user of the item that reportedly, it could be bought for $2.13 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis.

The IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and the occurrence of overpricing on the buys in question has not been substantiated.

Since the alternate source will not sell to the Center on this basis, purchase from this source would require the additional administrative effort and cost to the Government to route the item through a third party packager for repackaging, marking and forwarding to the Government requisitioner (first 3 buys) and to the depot on the latest buy, after the item had been recoded for stockage. There would be an increased cost of $30.00 - $50.00 per order for the packaging, barcoding, and marking charges. Furthermore, there would have been additional increases for F.O.B. destination and about $55 if the call had been converted to a manual award.

Notwithstanding these additions, however, the remaining differences are still substantial and warrant an expanded review effort by the Center. Accordingly, the Center's review is ongoing as of the date of this response. In the event overpricing can be substantiated, the Center will pursue a recoupment as appropriate.

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∞ Gasket ($551.40 total overpricing per IG; $0.00 per DLA)---The IG reported that the most recent 4 buys through 30 August 1995 for this item (3 in 1989---$39.40 ea/qty of 12 and $46.13 ea/qtys of 2 and 4; and 1 in 1991 for $29.81 ea/qty of 30) were overpriced based on advice subsequently forwarded to the Center in early 1993 from a user of the item that reportedly, it could be bought for $18.92 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis. Revised

DLA has determined these automated BPA calls to 3 different small business dealers were reasonably priced, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing on the buys in question has not been substantiated.

A review of the prices paid in 1989 on the 2 immediately preceding awards ($16.31 ea/qty of 15 and $16.76 ea/qty of 26), which were automated calls made to 1 of the 3 BPA holders receiving the buys in question reveals that the price for this item is quantity sensitive. This explains in part the substantial increase on the next 3 minimal quantity calls before the price decline on the latest, higher quantity purchase.

In addition, as previously noted, consideration of the price of the alternate source requires the addition a third party packager's charge of $2.00 - $3.00 per gasket (subject to a minimum charge of .$30.00 - $50.00 per order). Furthermore, there would have been additional increases for F.O.B. destination (to the customer on the first 3 buys, the depot on the most recent) and about $55 if the calls had been converted to manual awards.

When these the above factors are considered, the reasonableness of the prices paid on these buys becomes apparent. This notwithstanding, the Center has included a comment in the automated Contracting Guidance Data identifying the distributor as a potential alternate source in the event of a subsequent manual buy of this item

∞ Gasket ($1,790.00 total overpricing per IG; $1,644.00 per IG as corrected; $0.00 per DLA)--- The IG reported that the most recent 3 buys through 30 August 1995 for this item (actually, the most recent 2 buys (both in 1988 at $17.61 ea/qty of 100 and $19.14 ea/qty of 50) due to the inadvertent double-counting of the former buy) were overpriced based on advice forwarded in early 1993 from a user of the item that reportedly, it could be bought for $7.16 each from an alternate source, i.e., the same authorized distributor discussed above for the Engine Radiator and all 17 of the other items deemed "overpriced" on this basis. Revised

DLA has determined these calls to small business dealers were reasonably priced, that the IG's rationale of calculating "overpricing" based on the price of a subsequently identified supplier is flawed, and that the occurrence of overpricing on the buys in question has not been substantiated.

As previously noted, consideration of the price of the alternate source requires the addition a third party packager's charge of $2.00 - $3.00 per gasket (subject to a minimum charge of .$30.00 - $50.00 per order). Furthermore, there would have been additional increases for F.O.B. destination (to the customer on the first 3 buys, the depot on the most recent) and about $55 if the calls had been converted to manual awards.

These points notwithstanding, the principle reason overpricing has not been substantiated is that the Center determined that the alternate part number (5125635) the alternate source claimed was not the same as the only approved part number for this item (5144590). This crosses to NSN 5330-00-758-2882, which has a current standard price (including the Center's applicable markup) of $4.71. This may explain why the alternate source's price is substantially lower for the buys in question.

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oo Wire Rope Terminal ($105,258.51 total overpricing per IG; $10,570.00 per DLA)---The IG reported that the 4 buys (1 in 1989 for $560.00 ea/qty of 100 and 3 in Feb 1993 for $789.07 ea/qtys of 31) preceding the most recent buy through 30 August 1995 for this item were overpriced based on item competition received on the subsequent buy (Nov 1993 for $125.00 ea/qty of 183).

The Government does not own the drawings or data rights for this item, which was purchased on a sole source basis from the OEM, a major system manufacturer, until late 1993. As shown in the preceding paragraph, the buys in question were made at increasingly higher prices. There are some additional considerations, however, which should be included in the draft report discussion of this item (first through seventh paragraphs under the Finding B subsection entitled "Manual Procurements").

Revised

In discussing the first buy, which was awarded in May 1989 at $325.27 each for a quantity of 270, the report states that "the analyst noted..that he did not consider the $331 price [negotiation objective established for this buy] fair and reasonable because it was 65 percent higher than the $200 unit price on the previous procurement, one year earlier." This should be corrected. What the analyst actually stated in his report was that because of the price increase, the price of $331 could not be justified from a pricing basis and as a result he relied on field pricing support and cost analysis to determine price and cost reasonableness. The analyst developed a target negotiation objective of $331 which he felt was fair and reasonable. Accordingly, we do not concur in the report statements, or that the $325.27 unit price negotiated was unreasonable.

We note that this award was later partially terminated resulting in modification issued in May 1991 reducing the required quantity down to 100 and producing a combined new price, including termination costs, of $560.00 ea. The IG has treated this higher amount as the basis for its calculation of "overpricing. We do not agree.

The draft notes the absence of information substantiating the price increase. There is no indication the reduction in quantity is the result of a default on the part of the contractor. Based on documentation of a 25 July 1990 telephone conversation with the contractor which was referenced in the subsequent modification, the action was taken because the item had been overprocured, and incorporated the increased price for the reduced quantity. Since this call occurred 15 months after award, it should reasonably be presumed that substantial startup cost and recurring expenditures in producing the full 270 units was likely to have been incurred at that point by the contractor (and perhaps up until the 29 May 1991 effective date (when the contractor signed the modification). Absent information to the contrary, the original unit price for the order should be used in the IG's calculation the weighted average contract price and "overpricing," not this subsequent change for the convenience of the Government. The overstatement of reported "overpricing" attributable to this difference is $23,473.00 (i.e., 100 units X ($560.00-$325.27)).

The draft report discussion of the other three buys in question also requires supplementation. It appears to challenge the decision to award the orders (February 1993) for this urgent requirement while an alternate offer was being evaluated.

Deleted

This is a flight critical part for which alternate sources must qualify in accordance with the design control activity's procedures and be approved by the Government engineering activity. It is well-known that there is a considerable time frame required to obtain the necessary technical evaluations involved in processing an alternate offer on a critical item. Many are rejected and the process is not completed on others for a variety of reasons. The evaluation process for the alternate offer in question was initiated in October 1992 and was not completed until October 1993, and then was contingent upon adherence to first article testing and mandatory inspection. In the interim, there is no way to predict with assurance whether approval will be obtained from the cognizant Military engineering support activity. In the interim, purchase requirements must be met

Ultimately, in this case, the process led to approval of an alternate source. As a result, the subsequent buy was competed and the award went to the newly approved supplier. This in no way, means, however, that the higher prices paid a high-overhead producer were necessarily inflated and that the Government was overcharged. The difference should principally be attributed to the difference between a high-cost and a cost-efficient producer.

However, as noted in the report, the Center determined that there was an overstatement in labor hours for the latter 3 buys, resulting in a request for a voluntary refund of $10,570, which was rejected by the OEM. We view this amount as a reasonable measure of any overpricing that may have occurred.

oo Butt Hinge Leaf ($2,422.38 total overpricing per IG; $0.00 per DLA)---The IG reported that the 2 most recent buys for the item (in March and April 1992 for $127.45 ea/qty of 24 and $127.54 ea/qty of 27) were overpriced based on the price paid on recent preceding awards ($80.00 ea/qtys of 63 and 30 in 1990 and 1991 respectively).

The buys in question were automated noncompetitive small purchases placed with a small business dealer, whereas the preceding buys were competed and awarded through other (manual) small purchase procedures to the manufacturer.

During the build-up for Operation Desert Storm (ODS), DLA asked for, and was granted, deviation authority to make awards up to $5,000 on a noncompetitive basis. This would facilitate the heightened support necessary during this period and would help to avoid any degradation of supply support for non-ODS requirements.

The buys in question were made under this deviation authority in early 1992. The purchase requests were routed to the automated noncompetitive purchase system because the estimated value was below $5,000 and one or more BPAs existed with supplier's of the OEM's parts.

Historically, most buys through the automated noncompetitive system went to small business dealers under the prior statutorily-based small business small purchase setaside. The purchase price for items supplied by middlemen generally exceeds the prices of OEMs and other manufacturers that are willing to sell directly to the Government. In the lowest valued buys, the addition of a dealer markup is incidental to the total amount paid. And, the cost of the administrative effort to cancel or dissolve setasides on individual buys has made virtually precluded the viability of this option.

We note that there have been no further purchases through 30 August 1995 for this item. However, with the recent elimination by the FASA of setasides for micro-purchases, our Centers should be able to establish automated BPAs with manufacturers willing to participate in our automated awards system. In the event of the need for a buy of this item in the future, there is reason to believe the problem highlighted by the IG for this item will not recur.

oo Preformed Packing ($2,167.20 total overpricing per IG; $0.00 per DLA)---The IG reported that 1 buy (in March 1992 for $63.20 ea/qty of 72) out of the 6 buys of the item that were made during the 6 3/4 year period covered by the audit was "overpriced" based on the price paid on the recent preceding award (1991 award for $33.10 ea/qty of 70). Further, we note that the vendor for this buy was also targeted by the IG for a postaward review (Recommendation B.2.).

The preceding buy and all 8 of the subsequent buys to the current date were awarded using manual procurement procedures when buys have an estimated value that exceeds the $2,500 ceiling for micro-purchases. However, the buy in question had an estimated value of occurred during the period discussed

under the previous item in which DLA had deviation authority to make noncompetitive awards up to $5,000. The requirement had an estimated value below $5,000 and an automated BPA existed for a dealer of the OEMs parts, so it was routed for award through the automated noncompetitive purchase system. All 8 of the subsequent buys through 30 August 1995 were made after reversion to the $2,500 threshold. Because they all were for quantities producing an estimated award value exceeding the threshold, they were awarded using other purchase procedures. The weighted average paid through 30 August 1995 on these 8 buys is $39.73 ea/qty of 2267.

The buy in question was an automated noncompetitive small business small purchase setaside buy with a small business dealer that purchased the item from the OEM for $59.00 each and resold it at a reasonable (7.03%) markup to cover its costs of operations and profit. Although it is unclear why the dealer was charged an amount in excess of the price the Government had been paying on prior direct purchases, it is clear that the dealer did not overcharge the Government. And, once again, we are supplying the item to our customers at a more advantageous price comparable to that suggested by the IG.

Final Report Reference

TYPE OF REPORT. DRAFT AUDIT DATE OF POSITION: 12 SEP 1995

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Price Challenges on Selected Spare Parts (Project No. 4CH-8010.01)

RECOMMENDATION NO. B.1.a.: We recommend that the Director, Defense Logistics Agency, issue guidance to the respective buying centers that requires contracting Officers to:

Obtain independent Government estimates for negotiated procurements of spare parts as required by the Federal Acquisition Regulation and consider the estimates, including any Government-prepared should cost estimates, when determining fair and reasonable prices and establishing prenegotiation price objectives. Contracting officers should document in the contract files reasons for not adopting recommendations made in the independent estimates. Revised

DLA COMMENTS: Partially concur.

We agree in principle with the IG, based on our understanding of the recommendation as discussed herein.

In analyzing contractors' cost proposals and conducting price negotiation, our contracting officers often obtain pricing assistance from a number of sources, such as contract pricing specialists, technical analysts, DCAA auditors, etc. Contracting officers request independent Government estimates (IGEs) for use in appropriate instances, as explained in our position regarding this element of Finding B. However, the IG noted instances where an IGE had been prepared in support of price challenge reviews by another activity and not furnished to the cognizant Defense Plant Representative Office (DPRO) for use in price negotiations. The recommendation is apparently written with the intent that such existing IGEs obtained for other purposes be used in subsequent procurements.

DLA contracting officers should certainly consider IGEs along with other advisory reports, which they request, as well as other similar information that has been provided or is readily available for their use. (The DoD IG found that the IGEs were not provided to the contract administration office responsible for price negotiation of the awards in question involving 4 of the Navy-managed items). We suggest that this recommendation be modified to require offices that obtain IGEs for evaluation of price challenges or other purposes to promptly forward a copy to the cognizant contracting office. In addition, if responsibility for contract negotiation has been, or is subsequently, delegated to another contracting office, such as a contract administration office, whether internal or external to the contracting office, the contracting office should be deemed responsible for forwarding the IGE to the local or field contract administration office.

The DPRO never had the opportunity to consider the IGE at the time of contract negotiations. This notwithstanding, we have not found, nor has the DoD IG shown, any instance where a DLA contracting official failed to request an IGE required in connection with a procurement; where any other DLA employee failed to forward a copy of a relevant IGE that had been obtained for other purposes, or otherwise advice of its existence, to the cognizant contracting official; or any instance where such contracting official failed to consider an available IGE in connection with a contracting action.

The wording of the recommendation appears to imply that there has been failure by DLA contracting officers to follow some existing policy governing this matter. However, DLA has fully implemented the requirements of FAR and DFARS and our contracting officers have fully followed these policies. Therefore, there is no need for further policy implementation or management reemphasis of these policies. And accordingly, there

should be no expectation that the quality of pricing of the spare parts in question nor any other spares would improve if these in-depth evaluations were accomplished beyond the extent specified in current regulations.

No deficiencies in contract pricing by our contracting centers which would be remedied by mandating the development of IGEs were identified in the draft report. DLA contracting officers and contract pricing personnel are well aware of the availability of this assistance and routinely request performance of such analyses when needed in connection with both preaward pricing and post-award overpricing reviews. Further, our engineering personnel responsible for evaluating price challenges routinely record the existence of an IGE in the automated Procurement Guidance Information file and forward such reports to when requested by contracting personnel. Accordingly, we are unaware of any corrective action or improvement needed regarding this matter within DLA.

The second sentence of the recommendation, that contracting officers be required to document variances from recommendations provided in advisory reports, essentially paraphrases existing acquisition regulations, specifically FAR 15.807(a), 15.808(a)(8) and DFARS 215.808(a)(8). The contracting file should address any such estimate obtained or made available, explain how it and other information was used, or why it was not used, in formulating the prenegotiation position and in the resulting negotiations. Of course, IGEs are used in setting prenegotiation objectives only to the extent the contracting officer deems such estimate to be a reasonably reliable basis for price negotiations. These fundamentals are taught in introductory Government acquisition courses (CON 101, Contracting Fundamentals and CON 104, Contract Pricing). While we agree that such documentation is important, we find no evidence in the audit report to suggest that the recommended guidance is necessary.

Inasmuch as no instances were identified where DLA personnel failed to obtain, forward, or consider in preparing the prenegotiation objectives, and IGE received, either actually or by notification; or where contracting officers failed to document in the contract files reasons for not adopting recommendations made in an IGE, applicability of the recommendation to the Director, DLA should therefore be deleted upon issuance of the final report.

This notwithstanding, we agree that IGEs can be a useful tool in contract negotiations. We plan to include a discussion on notification and forwarding to contracting of IGEs obtained in connection with price challenge evaluations at DLA's next Value Engineering Program Managers' Meeting, which is scheduled during the last week of FY 1995. Further, we plan to discuss feedback on the extent of utility of each IGE for consideration at the time a decision is needed as to whether the IGE warrants updating for use in a future buy. Subsequently, we will issue a confirming letter recapping the workshop discussions and decisions reached on any steps to be taken to improve utilization and feedback regarding individual IGEs.

DISPOSITION:
(X) Action is ongoing. Estimated Completion Date: 30 November 1995
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

ACTION OFFICER: Jerry Gilbart, MMPPP, 11 September 95

REVIEW/APPROVAL MARGARET J. JANES, Assistant Executive Director (Policy & Oversight), Directorate of Procurement, 11 Sep 95

COORDINATION: JILL PETTIBONE, Assistant Executive Director (Operations/Policy Group), Directorate of Contract Management, 11 Sep 95

EILEEN SANCHEZ, Internal Management Control Program Manager, Management Control Improvement Group, 11 Sep 95

DLA APPROVAL: Maj Gen WILLIAM P. HALLIN, USAF, Deputy Director, Materiel Management, 12 September 1995

TYPE OF REPORT: DRAFT AUDIT DATE OF POSITION: 12 SEP 1995

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Price Challenges on Selected Spare Parts (Project No. 4CH-8010.01)

RECOMMENDATION NO. B.1.b.: We recommend that the Director, Defense Logistics Agency, issue guidance to the respective buying centers that requires contracting officers to:

Obtain field pricing support, or provide written justification for not obtaining it, for negotiated procurements expected to exceed $500,000 that require the contractor to submit cost and pricing data, and use the information to evaluate the contractor's proposal and establish prenegotiation price objectives.

DLA COMMENTS: Partially concur.

We concur in the general thrust of the recommendation but no additional actions are necessary by DLA.

This recommendation basically echoes the DFARS 215.805-5(a)(1)(A) requirements for obtaining field pricing support. DLA has fully implemented the requirements of FAR and DFARS and our contracting officers have fully followed these policies. Nevertheless, the IG has drafted this recommendation, which implies that there has been failure by DLA contracting officers to follow existing policies.

Apparently the recommendation was prompted by the two most recent DPRO procurements of the Head Hubs discussed in our position regarding this element of Finding B. The DPRO negotiator did not obtain a "field pricing report" or provide adequate written justification for not obtaining such report because this requirement does not apply when pricing and negotiation is being accomplished at the contract administration office (i.e., the field).

Additionally, although not expressly included in this recommendation, the DoD IG stated (within Finding B) that field pricing support should have been obtained for the proposed subcontract costs. The reasons why such support was unnecessary and not obtained is presented in our response to Finding B. We simply note here that there is no specific threshold at which to obtain subcontract pricing support; the matter is left to the discretion of the contracting officer. The acquisition regulations suggest a preference for reliance upon a prime contractor's analysis of its subcontract costs instead of a Government review whenever possible (see DFARS 215.806-3(a)(i)). There is no regulatory requirement to provide written justification for not obtaining field pricing support for subcontract costs.

As further explained in our comments regarding Finding B, the IG has failed to demonstrate any instances where there has been a failure to follow existing FAR or DFARS policies on use of field pricing support, or where there was a need to apply such policies beyond the restrictions for use in noncompetitive large purchases expected to exceed $500,000 were cost or pricing data was required and the requirement was not waived as authorized by DFARS 215.805-5(a)(1)(A). Therefore, there is no need for further policy implementation or management reemphasis of these policies. And accordingly, there should be no expectation that the quality of pricing of the spare parts in question nor any other spares would improve if these in-depth evaluations were accomplished and beyond the extent specified in current regulations.

Applicability of the recommendation to the Director, DLA should therefore be deleted upon issuance of the final report.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(X) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

ACTION OFFICER: Jerry Gilbart, MMPPP, 11 September 95

REVIEW/APPROVAL: MARGARET J. JANES, Assistant Executive Director (Policy & Oversight), Directorate of Procurement, 11 Sep 95

COORDINATION: JILL PETTIBONE, Assistant Executive Director (Operations/Policy Group), Directorate of Contract Management, 11 Sep 95

EILEEN SANCHEZ, Internal Management Control Program Manager, Management Control Improvement Group, 11 Sep 95

DLA APPROVAL: Maj Gen WILLIAM P. HALLIN, USAF, Deputy Director, Materiel Management, 12 September 1995

TYPE OF REPORT: DRAFT AUDIT DATE OF POSITION: 12 SEP 1995

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Price Challenges on Selected Spare Parts (Project No. 4CH-8010.01)

RECOMMENDATION NO. B.1.c.: We recommend that the Director, Defense Logistics Agency, issue guidance to the respective buying centers that requires contracting officers to:

Compare the price of the previous procurement to the proposed price and evaluate any price increase that common sense indicates is not reasonable. At a minimum, the contracting officer should evaluate proposed prices that increase 25 percent or more than the previous procurement price.

DLA COMMENTS: Partially concur.

We concur in the general thrust of the recommendation but no additional actions are necessary by DLA.

The DoD IG recommendation is basically to issue guidance requiring our contracting officers to perform adequate price analyses. As we explained in our comments regarding finding B, the IG failed to demonstrate any instances where there has been a failure to follow existing policies. Nevertheless, the IG has drafted this recommendation so as to imply that there has been failure by DLA contracting officers to follow existing FAR and DFARS policies

DLA has fully implemented the requirements of FAR and DFARS and our contracting officers have fully followed these policies. Furthermore, DCMC has issued numerous letters recently concerning the use of price analysis and our policies governing its use are more stringent than that required by the acquisition regulations. Notwithstanding the DoD IG "findings" that the prices negotiated by DPRO Boeing were excessive, in every case a price analysis was made.

DCMC policies do not specify a price increase threshold for conducting more detailed analysis. Such decisions are based upon price increases that are not explained by common factors such as quantity variation or the rates of change in indices such as the Producer Price Index or Data Resources, Inc. (DRI) forecasts. In providing field pricing assistance, the field pricing team is responsive to customer requests and performs detailed analyses of all line items identified by the buying office as requiring special consideration. [Note that DFARS 215.805-5(c)(iv) already requires contracting officers to identify in requests for field pricing support those spare parts where the proposed price exceeds by 25 percent or more the lowest price the Government has paid within the most recent 12 month period].

In summary, there is no need for further policy implementation or management reemphasis of these policies. Further, the IG has not substantiated that "overpricing" occurred as a result of a failure to perform such analysis. Therefore, there is no basis to expect that the quality of pricing of the spare parts in question nor any other spares would improve if these in-depth evaluations were accomplished beyond the extent specified in current regulations.

Inasmuch as no instances were identified where DLA personnel failed to compare the price of the previous procurement to the proposed price and evaluate any price increase that common sense indicates is not reasonable to the extent required by regulation or best practices, applicability of the recommendation to the Director, DLA should therefore be deleted upon issuance of the final report.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(X) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

ACTION OFFICER: Jerry Gilbart, MMPPP, 11 September 95

REVIEW/APPROVAL: MARGARET J. JANES, Assistant Executive Director (Policy & Oversight), Directorate of Procurement, 11 Sep 95

COORDINATION: JILL PETTIBONE, Assistant Executive Director (Operations/Policy Group), Directorate of Contract Management, 11 Sep 95

EILEEN SANCHEZ, Internal Management Control Program Manager, Management Control Improvement Group, 11 Sep 95

DLA APPROVAL: Maj Gen WILLIAM P. HALLIN, USAF, Deputy Director, Materiel Management, 12 September 1995

TYPE OF REPORT: DRAFT AUDIT DATE OF POSITION: 12 SEP 1995

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Price Challenges on Selected Spare Parts (Project No. 4CH-8010)

RECOMMENDATION NO. B.1.d.: We recommend that the Director, Defense Logistics Agency, issue guidance to the respective buying centers that requires contracting officers to:

Include qualified alternative sources identified by price challengers in the source lists for the parts and solicit the new sources, as well as the other qualified sources, on future procurements of the parts.

DLA COMMENTS: Partially concur.

For years, our Centers have been including qualified alternative sources identified by price challengers in the source lists for the parts. However, this is but 1 of the ways new sources are obtained. Our Centers have several proactive "outreach" initiatives for achieving or enhancing competition on the items they manage. These initiatives generally include the conduct or participation in trade fairs, the maintenance of display rooms of items lacking competition, and the distribution of pictures or "sources sought" listings of targeted items. Particular emphasis is placed in identifying and attracting small, small disadvantaged, woman owned, and other sources that actually manufacture the item or otherwise add value to the procurement (e.g, in terms of meeting standard or unique supply or support needs of our military customers).

The existence of multiple manufacturing sources of items is of prime importance because, generally speaking, this should enable the greatest improvement in the prices paid for items, once the alternate items they manufacture have been validated. Absent the existence of known sources for more than 1 approved part meeting the item specifications, pricing improvements can often be gained though efforts which enable procurement from the actual manufacturer of a part vice the sole source OEM for the major system or component containing the item.

The knowledge of a distributor, such as the one which gave rise to this recommendation, may be useful if a significant reduction can be obtained from soliciting it in future procurements. However, on the lowest value small purchases, especially those procured through DLA's automated systems, the marginal price difference between existing sources (generally small business dealers) and the reported price of the alternate (nonmanufacturing) source is often negligible. This proved to be the case in most of the automated buys for these items in question.

Center engineering personnel responsible for evaluating price challenges routinely validate alternative sources identified by price challengers, with particular emphasis on instances where a previously unknown manufacturer's part is identified, for the aforementioned reasons. If the alternate source supplies an alternate part, the engineer performs or initiates the validation effort for such alternate part. Once validated, the alternate part and/or alternate source are loaded into the Center's computerized source lists for the item. The engineer may also load a potential source and estimated price with other information into our automated system for buyer use. Similarly, when contract pricing personnel are involved in any part of an overpricing review, they routinely include information on suppliers found to offer favorable prices in the automated system.

These automated files are used by buyers in manual solicitations and may also be referenced in the case of a significant price increase under our automated procurement system. Furthermore, once the files have been updated with a newly approved manufacturer's part, BPA calls (and IDTC orders (DCSC only)) are automatically placed as new purchase requests with estimated amounts below the micro-purchase (for BPA calls) and simplified purchase (for IDTC orders) dollar value thresholds are received, calls and/or orders are issued on a rotational basis to current holders of an automated contractual instrument that supply the listed manufacturers' part numbers for the item. Accordingly, once validated, the new sources are eligible soliciting in future procurements, along with other, previously approved suppliers. As explained above, this happens without manual intervention under our automated system.

As further explained in our comments regarding this aspect of Finding B, buyers are accorded substantial latitude in the regulations in manual buys. DLA Centers personnel will continue to solicit alternate sources to the extent required by regulation and consistent with best practices. However, since no instances were identified where DLA personnel failed to meet these standards, applicability of the recommendation to the Director, DLA should be deleted.

During the course of our review of responses to price challenges involving an alternate source, we noted instances where improvements should be made. We share the view of our customers that this is an important program for reducing the costs of defense materiel. We strive to provide an effective yet concise explanation of the results of each price challenge review we conduct. The completion report should explain the basis for item pricing and whether overpricing occurred, and if so, should identify any recoupment or other actions taken or planned, and should identify or estimate any tangible and intangible benefits to the Government resulting from, or likely to result from, the customer's submission.

The responses furnished by our Centers did not always met this standard. In some Center responses involving the reported alternate source, the language used was unclear. In some other instances it was incomplete, and on occasion, erroneous. Some of the standard-type phraseology used in these completion reports should be improved so that customers will have a better understanding of our procurement processes and reasons why perceived "savings" may not be fully attainable.

We have decided to include a discussion of reporting price challenge results and promised follow-on actions in DLA's next Value Engineering Program Managers' Meeting (scheduled during the last week of FY 1995). We will address these specifics and the quality improvements that should be made. Subsequently, we will issue a confirming letter recapping the workshop discussions and decisions reached on steps to be taken to improve the quality of our responses to DLA's customers.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date: 31 October 1995
(X) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

ACTION OFFICER: Jerry Gilbart, MMPPP, 11 September 95

REVIEW/APPROVAL: MARGARET J. JANES, Assistant Executive Director (Policy & Oversight), Directorate of Procurement, 11 Sep 95

COORDINATION: EILEEN SANCHEZ, Internal Management Control Program Manager, Management Control Improvement Group, 11 Sep 95

DLA APPROVAL: Maj Gen WILLIAM P. HALLIN, USAF, Deputy Director, Materiel Management, 12 September 1995

Final Report Reference

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PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Price Challenges on Selected Spare Parts (4CH-8010.01)

RECOMMENDATION NO. B.2.: We recommend the Director [sic, Commander], Defense Construction Supply Center, and the Director [sic, Commander], Defense Industrial Supply Center, conduct audits of contractors participating in their automated purchasing systems who have not been audited recently and who have made overpriced sales of NSNs 2930-00-367-7375 and 4810-01-041-2285 to the Defense Construction Supply Center, and NSN 5330-00-103-2014 to the Defense Industrial Supply Center. Revised

DLA COMMENTS: Partially concur

In the final paragraph on the subsection entitled "Automated Procurements," the IG reports that "The contractors for NSNs 4810-01-041-2285 and 5330-00-103-2014 have not had recent audits. Construction Supply and Industrial Supply officials should audit the contractors for NSNs 4810-01-041-2285 and 5330-00-103-2014 to determine whether a pattern of overpricing exists that warrants a refund from the contractors."

The postaward reviews being recommended hereby are not mandated in regulation but rather are local initiatives of our Centers. Further, the draft report provides no rationale suggesting why suppliers of these 2 items, plus an additional DCSC-managed item (NSN 2930-00-367-7375) which was added into Recommendation B.2., should be subjected at this time to a full scale review of awards under their automated contractual instrument. Finally, we note that, based on the DLA reviews of the awards in question, we concluded that overpricing was not substantiated on other than the latter DCSC item (see DLA position on these items in Attachment to our response to Finding B).

The number automated IDTCs at DCSC and the number of BPAs at all the Centers fluctuate from year to year, with new vendors coming into the program and others dropping out for various reasons. DCSC currently has 252 automated BPAs and 29 automated IDTCs.

DCSC's policy is not to review a contractor more than once every 6 months. The 3 BPA holders for NSN 4810-01-041-2285 had all been audited in 1994. A follow-on review is pending on 1, nearing completion on a second, and in-process on the other supplier. A review of the IDC vendor for NSN 2930-00-367-7375 was completed earlier this year but surfaced no instances of overpricing.

DISC currently has 229 automated BPAs, a substantial increase from 171 in FY 94. DISC has two vendors with FY 94 calls totaling over $1 million. In addition, they had 43 in the $100 thousand to $1 million awards category last year. All vendors above $100 thousand have been audited recently. DISC has an additional 39 vendors with FY 94 calls in the $25 - $100 thousand range, 18 of which have been audited recently. The remaining 86 have FY 94 calls totaling below $25 thousand. The vendor for the DISC item in question had less than $75 thousand per year for the last two years.

DISC has vendors of higher sales/review priority than this supplier and has advised that it has had no indication of pricing irregularities warranting its selection for review at this time. DISC advised that they are continuing with these postaward reviews and the vendor will be subjected to review if conditions change and a review becomes appropriate. However, under the present circumstances, a review has not been scheduled.

DISC is continuing with these reviews and has assured us that this vendor will be subjected to review if conditions change and such review becomes appropriate.

Recommendation B.2. should be revised to delete applicability to the DISC-managed item in question.

DISPOSITION:
(X) Action is ongoing. Estimated Completion Date: 31 January 1996
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: $0 likely, but under $1,000.
DLA COMMENTS: Although it cannot at this point be predicted with any assurance whether any finding of overpricing will occur, much less whether any recoupment would be forthcoming, DCSC's past experience demonstrates that savings, if any, would be very minimal.

ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

ACTION OFFICER: Jerry Gilbart, MMPPP, 11 September 95

REVIEW/APPROVAL: MARGARET J. JANES, Assistant Executive Director (Policy & Oversight), Directorate of Procurement, 11 Sep 95

COORDINATION: EILEEN SANCHEZ, Internal Management Control Program Manager, Management Control Improvement Group, 11 Sep 95

DLA APPROVAL: Maj Gen WILLIAM P. HALLIN, USAF, Deputy Director, Materiel Management, 12 September 1995

Audit Team Members

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