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INSPECTOR GENERAL

U.S. Department of Defense

NOVEMBER 16, 2015



Improvements Needed in the Defense Logistics Agency's Evaluation of Fair and Reasonable Prices for C-130 Aircraft Spare Parts

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Results in Brief

Improvements Needed in the Defense Logistics Agency's Evaluation of Fair and Reasonable Prices for C-130 Aircraft Spare Parts

November 16, 2015

Objective

Our objective was to determine whether the Defense Logistics Agency (DLA) made cost-effective material purchases to support the C-130 Hercules aircraft through multiple contracts.

This is the second of two reports on DLA Aviation material purchases supporting the C-130. The first report addressed whether DLA Aviation cost effectively managed spare-part inventory for the C-130. In this report, we addressed whether DLA Aviation paid a fair and reasonable price for inventory unique to the C-130.

Findings

The support services and spare parts we reviewed were purchased from United Technologies Aerospace System (UTAS) and SupplyCore on commercial contracts to support the C-130 hub and blade (propeller). We determined that DLA Aviation contracting officers did not perform adequate proposal analysis to determine fair and reasonable prices for supply-support services and selected spare parts. This occurred because the DLA Aviation contracting officers did not:

- adequately justify a commercial item determination, which exempted UTAS from the certified-cost or pricing-data requirement;
- effectively and efficiently obtain sufficient data-other-than-certified cost or pricing data from the offerer or Government sources to perform a sufficient cost analysis of UTAS-proposed commercial-item prices;

Findings (cont'd)

- perform sufficient cost analysis of UTAS service fees and materials;
- include an economic price-adjustment clause in the contract to permit DLA Aviation savings when SupplyCore received supplier price reductions during contract performance; and
- establish adequate performance criteria to pay delivery-based incentives.

(FOUO) We performed a cost analysis of the UTAS service fee and calculated that DLA Aviation will overpay [REDACTED] in service fees to UTAS during the 3-year contract base period. If the remaining 2 option years are exercised, DLA Aviation will overpay [REDACTED] over the entire 5 years of the UTAS contract that could be put to better use. Additionally, we reviewed a nonstatistical sample of 20 commercial spare parts, including 17 sole-source parts awarded to UTAS, and three parts competitively awarded to SupplyCore. DLA Aviation will overpay [REDACTED] to UTAS for 6 of 17 sole-source parts during the 3-year base period and [REDACTED] over the entire 5-year contract that could be put to better use. Also, DLA Aviation will not receive lower prices when SupplyCore benefits from reduced costs in supplier material for two of three parts reviewed on the SupplyCore contract.

DLA Aviation contracting officers did not adequately support fair and reasonable price determinations for C-130 parts purchased on 23 of 26 Lockheed Martin delivery orders related to our nonstatistical sample of 20 spare parts. This occurred because DLA Aviation contracting officers performed an insufficient analysis that they presented as cost analysis. Contracting officers did not evaluate the reasonableness of proposed cost elements. Further, the DLA Aviation contracting officers applied outdated average industry rates. As a result, DLA Aviation paid increased prices for 18 C-130 spare parts, totaling \$2.5 million, without assurance that the prices were fair and reasonable. Additionally, DLA Aviation will risk overpaying for the same parts if those prices are used to determine whether future proposed prices are fair and reasonable.



Results in Brief

Improvements Needed in the Defense Logistics Agency's Evaluation of Fair and Reasonable Prices for C-130 Aircraft Spare Parts

Recommendations

Among other recommendations, we recommend the Director, DLA, perform appropriate market research in accordance with Federal Acquisition Regulation Part 10 and Defense Logistics Agency Directive Subpart 12.1, determine whether to include the Federal Acquisition Regulation 52.215-20 Alternate IV clause in solicitations for the supply of commercial items when it is expected that data other than certified cost or pricing data will be required, request field-pricing assistance from a DCMA cost-and-pricing analyst once it is determined that the data is insufficient to determine a fair and reasonable price, and evaluate all cost components when determining price reasonableness.

Management Comments and Our Response

Comments from the Director, Defense Logistics Agency, were responsive to Recommendations A.1.a, A.1.f, and B.1. However, the Director did not address all specifics of Recommendations A.1.b, A.1.c, A.2.a, A.2.b, B.2.a and B.2.b to include requirements for contracting officers to request field pricing assistance and consideration for inclusion of alternate FAR clauses in future contracts.

In addition, the Director did not address Recommendations A.1.d and A.1.e regarding evaluation of service cost components as part of cost analysis when determining a fair and reasonable price in future sole-source commercial supply support contracts, or the reevaluation of the subcontractor costs paid by Derco on the UTAS contract. Therefore, we request additional comments to the final report by December 15, 2015. Please see the Recommendations Table on the back of this page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Logistics Agency	A.1.b, A.1.c, A.1.d, A.1.e, A.2.a, A.2.b, B.2.a, B.2.b	A.1.a, A.1.f, B.1

Please provide Management Comments by December 15, 2015.





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

November 16, 2015

MEMORANDUM FOR FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

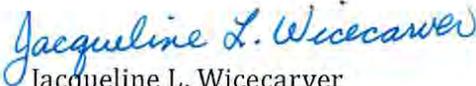
SUBJECT: Improvements Needed in the Defense Logistics Agency's Evaluation
of Fair and Reasonable Prices for C-130 Aircraft Spare Parts
(Report No. DODIG-2016-023)

(FOUO) We are providing this report for your review and comment. DLA Aviation did not adequately analyze proposals to determine fair and reasonable prices for services and spare parts purchased from United Technologies Aerospace System, SupplyCore, and Lockheed Martin. If United Technologies Aerospace System option years are exercised, DLA Aviation will overpay [REDACTED]. Also, DLA Aviation will not benefit when SupplyCore receives reduced cost for supplier material. Further, DLA Aviation paid Lockheed Martin \$2.5 million for spare parts that substantially increased in price without assurance that the prices were reasonable. We conducted this audit in accordance with generally accepted government auditing standards.

We considered management comments on a draft of this report when preparing the final report. DoD Instruction 7650.03 requires that recommendations be resolved promptly. Comments from the Director, Defense Logistics Agency, were responsive to Recommendations A.1.a, A.1.f, and B.1. However, we request additional comment from the Director, Defense Logistics Agency, for Recommendations A.1.b, A.1.c, A.1.d, A.1.e, A.2.a, A.2.b, B.2.a and B.2.b by December 15, 2015.

Please provide comments that conform to the requirements of DoD Instruction 7650.03. Please send a PDF file containing your comments to audapi@dodig.mil. Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

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


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

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Introduction

Objective

The overall objective of the audit was to determine whether the Defense Logistics Agency (DLA) Aviation made cost-effective material purchases to support the C-130 Hercules aircraft through multiple contracts. See Appendix A for a discussion of the scope and methodology and Appendix C for prior audit coverage related to the objective.

This is the second of two reports on DLA Aviation material purchases that support the C-130. The first report¹ addressed whether DLA Aviation cost effectively managed spare-part inventory for the C-130. In this report, we addressed whether DLA Aviation paid a fair and reasonable price for C-130-unique spare parts.²

Background

C-130 Hercules

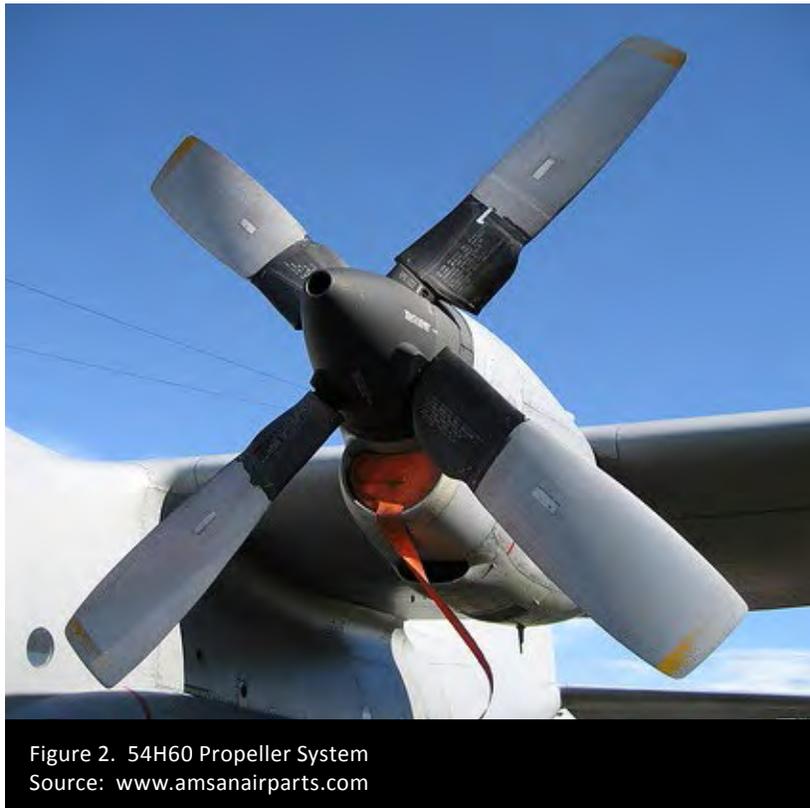
According to the Air Force and a Congressional Research Service report,³ the C-130 Hercules aircraft is a medium-sized tactical transport aircraft that delivers multipurpose theater support within the Marine Corps, Navy, Air Force, and Coast Guard. Specifically, the C-130 operates on rough, unpaved landing strips and airdrops personnel and equipment into hostile areas.

(FOUO) The C-130 has many modifications and variants, but there are currently two primary models: the H and J models. The C-130H model was first delivered in 1974, and is no longer produced. However, it remains in operation with an average fleet age of more than 25 years. The legacy C-130H was replaced with the C-130J model, which has significant advances in avionics and performance. According to the DLA acquisition plan for the C-130 hub and blade (propeller) program, [REDACTED] See Figure 1 for an image of the C-130H aircraft and Figure 2 for the 54H60 propeller system.

¹ DoDIG Report No. DODIG-2015-132, "Opportunities Exist to Improve the Inventory Management for Defense Logistics Agency Aviation C-130 Spare Parts," was issued on June 11, 2015.

² We focused our audit on parts that were only used on the C-130 aircraft.

³ Congressional Research Service Report, "C-130 Hercules: Background, Sustainment, Modernization, Issues for Congress," June 24, 2014.



Defense Logistics Agency

DLA is located at Fort Belvoir, Virginia, and provides logistics, acquisition, and technical support services to the Army, Marine Corps, Air Force, other Federal agencies, and combined and allied forces. To support its mission, DLA has six primary-level field activities located throughout the country. DLA also supports approximately 2,400 weapon systems and manages nine supply chains and about 6 million items. The agency also operates in 48 states and 28 countries and manages 25 distribution centers worldwide.

Defense Logistics Agency Aviation

DLA Aviation is headquartered at the Defense Supply Center Richmond, Virginia. It is one of six primary field activities that report to the Director, DLA. DLA Aviation manages the aviation supply chain and operates in 18 stateside locations that support more than 1,800 major weapon systems. Specifically, DLA Aviation manages more than 1.1 million repair parts and operating supply items for all fixed- and rotor-wing aircraft, including spares for:

- engines on fighters, bombers, transports, and helicopters;
- all airframe and landing gear parts;
- flight safety equipment; and
- propeller systems.

Hub and Blade Acquisition Strategy

(FOUO) [REDACTED]

[REDACTED] Rather than manage the effort, DLA Aviation determined that it was more cost-effective to pay a contractor to provide complete logistics support for the hub and blade program. Therefore, DLA Aviation executed a virtual prime vendor⁴ (VPV) strategy with customer-direct⁵ support, which involved the contractors who manage and directly deliver parts to Warner Robins Air Logistics Center (WR-ALC) and worldwide military customers. In December 2012, DLA Aviation reserved a portion of the hub and blade program logistics support requirement for small business.

United Technologies Aerospace Systems Contracts

United Technologies Aerospace Systems (UTAS)⁶ is located in Windsor Locks, Connecticut, and is owned by United Technology Corporation located in Hartford, Connecticut. According to UTAS, it is one of the largest suppliers of technologically advanced aerospace and defense products. During the past 19 years, DLA Aviation awarded three long-term, VPV-type contracts to UTAS. On April 9, 1996, DLA Aviation awarded the original hub and blade contract.⁷ The first follow-on contract⁸ was awarded on June 6, 2002.

⁴ VPV is a contract between one or more commercial vendors to provide commercial-off-the-shelf material to military customers on a just-in-time basis.

⁵ Customer direct is when contractors provide supply-chain-management functions to military customers.

⁶ Hamilton Sundstrand conducts business as UTAS.

⁷ The original hub and blade contract was contract SP0400-96-D-9426.

⁸ The first follow-on hub and blade contract was contract SP0400-02-D-9409, but DLA Aviation issued contracts SPM400-04-D-9432 and SPM4AX-09-D-9405 to extend the first follow-on because there were no additional manual delivery order numbers that could be issued against that contract. Additionally, DLA Aviation implemented an electronic contracting system and issued contract SPE4AX-09-D-9405 concurrently to execute electronic delivery orders.

(~~FOUO~~) The second follow-on contract⁹ was awarded on May 30, 2014. This UTAS contract is a commercial acquisition in which UTAS provides ■ national stock numbers (NSNs) and supply chain management services to WR-ALC and worldwide DoD customers. UTAS also provides:

- demand planning and forecasting;
- purchasing;
- inventory management;
- quality control;
- receipt;
- storage and warehousing;
- packaging;
- transportation; and
- customer service.

UTAS also operates and maintains inventory at a government-furnished storefront space at Robins Air Force Base, Georgia, to support WR-ALC industrial customers. The 5-year (3-year base period and 2 option years), indefinite-quantity, indefinite-delivery contract is firm-fixed price with an estimated base-period value of \$60.2 million. The contract's total estimated maximum value is \$99.5 million, including a \$12.8 million fixed service fee over 5 years. The fixed service fee is allocated annually to the contract and is incorporated into the negotiated unit price of each part as a percentage.

SupplyCore Commercial Contract

SupplyCore is a small business headquartered in Rockford, Illinois. To provide support services to its customers worldwide, SupplyCore manages:

- supply chains;
- distribution;
- warehousing and facilities; and
- program management.

⁹ The second follow-on hub and blade contract was contract SPE4AX-14-D-9417.

On September 19, 2013, DLA Aviation awarded a commercial contract¹⁰ to SupplyCore to provide 446 NSNs and supply-chain-management services to WR-ALC and worldwide customers. SupplyCore supply-chain-management responsibilities include:

- demand planning and forecasting;
- purchasing;
- inventory management;
- quality control;
- receipt;
- storage and warehousing;
- packaging;
- transportation; and
- customer service.

(FOUO) SupplyCore also operates and maintains inventory at a government-furnished storefront space at WR-ALC. The 5-year (3-year base period and a 2-year option period) indefinite-delivery, indefinite-quantity contract is firm-fixed price with an estimated base period valued at \$45.9 million. The total estimated maximum value is [REDACTED] over 5 years.

Lockheed Martin Basic Ordering Agreement

Lockheed Martin Corporation, Global Supply Chain Services, is located in Baltimore, Maryland. Lockheed Martin provides global management services including specialized delivery of off-the-shelf and hard-to-find spare parts.

On June 29, 2013, DLA Aviation awarded a contract¹¹ as a basic ordering agreement to Lockheed Martin to provide supplies or services. The contract period is 5 years with performance through June 27, 2018. According to the contract terms, all DoD contracting offices may issue delivery orders under the basic ordering agreement with advance coordination with the DLA Aviation contracting officer as the lead contract administrator. The contracting officers must negotiate each delivery order separately as the requirement arises. Additionally, the negotiated price for ordered items must be firm-fixed price with a minimum dollar amount of \$1,000.

¹⁰ The commercial contract was contract SPE4AX-13-D-9425.

¹¹ The Lockheed Martin contract was contract SPE4A1-13-G-0007.

Review of Internal Controls

DoD Instruction 5010.40, “Managers’ Internal Control Program (MICP) Procedures” May 30, 2013, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses associated with the cost-effective material purchases made by DLA Aviation to support the C-130 aircraft through multiple contracts. Specifically, DLA Aviation contracting officers did not perform adequate cost analysis to support fair and reasonable price determinations for C-130 parts and services purchased on the contracts awarded to UTAS and Lockheed Martin. Additionally, the DLA Aviation contracting officers did not justify the commercial item determination (CID), which exempted UTAS from the certified-cost or pricing-data requirement to support fair and reasonable prices. We will provide a copy of the report to the senior official responsible for internal controls in DLA.

Finding A

DLA Aviation Overpaid for Commercial Spare Parts and Services

The support services and spare parts we reviewed were purchased from UTAS and SupplyCore on commercial contracts¹² to support the hub and blade (propeller) for the C-130 aircraft. We determined that DLA Aviation contracting officers did not perform adequate proposal analysis to determine a fair and reasonable price for supply support services and selected spare parts. This occurred because the DLA Aviation contracting officers did not:

- adequately justify a commercial item determination,¹³ which exempted UTAS from the certified-cost or pricing-data requirement;
- effectively and efficiently obtain sufficient data-other-than-certified cost or pricing data from the offerer or Government sources to perform a sufficient cost analysis of UTAS-proposed commercial-item prices;
- perform sufficient cost analyses of UTAS service fees and materials;
- include an economic price-adjustment clause in the contract to permit DLA Aviation savings when SupplyCore received supplier price reductions during contract performance; and
- establish adequate performance criteria to pay delivery-based incentives.

(FOUO) We performed a cost analysis of the UTAS service fee and calculated that DLA Aviation will overpay ██████████ to UTAS during the 3-year contract base period. If the remaining 2 option years are exercised, DLA Aviation will overpay ██████████ over the entire 5 years of the UTAS contract. Additionally, we reviewed a nonstatistical sample of 20 commercial spare parts, including 17 sole-source parts awarded to UTAS, and three parts competitively awarded to SupplyCore. DLA Aviation will overpay ██████████ to UTAS for 6 of 17 sole-source parts during the 3-year base period and ██████████ over the entire 5-year contract that could be put to better use. Also, DLA Aviation will not receive lower prices when SupplyCore benefits from reductions in supplier material cost for two of three parts reviewed on the SupplyCore contract.

¹² Contract SPE4AX-14-D-9417 was awarded to UTAS, and contract SPE4AX-13-D-9425 was awarded to SupplyCore.

¹³ Defense Federal Acquisition Regulation Supplement (DFARS) 212.102, "Acquisition of Commercial Items," requires contracting officers to determine if the acquisition meets the commercial-item definition and include a written determination in the contract file.

Commercial Pricing Guidance

An acquisition regulation¹⁴ requires contracting officers to purchase products and services at a fair and reasonable price. Other acquisition guidance¹⁵ emphasizes that contracting officers should exercise particular care when they price sole-source commercial items.

Market Research Did Not Justify Commercial Item Determination

The DLA Aviation contracting officer did not adequately justify the CID, which exempted UTAS from the certified-cost or pricing-data requirement. According to the DLA Aviation contracting officer, previous acquisition material coding and information from UTAS's website and a press release were sufficient sources for the CID. However, the CID lacked adequate market research to include supporting independent technical reviews, industry agreement, and similar services. Additionally, the CID was not supported by products sold in substantial quantities in the commercial market. An acquisition regulation¹⁶ states that agencies should use market research to determine if commercial items or those similar to items available in the commercial market can meet agency needs.

Technical Engineering Reviews Were Not Requested

The contracting officer did not seek technical engineering assistance to support the CID for parts. An acquisition regulation¹⁶ states that contracting officers may contact knowledgeable Government individuals and query Government contracting databases to conduct market research.

In an e-mail dated October 3, 2014, a DLA Aviation procurement supervisor stated, ". . . for the contract that you are reviewing we did not send a request [Government technical engineers] because the NIINs [national item identification numbers] were already coded commercial from the previous contract." DLA Directive¹⁷ states that the preference is to accept a prior CID; however, buyers must conduct market research to determine if a prior commerciality designation is relevant to the current buy. Further, the directive states that prior determinations do not relieve the contracting officer from the individual responsibility to make CIDs based on appropriate market research for current buys.

¹⁴ Federal Acquisition Regulation (FAR) 15.402, "Pricing Policy."

¹⁵ DFARS Procedures, Guidance, and Information (PGI), 215.403-1, "Prohibition on obtaining certified cost or pricing data (10 U.S.C. 2306a and 41 U.S.C chapter 35)."

¹⁶ FAR Part 10, "Market Research."

¹⁷ Defense Logistics Agency Directive Subpart 12.1, "Acquisition of Commercial Items-General."

According to the acquisition method supply codes, none of the 20 items reviewed in our sample were coded as commercial items in the DLA Enterprise Business System database.

Additionally, according to the acquisition method supply codes,¹⁸ none of the 20 items reviewed in our sample were coded as commercial items in the DLA Enterprise Business System database. During an interview on March 20, 2015, a DLA Aviation Chief Engineer stated that the acquisition codes indicated that an Air Force product specialist previously determined that the items were not commercial before management responsibility was transferred to DLA Aviation. Further, according to the Chief Engineer, DLA Aviation contracting officers did not request that the commerciality of the 20 sampled parts be re-evaluated before soliciting contractor supply support of the parts under a commercial acquisition.

Aerospace Industry Member Disagreed That Materials Were Commercial

A member of the aerospace industry, which was a potential offerer, disagreed that the hub and blade parts were commercial. The potential offerer declined to bid on the hub and blade contract and took exception to soliciting the contractor supply support of the parts as a commercial acquisition. In its no-bid letter, the potential offerer stated:

Although this solicitation was advertised as a contract for commercial items[,] the parts listed in this solicitation are not manufactured for commercial aircraft and there is no interchangeability between the parts listed in this RFP [request for proposal] and commercial aircraft parts. We could find no competing commercial sources for the parts listed in this RFP.

An acquisition regulation¹⁹ states contracting officers may contact knowledgeable industry individuals to conduct market research. Additionally, the regulation allows contracting officers to conduct interchange meetings or pre-solicitation conferences with potential offerers to determine if commercial items are available to meet the Government's needs. However, the contracting officer did not rely on the potential offerer's opinion.

¹⁸ An acquisition-method supply code is a type of special acquisition coding, derived from technical reviews, that contracting officers rely on to select appropriate methods of contracting, identify sources of supply, and make other decisions during contract pre-award and award phases.

¹⁹ FAR Part 10.

UTAS Did Not Offer Military-Unique Supply Services to Commercial Customers

(FOUO) [Redacted]
[Redacted]
[Redacted]
[Redacted]

However, an acquisition regulation²⁰ defines services as commercial if the source of the services provides similar services to the general public under similar terms and conditions offered to the Government. Specifically, the regulation states that commercial services mean:

(5) Installation services, maintenance services, repair services, training services, and other services if—

(ii) The source of such services provides similar services contemporaneously **to the general public under terms and conditions similar to those offered to the Federal Government.** [emphasis added]

(FOUO) [Redacted]
[Redacted]
[Redacted]
[Redacted]

Therefore, the military-unique supply chain management services did not meet the characteristics of a commercial service based on an acquisition-regulation definition.

The military-unique supply chain management services did not meet the characteristics of a commercial service based on an acquisition-regulation definition.

UTAS Commercial Sales Were Not Comparable to Government Past or Future Requirements

(FOUO) UTAS's historical commercial sales were not comparable to its historical Government sales. Currently, there is no guidance requiring that a specific percentage of commercial sales exists to support a CID and a proposed price as fair and reasonable. However, according to a Director, Defense Pricing memorandum,²¹ the preference is for contracting officers to use market-based pricing when determining a fair and reasonable price. However, UTAS's commercial market sales were not sufficient to use as a basis to determine the proposed prices to be fair and reasonable. UTAS had Government or commercial sales (or both) for 10 of 17 parts

²⁰ FAR Subpart 2.1, "Definitions."

²¹ Director, Defense Pricing memorandum, "Commercial Items and the Determination of Reasonableness of Price for Commercial Items," dated February 4, 2015.

(FOUO) reviewed in our sample during a 31-month period from January 2012 through September 2014. According to the sales history for the 10 parts, as illustrated in Table 1, UTAS's propeller aftermarket sales of [REDACTED] to DLA Aviation accounted for [REDACTED] of UTAS's total sales. However, UTAS's sales of [REDACTED] to its commercial customers accounted for [REDACTED] of UTAS's sales for the 10 parts over the same time period.

Table 1. DLA Aviation Historical Purchases Versus UTAS Commercial Sales From January 2012 Through September 2014

(FOUO) NSN	31 Months of Sales		Share of UTAS Sales	
	DLA	Commercial	DLA (Percent)	Commercial Customers (Percent)
1610-00-168-6158	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
5930-00-805-5960	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-776-4162	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-651-3850	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-628-7220	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
UTAS (5 parts)	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-01-102-3006	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-873-6410	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-873-6422	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-717-7757	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-717-7769	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Derco (5 parts)*	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED] (FOUO)

* (FOUO) [REDACTED]

(FOUO) Further, DLA Aviation's estimated 2-year demand for the 17 parts reviewed on the UTAS hub and blade contract²² was \$3.5 million. As illustrated in Table 2, if DLA's 2-year contract demand was actually ordered for the 17 parts, it would account for [REDACTED] of UTAS's sales. However, UTAS's commercial sales of [REDACTED] from January 2012 through December 2013 accounted for [REDACTED] of UTAS's sales over the same time period.

²² The UTAS hub and blade contract was contract SPE4AX-14-D-9417.

(FOUO) Because UTAS [REDACTED] commercial sales for the 12 parts within our 17-part sample that were supplied by Derco,²³ we also reviewed Derco’s commercial sales history for a 1-year period from September 2013 through September 2014. DLA Aviation’s estimated demand in the first year of the hub and blade contract was \$1.3 million. As illustrated in Table 3, if DLA’s contract 1-year demand for the 12 parts was actually ordered from UTAS, it would account for [REDACTED] of total UTAS sales. However, Derco’s sales of [REDACTED] to its commercial customers accounted for [REDACTED] over the same time period.

Table 3. DLA Aviation Contract Demand Versus Derco Commercial Sales in 1 Year

(FOUO) NSN	1-Year Requirement/Sales		Share of Derco Sales	
	DLA Contract Demand	Commercial Sales (2012-2013)	DLA (Percent)*	Commercial Customer (Percent)
1610-00-717-7211	\$461,520	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-628-7978	289,494	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-717-7733	239,740	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-651-3870	83,402	[REDACTED]	[REDACTED]	[REDACTED]
1610-01-102-3006	64,878	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-651-3825	39,825	[REDACTED]	[REDACTED]	[REDACTED]
3040-00-651-3821	30,087	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-056-6237	27,588	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-873-6410	26,076	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-873-6422	24,265	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-717-7769	19,076	[REDACTED]	[REDACTED]	[REDACTED]
1610-00-717-7757	11,674	[REDACTED]	[REDACTED]	[REDACTED]
Derco (12 parts)	\$1,317,625	[REDACTED]	[REDACTED]	[REDACTED] (FOUO)

*(FOUO) DLA aviation shares of sales were based on DLA contract demand estimates and not actual purchases made. [REDACTED]

Although the CID lacked support, the DLA Aviation contracting officer issued the hub and blade solicitation as a commercial acquisition. As a result, UTAS was exempted from the requirement to certify that costs were accurate, complete, and current. The contracting officers should not rely on previous CIDs as a basis to issue follow-on contracts as commercial acquisitions without conducting market research to determine if the previous CID is relevant to the current acquisition.

²³ (FOUO) [REDACTED]

Instead, the Director, DLA, should require contracting officers to perform appropriate market research in accordance with the acquisition regulation and directive, including requesting Government engineering reviews, to determine whether a CID is appropriate before issuing a solicitation for follow-on supply support contracts.

Efforts to Obtain Cost or Pricing Data Were Not Effective or Efficient

The DLA Aviation contracting officer did not effectively and efficiently obtain sufficient data-other-than-certified cost or pricing data from the offerer or Government sources to perform a sufficient cost analysis of UTAS-proposed commercial-item prices. Acquisition guidance²⁴ states that obtaining sufficient data from the offerer is particularly critical in situations where an item is determined to be a commercial item. For commercial acquisitions that do not require certified-cost or pricing data, the acquisition regulation²⁵ requires the contracting officer to obtain whatever data is available from the Government or other sources to determine fair and reasonable prices. The contracting office may also require the submission of data-other-than-certified cost or pricing data directly from the offerer. However, the contracting officer did not effectively or efficiently obtain the necessary data from UTAS or a Defense Contract Management Agency (DCMA) cost or pricing analyst.

Solicitation Did Not Specify the Type of Cost Data Required by UTAS

The DLA Aviation contracting officer did not specify, in the solicitation for UTAS, the types of data-other-than-certified cost or pricing data required of a contractor to determine price reasonableness for commercial items as required by an acquisition regulation.²⁶ Specifically, the contracting officer did not request:

- purchase orders;
- estimated labor wages and hours;
- commercial sales of the same or similar items over a similar time period; and
- price-reasonableness justification for subcontractor prices.



The DLA Aviation contracting officer did not specify, in the solicitation for UTAS, the types of data-other-than-certified cost or pricing data required...

²⁴ DFARS PGI, 215.403-1.

²⁵ Federal Acquisition Regulation 15.403-3(a)(1), "Requiring data other than certified cost or pricing data."

²⁶ Federal Acquisition Regulation 15.408, "Solicitations provisions and contract clause."

The acquisition regulation requires the contracting officer to include an alternate clause²⁷ in the solicitation when an exception to the submission of certified cost or pricing data exists. The clause requires the contracting officer to insert the specific description and format of the data required, including access to records necessary to permit an adequate evaluation of the proposed price. Specifically, the alternate clause states with instruction:

Alternate IV (Oct 2010). As prescribed in 15.408(l), replace the text of the basic provision with the following:

- (a) Submission of certified cost or pricing is not required.
- (b) Provide data described below: **[Insert description of the data and the format that are required, including the access to records necessary to permit an adequate evaluation of the proposed price in accordance with 15.403-3].**
[emphasis added]

Instead, the contracting officer included a vague provision in the solicitation that reserved the right to request additional supporting price data, such as an informal cost breakdown. However, the solicitation did not require that the contractor submit specific cost data to be included as part of the contractor's proposal package. Specifically, the solicitation stated:

L.9.4. The government reserves the right to request additional supporting price data (i.e., data other than certified cost or price data) in accordance with FAR 15.403-3 in order to evaluate price proposals and ultimately, arrive at a fair and reasonable price determination. For example, the government may request an informal cost breakdown of U/P {unit price} costs (to include the distribution of each major cost component) to differentiate each supply chain management and materiel cost from costs associated with other cost components of the proposed U/P.

UTAS submitted its original price proposal on February 26, 2013, and the DLA Aviation contracting officer made the first attempt to request the supporting data-other-than-certified cost or pricing data (for example, commercial sales, material, labor, and outside processes) needed to evaluate the price reasonableness of the proposal on March 18, 2013.

After receiving the UTAS proposal, the DLA Aviation contracting officer made unsuccessful efforts to obtain adequate data-other-than-certified cost or pricing data. However, UTAS officials' efforts delaying or denying the requested data were consistent with UTAS's commercial item contracting policy for Government contracts.

²⁷ Federal Acquisition Regulation 52.215-20, "Requirements for Certified Cost or Pricing Data and Data Other Than Certified Cost or Pricing Data," Alternate IV (October 2010).

(FOUO)

After difficulties in obtaining more specific cost data from UTAS, the contracting officer elevated the matter to the DLA Aviation Deputy Commander. On September 18, 2013, the Deputy Commander requested UTAS to provide a reasonable level of cost data to determine a fair and reasonable price that included:

- manufactured items: labor hours and rates, basis of estimates, material cost data (for example, competitive vendor quotes, and long-term agreements), and profit;
- competitive purchase items: quotes to include vendor name, date, quantity breaks, prices, and any special terms or conditions, purchase order history, and profit;
- single-source purchase items: subcontractor cost data to the same level of detail as UTAS's data; and
- service fee: data to support the cost build up.

A UTAS Director stated, "...our interpretation of the Hub & Blade solicitation structure did not cause us to gather this level of data."

In an e-mail response to the DLA Aviation Deputy Commander, dated September 19, 2013, a UTAS Director stated, "... our interpretation of the Hub & Blade solicitation structure did not cause us to gather this level of data."

UTAS benefited from its status as DLA Aviation's only approved source by arguing against or delaying responses to requests for supporting data until the need to sustain the military aircraft in support of DoD missions became urgent. It took 15 months from UTAS's proposal submission on February 26, 2013, to award the hub and blade contract on May 30, 2014.

UTAS
delayed, denied,
or provided data
that did not satisfy
requests for data-other-
than-certified cost
or pricing data on
22 occasions.

According to the contract file, UTAS delayed, denied, or provided data that did not satisfy requests for data-other-than-certified cost or pricing data on 22 occasions. See Appendix B for a timeline of instances. When it is reasonably certain that data-other-than-certified cost or pricing data will be required for acquisition of commercial items, the Director, DLA, should direct the Head of the Contracting Activity to determine whether to (1) include FAR 52.215-20 Alternate IV clause in solicitations and specify that the data-other-than-certified cost or pricing data may include: commercial sales invoices of the same or similar items, direct-wage rates, estimated labor hours, indirect-cost rates, subcontractor price quotes and purchase-order history, and results of cost or pricing analysis of subcontractor prices at all levels and (2) to communicate that the submission of the requested data will be a condition of an acceptable proposal submission.

Requests for DCMA Cost or Pricing Support Were Too Late

The DLA Aviation contracting officer did not seek DCMA cost or pricing assistance to obtain UTAS's base material costs in a timely manner. The contracting officer received the UTAS price proposal on February 26, 2013, but did not request DCMA cost or pricing assistance to support proposed material prices until October 25, 2013, which was 8 months later.

A DCMA cost and pricing analyst had access to UTAS's business systems to retrieve standard unit cost and recent purchase-order detail. According to contract records, on November 12, 2013, the DLA Aviation contracting officer requested that DCMA analysts expedite the cost review of 156 parts for completion in 25 days. In December 2013, the DCMA cost and pricing analyst submitted price recommendations, including estimated material and labor costs.

An acquisition regulation²⁸ requires contracting officers to request field-pricing assistance early in negotiations when the information available at the buying activity is inadequate to determine a fair and reasonable price. The Director, DLA, should direct contracting officers to request field-pricing assistance from a DCMA cost and pricing analyst for sole-source commercial supply support contracts immediately after it is determined that information is not available or insufficient to determine a fair and reasonable price in accordance with acquisition regulations.

²⁸ FAR 15.404-2(a), "Data to support proposal analysis."

Cost Analyses on UTAS Prices for Materials and Services Were Insufficient

The DLA Aviation contracting officer performed insufficient cost analyses on UTAS-proposed prices for material and supply-chain services. Specifically, the DLA Aviation contracting officer did not:

- apply the DCMA forward-pricing rate recommendations (FPRR),²⁹ in effect at the time the final UTAS proposal was submitted, for material cost analysis;
- analyze the major cost elements that comprised the final service fee; and
- sufficiently verify that the prices paid by UTAS and its subcontractors were fair and reasonable.

Outdated Rates Were Applied for DLA Cost Analysis for Materials

The DLA Aviation contracting officer did not apply the DCMA FPRR in effect at the time that UTAS submitted its final price proposal on May 8, 2014. At the time of UTAS's final proposal of record, DLA Aviation inappropriately accepted UTAS prices that consisted of outdated general and administrative rates, base labor, overhead rates, and cost-of-money factors included in the DCMA FPRR, dated November 29, 2012. However, as a result of an indirect-rate audit, the DCMA divisional contracting officer updated the 2014-2018 FPRR.

(FOUO)
DLA Aviation will overpay UTAS [REDACTED] on 6 of 17 sole-source commercial parts in our sample during the 3-year base period and [REDACTED] over the entire 5-year contract.

(FOUO) According to the DCMA FPRR letter dated April 14, 2014, the updated rates were effective immediately and superseded the previous FPRR. Table 4 shows that DLA Aviation will overpay UTAS [REDACTED] on 6 of 17 sole-source commercial parts in our sample during the 3-year base period and [REDACTED] over the entire 5-year contract. We show examples of these potential overpayments in the next section for two parts: a support and sleeve and a rubber boot fairing.

²⁹ An FPRR is a rate established by the administrative contracting officer for use by the Government in negotiations or other contract actions when forward-pricing-rate-agreement negotiations have not been completed or when the contractor will not agree to a forward-pricing-rate agreement.

Table 4. Our Cost Analysis of 17 Parts on UTAS Contract SPE4AX-14-D-9417

(FOUO) NSN	DLA Contracts ¹			DoD IG Calculated Fair and Reasonable Price		Overpayment/ Underpayment		
	Qty	Unit Price Without Service Fee ¹	Total Price	Unit Price	Total Price	Year 1 Amount	Percent	Base Period (Years 1-3) Amount ²
1610-00-168-6158	129	████████	████████	████████	████████	████████	████████	████████
1610-00-628-7978	1,474	████████	████████	████████	████████	████████	████████	████████
5930-00-805-5960	200	████████	████████	████████	████████	████████	████████	████████
1610-00-628-7220	4	████████	████████	████████	████████	████████	████████	████████
1610-00-651-3850	29	████████	████████	████████	████████	████████	████████	████████
1610-00-776-4162	54	████████	████████	████████	████████	████████	████████	████████
Overpayments (6 parts)			████████		████████	████████	████████	████████
1610-00-651-3870	21,276	████████	████████	████████	████████	████████	████████	████████
3040-00-651-3821	103	████████	████████	████████	████████	████████	████████	████████
1610-00-717-7769	90	████████	████████	████████	████████	████████	████████	████████
1610-00-873-6410	80	████████	████████	████████	████████	████████	████████	████████
1610-00-717-7757	9	████████	████████	████████	████████	████████	████████	████████
1610-00-717-7211	56	████████	████████	████████	████████	████████	████████	████████
1610-01-102-3006	31	████████	████████	████████	████████	████████	████████	████████
1610-00-873-6422	57	████████	████████	████████	████████	████████	████████	████████
1610-00-717-7733	532	████████	████████	████████	████████	████████	████████	████████
1610-00-056-6237	189	████████	████████	████████	████████	████████	████████	████████
1610-00-651-3825	172	████████	████████	████████	████████	████████	████████	████████
Underpayments (11 parts)			████████		████████	████████	████████	████████ (FOUO)

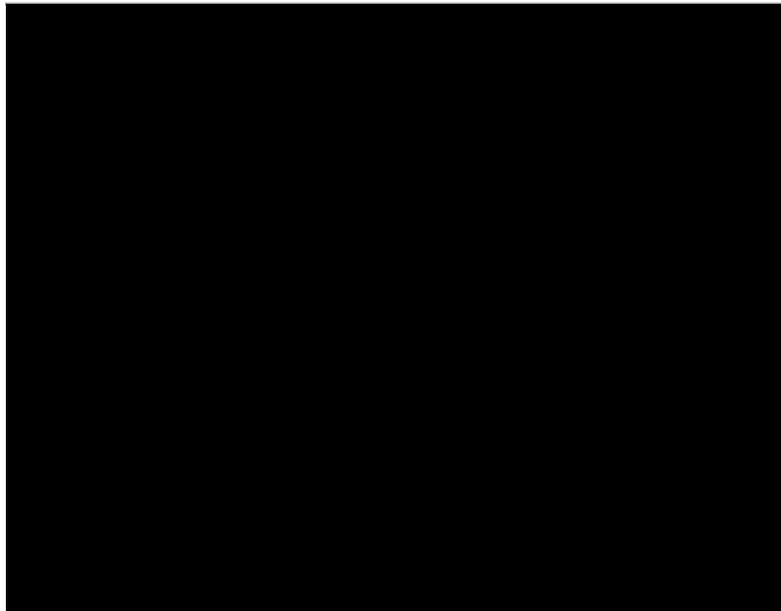
NOTE: Amounts may not equal the actual sums or differences because of rounding.

¹ (FOUO) For our cost analysis of the parts, we deducted the ██████████ service fee included in the contract unit price established for the last 8 months of the first year because we performed a separate cost analysis of the service fee.

² (FOUO) DLA Aviation and UTAS agreed to increase the unit prices by ██████████ annually. Therefore, we increased our calculated overpayments and underpayments by ██████████ annually over the 3-year base contract period.

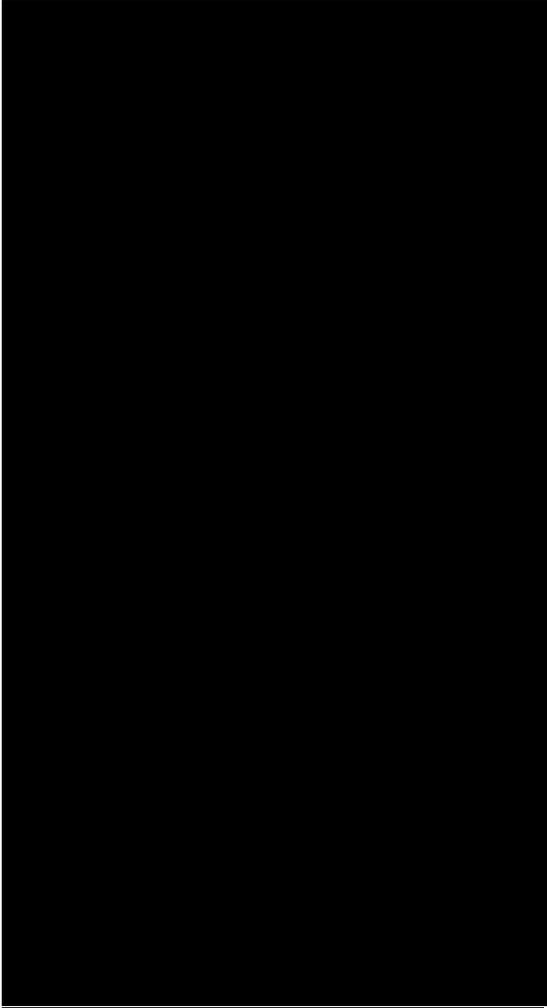
Support and Sleeve

(FOUO) For an annual quantity of 129 units of support and sleeves,³⁰ shown in Figure 3, the contract unit price without the service fee was [REDACTED] each, totaling [REDACTED]. However, we calculated a fair and reasonable unit price of [REDACTED] for the same quantity, totaling [REDACTED]. Therefore, DLA Aviation will overpay by [REDACTED] ([REDACTED]) in the first contract year. If the annual demand quantity is ordered each of the 3 years during the base period, DLA Aviation will overpay [REDACTED] and [REDACTED] if the 2 option years are exercised.



(FOUO) Figure 3. Support and Sleeve
Source: United Technologies Aerospace Systems

³⁰ Support and sleeve part (NSN 1610-00-168-6158).



(FOUO) Figure 4. Rubber Boot Fairing
Source: United Technologies Aerospace Systems

Rubber Boot Fairing

(FOUO) For an annual quantity of 1,474 units of rubber boot fairings,³¹ shown in Figure 4, the contract unit price without the service fee was [REDACTED] each, totaling [REDACTED]. However, we calculated a fair and reasonable unit price of [REDACTED] for the same quantity, totaling [REDACTED]. Therefore, DLA Aviation will overpay by [REDACTED] ([REDACTED]) in the first contract year. If the annual demand quantity was ordered each of the 3 years during the base period, DLA Aviation will overpay [REDACTED] and [REDACTED] if the 2 option years are exercised.

The Director, DLA, should direct contracting officers to apply the indirect rates from the most current DCMA-approved FPRR or forward-pricing-rate agreement when a cost analysis is performed to evaluate contractor price proposals for sole-source commercial supply support contracts. Additionally, during

extended negotiations, contracting officers should be required to verify whether indirect rates are current in the final proposal submission, and update if necessary.

³¹ Rubber boot fairing (NSN 1610-00-628-7978).

Service-Fee Cost Elements Were Not Sufficiently Analyzed

(FOUO)
DLA Aviation will overpay \$2.5 million during the 3-year base period and \$4.4 million over the entire 5-year contract if the option years are exercised...

(FOUO) The DLA Aviation contracting officer did not sufficiently analyze UTAS service-fee costs, totaling \$12.8 million, which includes \$7.3 million during the 3-year contract base period. During negotiations, the contracting officer reduced UTAS’s original proposed service fee of [REDACTED] to \$12.8 million awarded on the contract. However, we calculated a fair and reasonable price of [REDACTED] for the base period and [REDACTED] for all 5 years. This shows that DLA Aviation will overpay [REDACTED] during the 3-year base period and [REDACTED] over the entire 5-year contract if the option years are exercised as illustrated in Table 5.

Table 5. Our Cost Analysis of the UTAS Service Fee

(FOUO) Service Fee Elements	DLA Contract Base Period Price (Years 1-3) ¹	IG Fair and Reasonable Price	Overpayment		
			3-Year Contract Base Period ^{1,2}	Percent	5-Year Contract w/Options Amount ^{1,2}
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Subtotal	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Year 1 Adjustment	[REDACTED])	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED])
Total	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED] (FOUO)

¹ Amounts do not equal the actual sums and differences because of rounding.

² (FOUO) DLA Aviation and UTAS agreed to increase the service fee [REDACTED]. Therefore, we increased our calculated overpayments by [REDACTED] annually.

(FOUO) [REDACTED]
 [REDACTED]
 [REDACTED]
 [REDACTED]
 [REDACTED] Additionally, according to an UTAS official, the premium minimized the risk that UTAS would be left with extra inventory if DoD customers did not order the estimated annual demand quantities on the contract.

(FOUO) If UTAS considers the parts supply to be a commercial acquisition, then there should not be a high risk of retaining residual inventory because UTAS would have commercial customers to sell the inventory to in similar volume and under similar terms and conditions. [REDACTED]
 [REDACTED] if the options are exercised.

(FOUO) In a second example, UTAS charged DLA Aviation [REDACTED] for the 3-year contract base period to manage storefront operations in the C-130 propeller shop at WR-ALC, a Government-owned facility. Specifically, UTAS occupied, at no cost, only 370 square feet within the Government-owned facility. [REDACTED]
 [REDACTED]

(FOUO) After overhead and profit were applied, we calculated a fair and reasonable price of [REDACTED]. Therefore, DLA Aviation will overpay [REDACTED]³² for UTAS employees to manage and issue inventory. If the option years are exercised, DLA Aviation will overpay [REDACTED] over the entire 5-year contract period.

(FOUO) In another example of unsupported pricing, UTAS charged DLA Aviation [REDACTED] for an estimated [REDACTED] to provide engineering support in the first contract year. However, as of March 18, 2015, UTAS had accrued only [REDACTED] actual engineering hours. Table 6 illustrates that with 75 percent³³ of the first year of the contract complete, UTAS has only expended [REDACTED] of the estimated [REDACTED] ([REDACTED]) in the first year.

³² Amount does not equal the actual difference because of rounding.

³³ The first-year contract completion percentage was calculated from the contract effective date of June 6, 2014, to the receipt date of UTAS accrued engineering hours, which was March 18, 2015.

Table 6. UTAS Engineering Support Completed From June 6, 2014 to March 18, 2015

(FOUO) Obsolescence Management Engineering Tasks	Contract Year 1		Earned Through 9 Months		
	Estimated Hours	Contract Price	Hours	Amount ^{1,2}	Percent
Health Review	██████	██████	██████	██████	██████
Health Review – Engineering Oversight	██████	██████	██████	██████	██████
Mechanical Design Engineering	██████	██████	██████	██████	██████
Configuration Management	██████	██████	██████	██████	██████
Material Engineering	██████	██████	██████	██████	██████
Health Review – Obsolescence Review	██████	██████	██████	██████	██████
Reliability Engineering	██████	██████	██████	██████	██████
Total	██████	██████	██████	██████	██████ (FOUO)

¹ Total may not equal the actual sum because of rounding.

² The amount earned was calculated based on the accrued hours and applying labor rates, overhead rates, and profits consistent with the estimated contract fees.

The contracting officer inappropriately relied on a business case analysis performed by a DLA Aviation supply systems analyst to determine the UTAS service fee was fair and reasonable. The business-case analysis was performed to determine which of the following approaches was the most cost-effective to support the hub and blade program: 1) DLA Aviation managing and stock inventory, or 2) DLA Aviation paying a contractor to manage inventory and delivery directly to customers.

According to the contracting officer, it was unnecessary to analyze the service fee in a level of detail that included reviews of rates, overheads, and profits because it was a commercial acquisition.

According to the contracting officer, it was unnecessary to analyze the service fee in a level of detail that included reviews of rates, overheads, and profits because it was a commercial acquisition. Additionally, the contracting officer stated that the business-case analysis indicated that the contractor could perform the service at a lower cost than DLA Aviation. In a February 24, 2015, e-mail response to whether the cost breakdown of the service fee was analyzed, the contracting officer stated:

Yes, a breakdown of the service fee was obtained and analyzed, but not to the level of detail involving rates and overheads. We used it to make sure UTAS was not inflating the service fee, to give us a baseline versus just accepting it since it was lower than the benefit analysis.

Let's keep in mind that this is a commercial acquisition as well. If the contractor is providing the outcome we solicited for, and performing the work at a substantial savings over what it would cost DLA to do the same work, then the price can be considered fair and reasonable without getting into the details of what their cost (or profit) are. [emphasis added]

Based on the response, it could be implied that UTAS and the Government were competitors with UTAS having the more favorable price under a commercial acquisition. However, it would be inappropriate for the Government to be considered a competitor against private industry to satisfy its requirements when determining fair and reasonable prices.

An acquisition regulation³⁴ defines adequate competition as two or more responsible offerers, competing independently, submitting priced offers that satisfy the Government's expressed requirement. While commercial acquisitions are exempt from the requirement to submit certified cost or pricing data, a detailed analysis of the cost elements for the proposed price are still necessary when a fair and reasonable price cannot be determined through price analysis alone for commercial items. The Director, DLA, should direct contracting officers to perform proper cost analysis to determine price reasonableness by evaluating cost components included in the service fee on sole-source commercial supply support contracts.

UTAS and Subcontractor Negotiations Did Not Occur

DLA Aviation did not adequately verify that the subcontract prices paid by UTAS and its subcontractors were fair and reasonable. We determined that:

- UTAS did not negotiate prices with its suppliers until after the DLA Aviation contract was awarded; and
- Derco, UTAS's second-level distributor, did not adequately justify prices paid to third-level suppliers as fair and reasonable.

According to an acquisition regulation,³⁵ contracting officers are required to determine fair and reasonable prices for prime contractor and subcontracting costs. Contracting officers are encouraged to consider whether contractors or

³⁴ FAR 15.403-1(c), "Prohibition on Obtaining Cost or Pricing Data."

³⁵ FAR 15.404-3(a), "Subcontract pricing considerations."

subcontractors have performed cost or price analysis of proposed subcontractor prices or negotiated the subcontract prices before they negotiate the prime contract.

UTAS Negotiations With Subcontractors After Contract Award

(FOUO) UTAS did not negotiate prices with its suppliers until after DLA Aviation contract was awarded. For example, on [REDACTED]³⁶ quoted UTAS a unit price of \$ [REDACTED] for a support and sleeve part offered on the follow-on hub and blade contract³⁷. DLA Aviation negotiated an agreement with UTAS to apply a DCMA-recommended decrement of [REDACTED]³⁸ to UTAS-managed part prices supported by a supplier quote. Therefore, the quote price for the support and sleeve was reduced to [REDACTED]. UTAS used the decremented [REDACTED] quote to support the price proposal, which resulted in a negotiated unit price of \$1,641.47 for 129 units. On [REDACTED], after the contract was awarded, UTAS purchased the part for a unit price of [REDACTED], saving UTAS [REDACTED]. However, UTAS did not share those savings with DLA Aviation. Additionally, for this part, the DLA Aviation strategy to apply the DCMA-recommended [REDACTED] decrement to the supplier quoted price was not effective because the UTAS-negotiated reduction of [REDACTED] was substantially greater.

(FOUO) According to a UTAS official during a site visit in October 2014, UTAS's negotiations with its suppliers are not relevant to the Government under commercial contracts. In purchase order documents, UTAS officials stated, "[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]" This UTAS practice violates the acquisition regulation,⁴⁰ requiring prime contractors to conduct appropriate cost or price analyses to establish the reasonableness of proposed subcontractor prices and include the results in the price proposal.

According to a UTAS official during a site visit in October 2014, UTAS's negotiations with its suppliers are not relevant to the Government under commercial contracts.

³⁶ [REDACTED] is a UTAS-approved supplier for the support and sleeve part.

³⁷ The follow-on hub and blade contract was contract SPE4AX-14-D-9417.

³⁸ (FOUO) DCMA recommended a [REDACTED] decrement based on a DCAA review of UTAS's material quotations and subsequent purchase orders issued between January 1, 2009, and August 18, 2009.

³⁹ FAR 12 refers to commercial acquisitions, which are executed under the policies and procedures in FAR 12, "Acquisition of Commercial Items."

⁴⁰ FAR 15.404-3(b).

The contracting officer included a price-redetermination clause in the UTAS contract. The clause allowed DLA Aviation and UTAS to reprice the ordered parts that represented 80 percent of the total dollar amount spent during the contract's first 30 months. Additionally, the contractor was required to propose new prices for the selected parts based on the costs and forward pricing rates in effect at the time of the repricing. However, the contractor was required to use the profits and escalation rates that were agreed upon when DLA Aviation awarded the base contract.

(FOUO) The price-redetermination clause can be an effective mitigation strategy; however, the repricing was only permitted at the time that the first option year is exercised. The first option year is scheduled to be exercised in June 2017, which is 3 years after the base contract was awarded. Our cost analysis in Tables 4 and 5 shows DLA Aviation may potentially overpay ██████████ in service fees and ██████████ in material costs during the 3-year contract base period. DLA Aviation could save and put those funds to better use if the parts repricing was completed during the 3-year base period.

Long-Term Agreements of Second-Level Subcontractor Did Not Justify Prices

(FOUO) DLA Aviation accepted material base prices paid by Derco, a second-level distributor, to UTAS-approved suppliers without adequate justification that the Derco prices paid were fair and reasonable. Derco supplied 12 of 17 parts reviewed in our sample on the UTAS hub and blade contract.⁴¹ ██████████
██████████
██████████

...UTAS and Derco erroneously claimed that the LTAs supported the prices when LTAs did not exist.

(FOUO) However, UTAS and Derco erroneously claimed that the LTAs supported the prices when LTAs did not exist. ██████████
██████████
██████████
██████████
██████████

However, after a review of the purchase orders for the 11 parts, we determined that the purchase orders were not LTAs because terms did not stipulate a performance period and negotiated prices for future purchases not yet executed.

⁴¹ The UTAS hub and blade contract was contract SPE4AX-14-D-9417.

(FOUO) Additionally, the Derco purchase orders that UTAS presented as LTAs did not justify the substantial price increases displayed in Derco's purchase order history that ranged from [REDACTED]

[REDACTED]

(FOUO) In another example, [REDACTED]

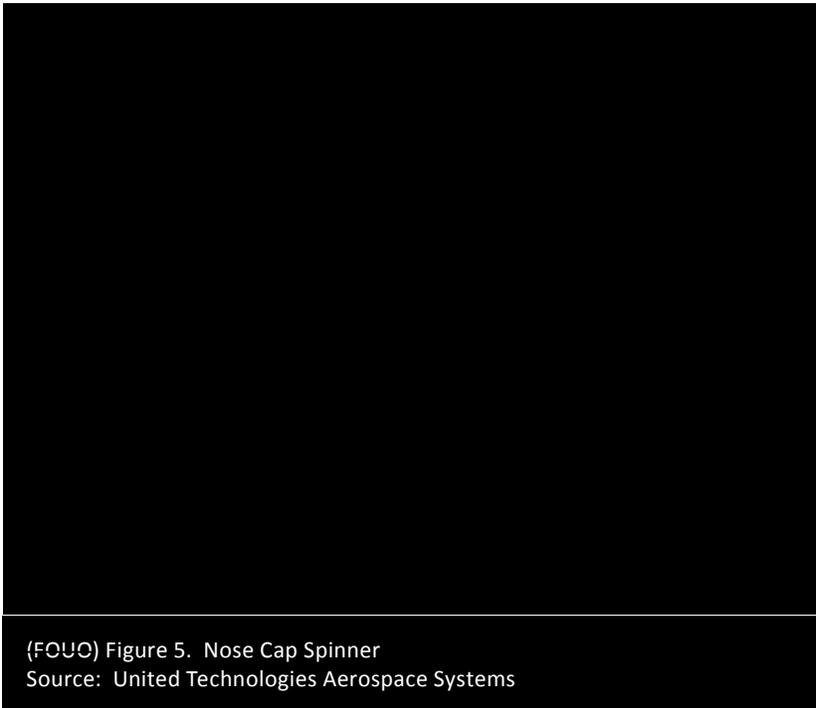
[REDACTED]

Therefore, quantity was not a factor for the price difference.

(FOUO) A third example shows that on [REDACTED]

[REDACTED] Therefore,

quantity was not a factor for the price difference.



⁴² Pitch lock housings (NSN 1610-01-102-3006).
⁴³ Nose cap spinner (NSN 1610-00-056-6237).

The Director, DLA, should direct contracting officers to re-evaluate pricing for Derco-managed priced items before exercising the first option year on the UTAS contract until UTAS provides the results of cost or price analyses of Derco prices that would support a fair and reasonable price.

SupplyCore Contract Did Not Allow for Price Adjustments

The DLA Aviation contracting officer did not include an economic-price-adjustment clause in the contract to permit Government savings when SupplyCore received supplier price reductions during contract performance. SupplyCore benefited from price reductions during the contract⁴⁴ performance for two of three parts reviewed.

On January 30, 2013, Gigli Enterprise quoted SupplyCore a unit price of \$103.41 each for 280 units of breather term covers.⁴⁵ SupplyCore used the quote to develop its price proposal for the DLA Aviation contract. The negotiated unit price charged to DLA Aviation was \$118.74 for an annual quantity of 96 units. However, on February 20, 2014, after contract award, SupplyCore purchased 194 units of the part from Gigli Enterprise for \$81.74, which was a total savings of \$2,080 (21 percent) based on the contract estimated annual quantity. SupplyCore, not DLA Aviation, benefited from the savings.



SupplyCore,
not DLA
Aviation,
benefited from
the savings.

On February 5, 2013, Derco quoted SupplyCore a unit price of \$331.82 for 75 units of fluid transfer tubes.⁴⁶ According to SupplyCore, the Derco quote supported SupplyCore's price proposal, which ultimately resulted in a negotiated-contract unit price of \$337.32 for an annual quantity of 80 units. On May 16, 2014, after DLA Aviation awarded the contract, SupplyCore purchased 29 units of the tube at a unit price of \$239.74. SupplyCore's purchase price saved them a total of \$7,366 (27.7 percent) based on the contract annual quantity; however, DLA Aviation never benefited from these savings.

⁴⁴ The SupplyCore contract was contract SPE4AX-13-D-9425.

⁴⁵ Breather term cover (NSN 1610-00-628-7131).

⁴⁶ Fluid transfer tube (NSN 1610-00-628-7436).

(FOUO) [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

An acquisition regulation⁴⁷ requires contracting officers to use firm fixed price or fixed price with economic-price-adjustment contracts when they acquire commercial items. According to the regulation, fixed-price with economic-price-adjustment contracts allow increases and decreases in established contract prices based on changes that the contractor experiences in actual labor and material costs.

In the examples of the breather term cover and fluid transfer tube, SupplyCore experienced decreases in material cost. DLA Aviation could have shared in the post-award savings if the contracting officer included an economic price adjustment clause in the contract based on actual material costs. The Director, DLA, should direct the contracting officer to determine whether to insert an economic price adjustment clause in competitive solicitations for supply support that allows for adjustments to unit prices when subcontractor material costs substantially change during the contracts performance period.

Performance Criteria to Pay Incentive Fees Need Improvement

The DLA Aviation contracting officer established inadequate performance criteria to pay incentive fees to UTAS for meeting the minimum performance standards. The incentive terms stated that a 1.5 percent increase would be applied to unit prices when UTAS achieved 98 percent to 98.4 percent of orders delivered within 48 hours. However, the contract terms for the minimum performance standards required UTAS to deliver 98 percent of orders within 48 hours.

⁴⁷ FAR Subpart 16.2 "Fixed-Price Contracts."

An acquisition regulation⁴⁸ states that incentives should only be provided for achievements that exceed the targets and not the minimum performance requirements. The Director, DLA, should direct the contracting officer to modify the UTAS contract to raise the current delivery incentive metric above the minimum performance standard of 98 percent of orders delivered within 48 hours of demand.

Conclusion

DLA Aviation contracting officers' responsibility to determine reasonableness of proposed prices for sole-source items can be a challenge when only a single source exists to supply the Government. This challenge increases when sole-source contractors use their leverage as the single source to deny requests for data or provide insufficient data under the false basis that commercial acquisitions do not require them to substantiate prices as fair and reasonable. However, the acquisition requirement for DLA Aviation contracting officers to purchase supplies and services at fair and reasonable prices still remains. Therefore, contracting officers must proactively and consistently exhaust all of the tools at their disposal efficiently and effectively to protect the Government from overpayments.

Management Comments on the Finding and Our Response

The Director, DLA Acquisition, disagreed with our finding that the contracting officers' efforts to obtain data-other-than-certified cost or pricing data were not effective or efficient. The Director stated that our finding mischaracterized the extensive efforts that DLA contracting officers went through to obtain data-other-than-certified cost or pricing data.

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, stated that the DoD IG has identified issues related to commercial item determinations and commercial item pricing which will benefit DLA and DoD. The Director stated that DLA has been the subject of five published commercial pricing audits since April 2014. Specifically, the Director stated that of the 19 recommendations, DLA agreed with 14 recommendations, partially agreed with 2 recommendations, and disagreed with 3 recommendations. The Director stated that DLA complied with the recommendations by establishing quality assurance processes, providing training to contracting professionals, performed additional internal reviews, and

⁴⁸ FAR Subpart 16.4, "Incentive Contracts."

reviewed contracting officers' performance. Additionally, the Director stated that the Director, Defense Procurement and Acquisition Policy, issued proposed changes to the DFARS to address issues raised by DoD IG regarding commercial item acquisitions.

The Director stated that our report detailed 22 instances where UTAS was nonresponsive or evasive to the contracting officer's request for information to support prices as fair and reasonable. Additionally, the Director stated that the contracting officers properly elevated problems with obtaining data-other-than-certified cost or pricing data to the Head of the Contracting Activity. The Director commended the contracting officers for doing an outstanding job of asking detailed questions about the data, performing price and cost analysis, and negotiating prices. Further, the Director stated that the report finding mischaracterized the extensive efforts that DLA contracting officers went through to obtain cost or pricing data.

Our Response

The Director identified actions taken in response to previous DoD IG audit report recommendations. Our audit focused on material purchases to support the C-130 Hercules aircraft; therefore, we did not validate DLA's implementation of the 16 previous recommendations from other reports.

We agree that DLA contracting officers requested data-other-than-certified cost or pricing data on multiple occasions, and elevated problems, despite UTAS's resistance to provide the information. However, the contracting officers did not take effective and efficient actions because they requested the data after the UTAS proposal was submitted rather than in the solicitation of the proposal. Further, DLA contracting officers did not establish in the solicitation that the submission of specific data-other-than-certified cost or pricing data would be a mandatory requirement for a proposal to be considered. Therefore, UTAS was able to stall in providing the requested data.

Recommendations, Management Comments, and Our Response

Recommendation A.1

We recommend that the Director, Defense Logistics Agency, direct the Head of the Contracting Activity require the contracting officer to:

- a. **Perform appropriate market research, including requesting Government engineering reviews, to determine whether a commercial item determination is appropriate before a solicitation is issued for follow on supply support contracts in accordance with Federal Acquisition Regulation Part 10 and Defense Logistics Agency Directive Subpart 12.1.**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, agreed. The Director stated that DLA will perform market research, including requesting engineering reviews to determine whether a CID is appropriate before a solicitation is issued for the follow-on UTAS contract. However, the Director stated that he did not agree with the audit report's use of commercial sales as a basis for a CID. The Director stated that the neither FAR nor DFARS require a percentage of commercial sales to be used as a basis for CIDs. Further, the Director stated that for the follow-on UTAS contract, DLA will follow the FAR market research and CID policy in place at the time of the solicitation.

Our Response

The Director's comments were responsive and met the intent of the recommendation. No further comments were required.

The Director disagreed with the report's discussion about commercial sales and CIDs. We acknowledge that neither the FAR nor DFARS require a percentage of commercial sales as a basis for CIDs; however, a Defense Pricing memorandum⁴⁹ states that the preference is for contracting officers to use market-based pricing to determine fair and reasonable prices. In the report, we presented the lack of significant commercial sales as an impediment to DLA contracting officers using market-based pricing as the preferred method to determine fair and reasonable prices. Although the Director disagreed with the audit's presentation of commercial sales, his comments remain responsive to the recommendation.

⁴⁹ Director, Defense Pricing memorandum, "Commercial Items and the Determination of Reasonableness of Price for Commercial Items," dated February 4, 2015.

- b. Request field-pricing assistance from DCMA cost-and-pricing analyst for sole-source commercial supply support contracts immediately after it is determined that information is not available or insufficient to determine a fair and reasonable price in accordance with Federal Acquisition Regulation 15.404-2(a).**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, disagreed with the recommendation, stating that the contracting officers requested field pricing assistance from DCMA immediately after they received useable data-other-than-certified cost or pricing data in accordance with the FAR. Additionally, the Director stated that the contracting officers did not have complete data to send to DCMA until November 2013. The Director stated that no further action is required.

Our Response

The Director's comments did not address all specifics of the recommendation. The Director did not address whether contracting officers will be required to request field-pricing assistance for DLA sole-source commercial supply support contracts immediately after it is determined that information is not available or insufficient.

Specifically, the Director stated that the contracting officers requested field pricing assistance from DCMA once they obtained usable data during negotiations for UTAS contract. However, the DLA contracting officers should have requested assistance from DCMA once they determined that the information was either unavailable or insufficient to determine fair and reasonable price in accordance with the FAR⁵⁰. Instead, the DLA contracting officers continued to correspond and request data over 8 months. However, within 2 months of negotiations, UTAS started stalling in providing the requested data. The contracting officer should have immediately requested DCMA field pricing assistance. Therefore, we request the Director provide comments on the final report.

⁵⁰ FAR 15.404-2(a).

- c. **Apply the indirect rates from the most current Defense Contract Management Agency-approved forward-pricing-rate recommendations or forward-pricing-rate agreement when performing cost analysis to evaluate contractor price proposals for sole-source commercial supply support contracts and verify the indirect rates in the final proposal submission are current.**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, disagreed with the recommendation, stating that the contracting officers had gone through 15 months of negotiations prior to UTAS submitting their final proposal on May 8, 2014, and reopening contract negotiations to apply DCMA's updated April 14, 2014, FPRR would not have provided any further benefits. Additionally, the Director stated that the overpayments discussed in the report were offset by underpayments, and the difference of \$128,000 for a 3-year period was nominal. Further, the Director stated that FAR criteria do not direct the contracting office to confirm indirect rates are current for uncertified final cost proposals.

Our Response

The Director's comments partially addressed the recommendation. The Director stated that using the updated DCMA recommended indirect cost rates would not have been beneficial and would have extended the contract negotiation process. However, DLA Aviation did not provide any supporting analysis that it would not have benefited from extending negotiations and using the updated indirect rates. Further, the Director did not address DLA's plan to require contracting officers to use the current FPRA or FPRR indirect rates to evaluate final contractor proposals for future sole-source commercial supply support contracts.

Although the FAR does not require that contracting officers verify indirect rates in the final proposal submission are current when the costs are uncertified, a Director, Defense Pricing memorandum⁵¹ requires contracting officers to use DCMA FPRRs to establish pre-negotiation objectives when FPRAs are not approved. Additionally, the guidance states that contracting officers may deviate from the FPRR when there is a solid reason, but they are expected to discuss the exceptions with DCMA and document the reason in the business clearance or negotiation memorandum. The price negotiation memorandum submitted for our review did not explain why the contracting officer did not use the most current FPRR for the final proposal.

⁵¹ Director, Defense Pricing memorandum, "Forward Pricing Rates," dated November 16, 2011.

Further, the Director, Defense Pricing memorandum requires the contracting officers to use DCMA FPRRs. DLA should obtain reasonable prices for spare parts and/or services; therefore, DLA Aviation should have used the DCMA FPRRs for UTAS, dated April 14, 2014, which were effective immediately and superseded the previous recommendations. Therefore, we request the Director provide comments on the final report.

- d. Perform proper cost analysis to determine price reasonableness by evaluating cost components included in the service fee on the sole-source commercial supply support contracts.**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, disagreed with the recommendation, stating that the analysis performed on this acquisition is aligned with the FAR 15.404-1(b)(v) comparison with independent government cost estimates. The Director stated that the contracting officer properly determined price reasonableness based on the analysis that showed the cost of the government performing the services would be significantly higher when compared with the cost of UTAS performing these same services. The Director stated that no additional action is necessary.

Our Response

The Director's comments did not address the specifics of the recommendation. The Director did not address whether he will direct contracting officers to evaluate proposed service cost components as part of cost analysis when determining a fair and reasonable price in future sole-source commercial supply support contracts. Instead, the Director stated that DLA Aviation contracting officers developed and compared an independent government cost estimate to UTAS's proposed price to determine price reasonableness for the UTAS contract.

Additionally, according to the Director, Defense Procurement and Acquisition Policy Handbook,⁵² an independent government cost estimate is the Government's estimate of the resources and projected cost of the resources a contractor will incur to perform a contract. Further, the Handbook states that the projected contractor costs should include labor, labor overhead, material overhead, other direct costs, general and administrative, and profit. According to a DLA Aviation supply systems analyst, DLA Aviation's independent government cost estimate only included its cost of goods sold for the past 5 years, inventory turn ratio, obsolescence rate, storage rate, and cost of capital. The cost estimate did not

⁵² Director, Defense Procurement and Acquisition Policy, "COR [Contracting Officer Representative] Handbook," March 22, 2012.

include industry cost factors, as described in the Director, Defense Procurement and Acquisition Policy Handbook. Therefore, the DLA Aviation's estimate was not an independent government cost estimate that projected contractor cost. We request the Director provide comments on the final report.

- e. Re-evaluate pricing for Derco-managed priced items before exercising the first option year on the UTAS contract SPE4AX-14-D-9417 until UTAS provides the results of cost or price analyses of Derco prices that would support a fair and reasonable price.**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, disagreed with the recommendation, stating that Derco provided its purchase history to the DLA Aviation contracting officer. He commented that the DLA cost-and-pricing analyst analyzed Derco's prices. Additionally, the Director stated that the contracting officer questioned Derco's quantity range pricing from its suppliers and obtained a lower price. The Director stated that the report cited three examples where Derco obtained a lower price from its suppliers after the contract was awarded, and disagreed that the examples warrant a re-evaluation of Derco-managed items before the first option year. The Director stated that DLA Aviation will follow the price redetermination provisioned in the contract 30 months after the contract award.

Our Response

The Director's comments did not adequately address the specifics of the recommendation. The Director's comments did not address the re-evaluation of subcontractor prices paid by Derco. Additionally, the Director did not comment on having UTAS provide results of cost or price analyses of Derco prices that would support a fair and reasonable price before exercising the first option year on the UTAS contract.

The FAR⁵³ states that contracting officers should consider whether contractors or subcontractors have performed cost or price analysis of proposed subcontractor prices, or has negotiated the subcontract prices before negotiation of the prime contract. Additionally, the FAR⁵⁴ requires prime contractors or subcontractors to conduct appropriate cost or price analyses to establish price reasonableness of subcontract prices and include the results of the analyses in the price proposal. Based on our review of three nonstatistical sampled parts, we determined that DLA Aviation contracting officers did not follow best practices.

⁵³ FAR 15.404-3(a).

⁵⁴ FAR 15.404-3(b).

The re-evaluation of Derco prices would not occur at the price redetermination period outlined in the contract. The price redetermination provision states that the contractor would propose new prices for select parts based on the costs and contractor forward pricing rates in effect at the time of pricing. Therefore, the pricing review would be limited to the UTAS's cost as the prime contractor and the contracting officer would not evaluate Derco's cost as the subcontractor. Also, the contracting officer would inappropriately accept UTAS's actual cost and apply the applicable rates, profits, and escalation factors with the assumption that the price UTAS paid to Derco was fair and reasonable. Therefore, we request the Director provide comments on the final report.

- f. Modify the UTAS contract to raise the current delivery incentive metric above the minimum performance standard of 98 percent of orders delivered within 48 hours of demand.**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, agreed, stating that the delivery incentive metric was increased in a contract modification on July 9, 2015. The Director provided a copy of the contract modification that showed the delivery metric required to earn an incentive fee was increased from 98 percent to 98.1 percent of ordered parts being available within 48 hours.

Our Response

The Director's comments were responsive and met the intent of the recommendation. No further comments were required.

Recommendation A.2

We recommend that the Director, Defense Logistics Agency, direct the Head of the Contracting Activity to require the contracting officer to determine whether to:

- a. Include Federal Acquisition Regulation 52.215-20 Alternate IV clause in solicitations when it is reasonably certain that data-other-than-certified cost or pricing data will be required for the acquisition of commercial items to:**
 - (1) Require contractors to submit data-other-than-certified cost or pricing data to include: commercial sales invoices of the same or similar items, direct wage rates, estimated labor hours, indirect cost rates, subcontractor price quotes and purchase order history, and results of cost or pricing analysis of subcontractor prices at all tiers.**

(2) Require the contractor's submission of the requested data in Federal Acquisition Regulation 52.215-20 Alternate IV clause to be a condition of an acceptable proposal.

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, disagreed with the recommendation. He stated that given UTAS's commercial item contracting policy, which denied requests for data on Government contracts, there was no basis for the DoD IG assumption that UTAS would have provided the data if the DoD IG recommended language was included in the solicitation. Additionally, the Director stated that the FAR⁵⁵ requires contracting officers to obtain the type and quantity of data necessary to establish fair and reasonable prices, but not more data than is necessary. The Director stated that requesting unnecessary data can lead to increased proposal preparation costs, extended acquisition lead times, and consumption of contractor and Government resources.

Our Response

The Director's comments partially addressed the specifics of the recommendation. The Director did not provide details on DLA's procedures for contracting officers to determine whether to include the FAR 52.215-20 Alternate IV clause in solicitations for commercial items when it is reasonably certain that data-other-than-certified cost or pricing data will be required. If the DLA contracting officers would have included FAR 52.215-20 Alternate IV clause in the solicitation for the hub and blade contract, DLA would have expressed a clear expectation for UTAS to provide specific data-other-than-certified cost or pricing data in order for UTAS's proposal to be considered. Additionally, the clear expectation for data in the solicitation could have potentially prevented UTAS from stalling to provide the necessary data and shortened the 17-month negotiation for the hub and blade contract.

We presented, as a best practice, specific types of data that may be requested in a solicitation for commercial items. The recommended types of data include: commercial sales invoices of the same or similar items, direct wage rates, estimated labor hours, indirect cost rates, subcontractor price quotes and purchase order history, and results of cost or pricing analysis of subcontractor prices at all tiers. However, the contracting officers would use professional judgement when including in the solicitation, the types of data being requested from contractors. Therefore, we request the Director provide comments on the final report.

⁵⁵ FAR 15.402(a)(3).

- b. Insert an economic-price-adjustment clause in competitive solicitations for supply support that allows for adjustments to unit prices when subcontractor material costs substantially change during the contract performance period.**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, disagreed with the recommendation. The Director stated that the recommendation follows a discussion of two examples where SupplyCore obtained lower prices from their suppliers after the contract was awarded. The Director stated that the two examples were not significant enough to warrant a requirement for contracting officers to insert an economic price adjustment clause in competitive solicitations.

Our Response

(~~FOUO~~) The Director's comments partially addressed the recommendation. The Director did not provide details on DLA's procedures for contracting officers to determine whether to insert economic price adjustment clauses in competitive solicitations for supply support when subcontractor cost are expected to substantially change during the contract performance period. [REDACTED]

[REDACTED] However, by DLA not establishing a contractual mechanism, DLA is not able to benefit from those reduced prices on the hub and blade contract. We request the Director provide comments on the final report.

Finding B

DLA Aviation Needs Better Support For Price Reasonableness of Noncommercial Spare Parts

DLA Aviation contracting officers did not adequately support fair and reasonable price determinations for C-130 parts purchased on 23 of 26 Lockheed Martin delivery orders related to our nonstatistical sample of 20 spare parts. This occurred because DLA Aviation contracting officers inappropriately:

- performed an analysis that they presented as cost analysis, which did not evaluate proposed cost elements; and
- applied outdated average industry rates.⁵⁶

As a result, DLA Aviation paid increased prices for 18 C-130 spare parts, totaling \$2.5 million, without assurance that the prices were fair and reasonable. Additionally, DLA Aviation will risk overpaying for the same parts if those prices are used to determine future proposed prices fair and reasonable.

⁵⁶ The Navy Price Fighters and DLA Aviation Pricing Office developed the average industry rates, including overhead rates, general and administrative rates, and labor rates.

Price Reasonableness Determinations Lacked Support

The contracting officers determined all of Lockheed Martin's proposed prices reasonable for 18 parts, despite the fact that prices increased from 10 percent to 113.9 percent annually from prior purchases...

DLA Aviation contracting officers did not adequately support determinations of fair and reasonable prices for 23 of 26 Lockheed Martin delivery orders related to our nonstatistical sample of 20 spare parts. DLA Aviation purchased 18 different C-130 parts on these 23 delivery orders. The contracting officers determined all of Lockheed Martin's proposed prices reasonable for 18 parts, despite the fact that prices increased from 10 percent to 113.9 percent annually from prior purchases, as shown in Table 7.

Table 7. Our Price Analysis of 18 Parts Purchased on Lockheed Martin Delivery Orders for Basic Ordering Agreement SPE4A1-13-G-0007

NSN	Unit Price on Delivery Order	Prior Unit Price ¹	Unit Price Increase	Percent Price Increase	Months Elapsed Between Purchases	DoD IG Annualized Percent Price Increase ²	Percent Price Increase Within Last 12 Months
Comparison to Previous Price Obtained More than 12 Months Prior							
4820-01-395-5254	\$13,315.94	\$6,381.59	\$6,934.35	108.7	13	97.2	n/a
1560-00-307-1704	1,081.77	400.00	681.77	170.4	27	55.6	n/a
1560-00-650-9982	781.76	549.87	231.89	42.2	15	32.5	n/a
1560-01-422-0984	41,224.64	3,178.00	38,046.64	1,197.2	110	32.3	n/a
6150-00-652-7770	1,347.40	843.36	504.04	59.8	21	30.7	n/a
1660-00-673-9909	6,344.91	4,151.98	2,192.93	52.8	19	30.7	n/a
6220-01-442-7180	1,230.60	907.97	322.63	35.5	18	22.5	n/a
1560-00-070-6078	511.55	429.13	82.42	19.2	13	17.6	n/a
1560-00-629-3076	5,010.62	3,536.09	1,474.53	41.7	29	15.5	n/a
1560-01-571-4021	7,410.74	5,720.66	1,690.08	29.5	29	11.3	n/a
1560-00-547-2399	25,906.49	22,026.03	3,880.46	17.6	19	10.8	n/a
1560-00-590-0682	1,554.29	765.99	788.30	102.9	84	10.6	n/a
Comparison to Previous Price Obtained in the Last 12 Months							
1560-01-455-0910	1,895.82	886.48	1,009.34	113.9	12	n/a	113.9
3010-01-439-3982	8,654.05	6,500.00	2,154.05	33.1	12	n/a	33.1
1560-01-134-4469	4,734.37	3,803.17	931.20	24.5	8	n/a	24.5
1660-00-545-6972	2,916.85	2,407.15	509.70	21.2	9	n/a	21.2
1680-01-442-8520	3,708.62	3,085.00	623.62	20.2	2	n/a	20.2
1620-00-886-8889	2,544.33	2,312.89	231.44	10.0	6	n/a	10.0

n/a = not applicable

¹ We obtained prior Government unit prices from the Haystacks Gold database, which provides access to current and historical procurement information on parts.

² For unit prices obtained more than 12 months prior, we calculated a compound annualized percent price increase for the part.

Cost Analysis Did Not Evaluate Cost Elements

DLA Aviation contracting officers determined prices fair and reasonable for 23 of 26 delivery orders based on an inappropriate analysis they presented as cost analysis. Specifically, the contracting officers stated in the contract files that the prices were reasonable based on “limited cost data analysis.” An acquisition regulation⁵⁷ states that cost analysis is the evaluation of any separate cost elements and profit in a contractor’s proposal. However, the DLA Aviation contracting officers did not evaluate the proposed cost elements, including overhead, general and administrative, material, and profits. Most significantly, the contracting officers did not evaluate subcontractor material cost, which was the largest cost element of the proposed prices.

The DLA Aviation contracting officers did not evaluate the proposed cost elements, including overhead, general and administrative, material, and profits. ...officers did not evaluate subcontractor material cost, which was the largest cost element of the proposed prices.

(FOUO) For the 23 delivery orders, the material cost represented on average ██████████ of the proposed part prices. However, the contracting officers accepted Lockheed Martin’s material cost and applied an average industry rate and profit to develop a Government estimate. DLA Aviation contracting officers used this inappropriate analysis to determine all Lockheed Martin’s proposed prices were fair and reasonable on 23 delivery orders reviewed.

A DLA Aviation acquisition procedure⁵⁸ establishes cost analysis of an informal cost breakdown as a technique for contracting officers to evaluate proposed prices for price reasonableness. According to the DLA Aviation acquisition procedures, the contracting officer must:

- apply currently approved indirect rates or average industry rates when approved rates are not available;
- evaluate the reasonableness of the contractor’s material and labor hours;
- determine reasonableness of the contractor’s profit; and
- develop a Government negotiation estimate.

⁵⁷ FAR 15.404-1(c), “Proposal analysis.”

⁵⁸ DLA Aviation Acquisition Procedure (DAAP) Part 15, “Contracting by Negotiation.”

(~~FOUO~~) On January 30, 2014, a DLA Aviation contracting officer determined that Lockheed Martin's proposed unit price of \$13,315.94 for 13 valve plugs,⁵⁹ totaling \$173,107, was fair and reasonable based on cost analysis. The \$13,315.94 unit price was an increase of \$6,934.35 (108.7 percent) from the previous unit price of \$6,381.59 paid 12 months earlier on January 26, 2013. At the request of the contracting officer, Lockheed Martin submitted an informal cost breakdown that included material costs, labor costs, overhead costs, general and administrative costs, and profit. However, the contracting officer did not evaluate any of the cost elements included in the cost breakdown. Instead, the contracting officer inappropriately accepted the unsupported Lockheed Martin material cost of [REDACTED], representing [REDACTED] of the proposed price, and applied the average industry rates. The contracting officer developed a Government estimate of \$14,153.42, which made Lockheed Martin's proposed price appear favorable.

(~~FOUO~~) Also, on May 28, 2014, a DLA Aviation contracting officer determined that Lockheed Martin's proposed unit price of \$1,081.77 for 130 lower bracket assemblies,⁶⁰ totaling \$140,630, was fair and reasonable based on cost analysis. The \$1,081.77 unit price was an increase of \$681.77 (170.4 percent) from the previous unit price of \$400 paid on March 1, 2012. The DLA Aviation contracting officer did not use a DLA Aviation engineer's analysis, which calculated that the part should cost DLA Aviation [REDACTED]. Additionally, at the request of the contracting officer, Lockheed Martin submitted an informal cost breakdown. However, the contracting officer did not evaluate the reasonableness of the proposed material cost of [REDACTED], representing [REDACTED] of the proposed price. According to the contract file the contracting officer "accepted material cost as valid," and applied the average industry rates. As a result, the contracting officer calculated an unreliable Government estimate of \$1,173.21, which made Lockheed Martin's proposed price appear favorable.

(~~FOUO~~) Additionally, on June 27, 2014, a DLA Aviation contracting officer determined that Lockheed Martin's proposed unit price of \$1,347.40 for 55 electrical assemblies,⁶¹ totaling \$74,107, was fair and reasonable based on "limited cost data analysis." The \$1,347.40 unit price was an increase of \$504.04 (59.8 percent) from the previous unit price of \$843.36 paid on October 24, 2012. The contracting officer did not request an informal cost breakdown for this delivery order, but instead, obtained the proposed subcontract material cost from Lockheed Martin. The contracting officer did not evaluate the

⁵⁹ Valve Plug (NSN 4820-01-395-5254).

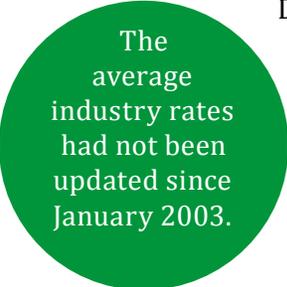
⁶⁰ Lower Bracket Assembly (NSN 1560-00-307-1704).

⁶¹ Electrical Assembly (NSN 6150-00-652-7770).

(FOUO) material cost or request any other data to support the proposed price. Instead, the contracting officer inappropriately accepted the unsupported Lockheed Martin material cost of [REDACTED], representing [REDACTED] of the proposed price, and applied the average industry rates. As a result, the contracting officer calculated a Government estimate of \$1,412.90, which made Lockheed Martin's proposed price appear favorable.

In the examples of the valve plug, lower bracket assembly, and electrical assembly, the contracting officer applied the average industry rates because DCMA-approved rates were not available. However, the DLA Aviation guidance states that use of the average industry rates "does not eliminate the need to determine reasonable material cost, labor hours, and profit rate." For 23 delivery orders, contracting officers did not support the reasonableness of the material cost elements when applying average industry rates to determine if proposed part prices were reasonable. The Director, DLA Aviation should direct contracting officers to obtain sufficient data-other-than-certified cost or pricing data and conduct adequate cost analysis in accordance with the acquisition regulation and DLA Aviation acquisition procedures to support sole-source awards.

Government Estimates Based on Outdated Average Industry Rates



The average industry rates had not been updated since January 2003.

DLA Aviation contracting officers used outdated average industry rates to develop Government estimates when they evaluated the proposed prices from Lockheed Martin. According to a DLA Aviation acquisition procedure,⁶² contracting officers may use the average industry rates if DCMA-approved rates are not available. However, the average industry rates had not been updated since January 2003.

The DLA Aviation cost or pricing officials disagreed with the acquisition procedure that directs contracting officers to use the average industry rates. During a site visit to DLA Aviation in September 2014, the DLA Aviation Pricing Division Chief stated that the pricing office discouraged contracting officers from using the 2003 average industry rates. To address the problem, a cost-and-pricing analyst stated that the pricing office offered training to DLA Aviation contracting officers in June 2014, and encouraged them to request the contractor's actual historical rates when DCMA-approved rates were not available.

⁶² DAAP Part 15.

As of April 2015, the DLA Aviation acquisition procedure did not align with the DLA Aviation pricing office's preference to use actual historical rates when DCMA-approved rates are not available. In an e-mail dated April 21, 2015, the DLA Aviation cost-and-pricing analyst stated, "No new guidance has been issued by Policy, however, the Pricing Division insists on requesting/receiving [3] year actuals from a contractor if DCMA/DCAA {Defense Contract Audit Agency} does not have audited rates." The Director, DLA should revise the DLA Aviation acquisition procedure to require contracting officers to request the contractor's historical indirect rates for the last 3 years to calculate average rates when DCMA-approved rates are not available and apply the historically based average rates to material cost and labor hours, once verified, to develop a Government estimate for proposal analysis.

Conclusion

DLA Aviation paid \$2.5 million for 18 C-130 spare parts that increased in price without assurance that the prices were fair and reasonable. DLA contracting officers based price reasonableness determinations for parts on inappropriate analysis that they presented as cost analysis. DLA Aviation will risk overpaying for the same parts if those prices are used to determine whether future proposed prices are fair and reasonable. An acquisition regulation⁶³ states that when comparing proposed prices to historical prices paid by the Government, the prior price must be a valid basis for comparison. Additionally, the regulation states that if the reasonableness of the prior price is uncertain, the prior price may not be used as a valid basis for comparison.

Recommendation, Management Comments, and Our Response

Recommendation B

We recommend the Director, Defense Logistics Agency, direct the Head of the Contracting Activity to:

- 1. Require contracting officers to obtain sufficient data-other-than-certified cost or pricing data and conduct adequate cost analysis to determine price reasonableness for sole-source spare parts in accordance with Federal Acquisition Regulation Subpart 15.4, "Contract Pricing" and DLA Aviation Acquisition Procedures Part 15, "Contracting by Negotiation."**

⁶³ FAR 15.404-1(b)(2)(ii)(A).

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, agreed. The Director stated that DLA Aviation has conducted training with the Lockheed Martin Integrated Supplier Team, which included specific examples of Lockheed Martin proposals and analysis of material cost, labor hours, indirect rates, and profit.

Our Response

The Director's comments were responsive and met the intent of the recommendation. No further comments were required.

- 2. Revise Defense Logistics Agency Aviation Acquisition Procedure, Part 15 to require contracting officers to:**
 - a. Establish average indirect rates based on the contractor's historical indirect rates for the last 3 years when Defense Contract Management Agency-approved rates are not available.**
 - b. Apply the historically based average rates to material cost and labor hours, once verified, for analysis of proposed prices as fair and reasonable.**

Defense Logistics Agency Comments

The Director, DLA Acquisition, responding for the Director, DLA, partially agreed. The Director stated that DLA Aviation provided training to the Lockheed Martin Integrated Supplier Team on procedures for analyzing and negotiating Lockheed Martin price proposals. Specifically, the Director stated that the training provided step-by-step procedures for extensive reviews of material cost, labor hours, FPRRs, FPRAs, and profit. Additionally, the Director stated that the training extended beyond the report recommendation for revisions to the DLA Aviation Acquisition Procedure, Part 15. Therefore, the Director stated that DLA Aviation Acquisition Procedure, Part 15, does not need to be revised because the training was sufficient to meet the intent of the recommendations.

Our Response

The Director's comments partially addressed the recommendation. According to the Director, the new DLA Aviation training was responsive to the report recommendation to revise the DLA Aviation Acquisition Procedure, Part 15 to require contracting officers to establish average indirect rates based on contractors' historical indirect rates for the last 3 years when DCMA-approved

rates are not available. However, the new DLA Aviation training does not establish a requirement; therefore, the Director did not address whether DLA Aviation Acquisition Procedures, Part 15 will be revised or updated to provide policy based on the recommendation.

We reviewed the revised DLA Aviation training document provided by the Director on August 31, 2015, and it did not provide procedures for contracting officers to analyze indirect rates when FPRRs and FPRAs were unavailable. Additionally, the DLA Aviation Acquisition Procedure is a policy document that, if revised, would require contracting officers to use actual historically based average indirect rates when DCMA-approved rates are not available. Therefore, we request the Director provide comments to the final report.

Appendix A

Scope and Methodology

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

This is the second of two reports on DLA Aviation material purchases that support the C-130. The scope of this report focused on fair and reasonable pricing for C-130 spare parts. The first report addressed whether DLA Aviation cost effectively managed spare-part inventory for the C-130.

Interviews and Documentation

To determine whether prices were justified as fair and reasonable, we met with officials from:

- DLA Aviation, Richmond, Virginia, to obtain the following contract files related to contracts SPEAX-14-D-9417, SPE4AX-13-D-9425, and SPE4A1-13-G-0007:
 - acquisition plan;
 - pre-negotiation memorandums;
 - solicitations;
 - delivery orders; and
 - other contract-related documents from October 2012 to June 2014.
- DCMA at UTAS, Windsor Locks, Connecticut, to obtain DCMA forward-pricing rate recommendations, dated April 14, 2014, and UTAS's 2014 standard material cost; and
- UTAS and SupplyCore to obtain documents or information related to cost and pricing that included:
 - purchase-order history;
 - sales history;
 - overhead;
 - profit rates; and
 - bill of materials.

We reviewed the following guidance on contract pricing.

- FAR;
- DFARS and DFARS-PGI;
- DLA Aviation Acquisition Procedures; and
- Defense Logistics Agency Directive.

Nonstatistical Sample Selection

DLA managed 25,719 spare parts unique to the C-130. From the universe of 25,719 parts, we selected a nonstatistical sample of 40 NSNs purchased on active DLA Aviation contracts that experienced price increases of 10 percent or more from previous purchases. The total demand dollars for the selected 40 NSNs were within the top 80 percent of total DLA Aviation demand dollars for the NSNs unique to the C-130 weapon system. Purchases from three contracts comprised the selected 40 NSNs:

- 20 parts from basic ordering agreement SPE4A1-13-G-0007 awarded to Lockheed Martin;
- 17 parts from contract SPE4AX-14-D-9417 awarded to UTAS; and
- 3 parts from contract SPE4AX-13-D-9425 awarded to SupplyCore.

Commercial Sales Analysis

To determine whether a substantial commercial market existed for our sample of 17 UTAS parts, we compared UTAS sales to the DoD versus their sales to commercial entities. We used historical sales data received from UTAS from January 2012 through September 2014 to perform the analysis. Secondly, we compared DLA Aviation's 2-year estimated requirements on the hub and blade contract to UTAS commercial sales from January 2012 through December 2013. Finally, for the 12 Derco-managed parts that UTAS provided in our sample, we compared DLA Aviation's estimated requirement on the hub and blade contract to Derco's commercial sales from September 2013 through September 2014.

SupplyCore did not sell the three parts in our sample to commercial customers; therefore, we did not perform a commercial sales analysis for those parts.

Cost Analysis

We analyzed the cost on 17 parts and the UTAS service fee. To determine a fair and reasonable price for parts and the service fee, we used the DCMA-approved FPRR, dated April 14, 2014, to apply the following rates to material costs and estimated labor hours:

- base labor, overhead;
- general and administrative; and
- cost of money.

(FOUO) Additionally, we applied to the parts and service fee cost an [REDACTED] profit negotiated between DLA Aviation and UTAS on the hub and blade contract.

For the parts, we applied the indirect rates from the DCMA FPRR and the contract negotiated profit to UTAS's 2014 purchase order prices and 2014 standard material cost for parts that were not purchased by UTAS in 2014. We then compared our calculated part prices to the hub and blade contract prices without the service-fee component to determine whether DLA Aviation overpaid for parts.

(FOUO) For the service fee, we applied the FPRR rates and negotiated profit to the estimated labor hours to calculate a fair and reasonable service fee. We also compared our calculated service fee price to the contract service fee to identify DLA Aviation overpayments. We calculated parts and service-fee overpayments over the 3-year contract base period and total 5-year performance period by applying a [REDACTED] escalation rate compounded annually.

Price Analysis

We performed an analysis of parts purchased on our sample Lockheed Martin basic ordering agreement SPE4A1-13-G-0007 delivery orders to identify changes in price. Specifically, we compared the sampled part prices from the Lockheed Martin delivery orders to previous part prices paid before the award of contract SPE4A1-13-G-0007. We calculated the unit price and percentage difference between the two purchases by dollar amount and percentage. When the period between the two purchases exceeded 12 months, we calculated an annualized percent price increase.

Use of Computer-Processed Data

We used computer-processed data to analyze prices and select our sample of parts. Specifically, we used information from the DLA Office of Operations Research and Resource Analysis (DORRA) to select our nonstatistical sample of parts. DORRA is a database that provides spare-part inventory information such as:

- on-hand inventory;
- requisition history;
- standard unit price; and
- weapon-platform application.

To determine the reliability of DORRA, we compared the historical requisition data in the DORRA report to the corresponding customer order document for selected parts. Based on our evaluation, we determined that DORRA was sufficiently reliable for the purpose of this audit.

Additionally, we used the Haystacks Gold database to obtain Government procurement history and identify the parts that experienced substantial price increases. Haystacks Gold is a parts-and-logistics information-management system that provides access to current and historical procurement information on parts. We used the data extracted from Haystacks to identify three active DLA contracts on which orders were placed for parts with substantial price increases. To determine the reliability of Haystacks, we compared the following procurement data from Haystacks to contract files:

- NSNs;
- dates;
- quantities; and
- unit prices.

Therefore, we determined that the Haystacks Gold database was sufficiently reliable for the purpose of this audit.

Use of Technical Assistance

We consulted with the DoD Office of Inspector General Quantitative Methods Division to determine the nonstatistical audit sample and method to calculate annualized percent price changes for parts purchased on the Lockheed Martin delivery orders.

Appendix B

DLA Aviation Chronology of Negotiations with UTAS

The table below shows the instances where DLA Aviation requested data-other-than-certified cost or pricing data, and UTAS either delayed, denied, or provided insufficient data. We identified 22 instances (italicized in Table) where UTAS was nonresponsive or evasive with DLA Aviation's requests to obtain information to support proposed prices as fair and reasonable. As a result, DLA Aviation took 17 months to award the hub and blade contract SPE4AX-14-D-9417 to UTAS.

Table B. Requests for Data-Other-Than-Certified Cost or Pricing Data

Date	Event Description
December 26, 2012	Hub and blade solicitation issued as commercial acquisition without specification of the type of data-other-than-certified cost or pricing data required.
February 26, 2013	UTAS submitted the proposal.
March 18, 2013	The contracting officer requested commercial sales invoices and informal cost breakdown for 147 NSNs.
April 2, 2013	The contracting officer reduced the population to 113 NSNs because <i>UTAS argued against the requests to provide data for proposed prices that were less than the previous virtual prime vendor contract.</i> UTAS agreed to provide the data by April 5, 2013.
April 5, 2013	<i>UTAS notified the contracting officer that the data-other-than-certified cost or pricing data would be delayed until April 9, 2013.</i>
April 9, 2013	<i>UTAS did not satisfy the request for commercial sales invoices. UTAS e-mailed commercial sales prices for 68 of 113 NSNs without the actual commercial sales invoices.</i> Additionally, UTAS stated that they would provide a certain amount of cost data for the remaining 45 NSNs by April 12, 2013. The contracting officer requested commercial sales invoices for quantities similar to the Government annual demand quantities.
April 10, 2013	During a phone conversation, <i>UTAS requested a reduction in the amount of commercial invoices requested.</i> The contracting officer requested UTAS's commercial pricing methodology before considering any reductions in the number of commercial invoices requested.
April 11, 2013	The contracting officer reiterated to UTAS that if UTAS could not significantly improve proposed prices closer to the Government objectives, then commercial sales data or data-other-than-certified cost or pricing data would be needed to substantiate the fair and reasonable prices for parts beyond the 113 NSNs in which cost data had already been requested.

Table B. Requests for Data-Other-Than-Certified Cost or Pricing Data (cont'd)

Date	Event Description
April 18, 2013	<i>UTAS officials stated that they are not required to provide data for any parts since the contract was solicited as a commercial acquisition. The contracting officer stated that commercial sales or informal cost data must be submitted in order to support material pricing as fair and reasonable. Also, the contracting officer warned that if acquisition milestones are adversely affected by the lack of sufficient data provided, then the problem would be elevated to DLA Aviation command. UTAS stated that the commercial invoices for 68 NSNs would be submitted by April 19, 2013, and data-other-than-certified cost or pricing data for 45 NSNs by April 23, 2013.</i>
April 22, 2013	<i>UTAS submitted cost data. The contracting officer forwarded the data to DLA Aviation cost or pricing analyst, but the data was incomplete. Commercial sales invoices did not reflect the Government's annual demand quantities and data-other-than-certified cost or pricing data did not breakdown material, indirect cost, and profits.</i>
April 24, 2013	The DLA Aviation cost-and-pricing analyst determined that the data was useless because unit price breakdowns were not provided and the NSNs did not match the part numbers. The contracting officer e-mailed UTAS that the data was insufficient because unit price breakdown of material cost, indirect cost, and profits were needed. Additionally, the contracting officer expressed concerns with meeting acquisition milestones and contract award date.
April 26, 2013	The contracting officer notified UTAS that commercial sales invoice quantities did not reflect quantities comparable to the Government's estimated annual demand quantities. The contracting officer requested a summary of commercial sales over a year. If commercial invoices could not be provided, then cost data was requested. Also, the contracting officer notified UTAS that the commercial acquisition solicitation did not limit the Government's requirement to obtain data-other-than-certified cost or pricing data. Finally, the contracting officer requested cost breakdown for service fees, including labor categories and labor rates, labor hours, indirect rates, and profits.
April 30, 2013	<i>UTAS stated that the Government should be able to derive the cost of all parts based on the amount of data that they already provided and application of DCMA forward-pricing rate recommendations from November 30, 2012. The DLA Aviation cost-or-pricing analyst reluctantly agreed to replicate the pricing model based on the limited cost data provided by UTAS and the forward-pricing rate recommendations.</i>
May 2, 2013	UTAS stated that the cost breakdown of the service fee would be submitted by May 3, 2013.
May 3, 2013	The contracting officer updated the Chief of the Contracting Office that, to date, <i>UTAS provided data on 82 of 113 NSNs.</i> The contracting officer e-mailed a request to UTAS for an update on the April 26, 2013, request for summary screenshots of commercial sales or additional invoices with comparable quantities to the Government annual demand quantities.
May 6, 2013	<i>The contracting officer received sales data for 110 of 113 NSNs.</i>

Table B. Requests for Data-Other-Than-Certified Cost or Pricing Data (cont'd)

Date	Event Description
May 10, 2013	The contracting officer notified UTAS that based on the data provided by UTAS, the contracting officer estimated UTAS profit between 12 percent and 389 percent. Therefore, the contracting officer informed UTAS to either reduce material profit to 10 percent or provide additional cost data, (for example, material costs, and Derco's overheads and profits) to challenge the contracting officer's analysis. Additionally, the contracting officer notified UTAS that his analyses identified that UTAS used lower price-break quantities when higher price-break quantities were in line with the Government's annual demand quantities. The contracting officer requested a teleconference to address profit and additional data requirement concerns.
May 13, 2013	DLA Aviation and UTAS held a teleconference to discuss profit and application of indirect rates. The contracting officer explained DLA Aviation's challenges with estimating UTAS cost without sufficient data. <i>According to the contracting officer, UTAS indicated that the Government should be able to replicate their cost model with the data provided and suggested DLA was lazy and didn't want to do the work.</i> UTAS notified the contracting officer that incorrect indirect rates were used for the analysis and indicated that they would clarify the rates.
May 15, 2013	The contracting officer requested a forward-pricing-rate proposal from UTAS.
May 17, 2013	The contracting officer e-mailed UTAS the following open-action items from previous requests: 1) commercial sales invoices; 2) service-fee cost breakdown; and 3) forward-pricing-rates proposal with applicable rates highlighted.
May 20, 2013	UTAS identified applicable rates used from the forward-pricing-rate proposal.
May 21, 2013	<i>The contracting officer e-mailed UTAS that no responses were provided beyond the rate request in the May 17, 2013, e-mail.</i>
May 29, 2013	UTAS e-mailed generic labor-hour information. The contracting officer requested clarification on what labor categories and rates to apply to the labor hours.
May 31, 2013	UTAS provided annual commercial sales quantities for Derco parts. UTAS stated that the parts are not quantity-sensitive; therefore the quantity sold did not cause the price to fluctuate. <i>UTAS stated that Derco could not provide an annual sales snapshot. The contracting officer requested the status of the labor rate request from May 29, 2013.</i> UTAS responded in an e-mail with the labor-rate categories.
June 1, 2013 – June 18, 2013	Cost or price data was not discussed during this period from either the contracting officer or UTAS. DLA Aviation contracting officials agreed to focus on the set-aside contract negotiations.
June 19, 2013	The contracting officer notified UTAS that the invoices for 70 NSNs were not sufficient to determine price reasonableness because the quantities sold were not comparable to the Government quantities. The contracting officer requested that the following be provided for each NSN by July 3, 2013: 1) total sales for each part for the past 3 years with identification of the Government's percentage of the market; 2) lowest price paid in the past 3 years; and 3) largest quantity sold in the past 3 years.

Table B. Requests for Data-Other-Than-Certified Cost or Pricing Data (cont'd)

Date	Event Description
July 2, 2013	The contracting officer e-mailed the entire population of outstanding NSNs that required substantiating cost data to UTAS. For any of the 70 NSNs that have not been sold commercially, the contracting officer requested that UTAS provide the following by July 19, 2013: 1) material cost build-up and labor hours and rates, if applicable for make parts; and 2) summary of all quotes received, to include vendor name, date, quantity breaks, prices, and any special terms and conditions.
July 19, 2013	UTAS e-mailed the contracting officer that UTAS provided cost data for any part where cost data was justified by a commercial invoice or price list and had a selling price higher than \$500. UTAS stated that they did not provide cost data for the remaining parts because UTAS previously provided supporting documentation, such as 80 percent of the bill of materials, long-term agreements, or purchase orders. <i>UTAS stated that they would provide supporting documentation for the cost data for a sample of parts, but will not provide it for the entire list.</i>
August 1, 2013	The contracting officer notified UTAS that substantiated cost data was never provided. <i>UTAS argued that they had provided more data under the solicitation than ever for a commercial acquisition and would not provide any further cost data for the outstanding NSNs.</i> The contracting officer noted that the problem would have to be elevated. Also, the contracting officer notified UTAS that for Derco-managed parts the contracting officer would request 3 years of commercial sales history directly from Derco.
August 6, 2013	<i>UTAS notified the contracting officer that UTAS did not authorize direct communication with Derco and the requested sales history was irrelevant to assessing cost data.</i>
August 15, 2013	The matter regarding UTAS's unwillingness to support material-cost data was elevated to the Chief of the Contracting Office. During a teleconference, <i>UTAS management stated that compiling vendor quotes, long-term agreements, and bill of materials for the outstanding NSNs was too time-consuming and didn't agree that the level of effort was necessary.</i>
August 19, 2013	The problem was further elevated to DLA Aviation Head of Contracting Activity. UTAS officials agreed to see what they could provide to support material cost. The contracting officer provided UTAS with a population of 386 outstanding NSNs with proposed prices that were 100 percent more than the Government target price.
August 29, 2013	The contracting officer later notified UTAS that 115 NSNs were removed due to low demand, which left 512 outstanding NSNs that required cost data. The contracting officer requested an update from UTAS on the cost-data-collection proposal that UTAS agreed to provide DLA Aviation from the Head of Contracting Activity meeting on August 19, 2013. UTAS stated that the UTAS team was still working on the data-collection proposal and would advise of progress in the next couple of days.
September 3, 2013	The contracting officer notified UTAS that seven additional NSNs were removed from the outstanding population, which left 505 outstanding NSNs requiring cost data.
September 10, 2013	The contracting officer requested the status of UTAS's cost-data-collection proposal.

Table B. Requests for Data-Other-Than-Certified Cost or Pricing Data (cont'd)

Date	Event Description
September 11, 2013	UTAS management proposed to the Head of Contracting Activity that DLA Aviation reduce the universe of parts that require cost data to NSNs that would make the greatest impact to the future of the program. UTAS management promised the details of the proposal to be submitted by September 13, 2013.
September 15, 2013	<i>UTAS management proposed that the universe of parts that required costs data be reduced from 505 NSNs to 25 NSNs.</i>
September 16, 2013	The Head of Contracting Activity notified UTAS management that 134 NSNs represented cost drivers (80 percent) and full details on 25 NSNs could not substantiate price increases on the 505 outstanding NSNs. The Head of Contracting Activity stated that the problem may need to be elevated to the DLA Aviation Commander or DLA Director.
September 18, 2013	The Head of Contracting Activity notified UTAS management that a DLA Aviation team would not visit the UTAS facility unless UTAS would commit to provide the team with access to detailed cost data to substantiate material, labor, and service-fee costs.
September 19, 2013	UTAS management notified the Head of Contracting Activity that UTAS was willing to provide all of the data it could to support the effort, but UTAS was challenged by diminishing part-manufacturing sources for the legacy C-130 aircraft. This limited the ability for UTAS to obtain material cost data for the universe of proposed NSNs. Further, UTAS stated that its interpretation of the solicitation did not cause them to gather such a vast amount of cost data. The Head of Contracting Activity was not satisfied with the UTAS response and warned that he may have to schedule a meeting with DLA Aviation, UTAS, and the Air Force to explain to the Air Force that UTAS's lack of cooperation caused the committed contract date to slip.
September 20, 2013	The contracting officer, with the Head of Contracting Activity's approval, notified UTAS that DLA Aviation would agree to UTAS's proposal to reduce the amount of NSNs to a sample selected by the contracting officer.
September 23, 2013	The contracting officer e-mailed UTAS with the selected sample of the top 87.5 percent cost-driver NSNs. The contracting officer requested vendor quotes (with competing quotes noted), long-term agreements, and purchase-order history on all NSNs where commercial invoices were previously provided. For the 80 percent bill of material items, the contracting officer requested the basis of estimate for labor hours. The contracting officer reduced the population of outstanding NSNs with significant material price increases to a sample of 70 NSNs under the condition that UTAS could demonstrate a pattern for increases among NSNs with common suppliers.
October 10, 2013	DLA Aviation received the requested cost data from UTAS.
October 18, 2013	<i>DLA Aviation held a teleconference with UTAS to explain that the data (vendor quotes, long-term agreements, and bill of material) did not support how UTAS determined that subcontractor prices were reasonable. UTAS officials stated that they did not have that type of information and the data previously provided was beyond what they would normally provide under a commercial acquisition.</i>
November 4, 2013	<i>The contracting officer sent a follow-up e-mail regarding the status of his previous request about UTAS's basis for the inventory carrying cost being 15 percent of the estimated annual inventory value.</i>

Table B. Requests for Data-Other-Than-Certified Cost or Pricing Data (cont'd)

Date	Event Description
November 6, 2013	UTAS responded that 15 percent of the estimated inventory value for the inventory carrying cost is the same as what was used on the existing virtual prime vendor contract.
November 7, 2013	<i>The contracting officer e-mailed UTAS that additional support was needed to support the 15 percent inventory carrying cost beyond the percentage being the same percentage charged in the existing contract.</i>
February 4, 2014	The contracting officer requested material cost data for the sampled buy parts and labor data for make parts.
February 5, 2014	<i>The contracting officer sent a follow-up e-mail to UTAS for the request of material cost and labor data.</i>
May 30, 2014	Contract awarded.

Appendix C

Prior Coverage

During the last 5 years, the Department of Defense Inspector General (DoD IG) issued 13 reports related to fair and reasonable prices within the DoD. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

DoD IG

DoDIG Report No. DODIG-2015-103, "Summary of DoD Office of Inspector General Spare-Parts Pricing Audits: Additional Guidance is Needed," March 31, 2015

DoDIG Report No. DODIG-2015-053, "Naval Supply Systems Command Needs to Improve Cost Effectiveness of Purchases for the Phalanx Close-In Weapon System," December 19, 2014

DoDIG Report No. DODIG-2014-110, "Onitic Engineering and Manufacturing Overcharged the Defense Logistics Agency for Sole-Source Spare Parts," wSeptember 15, 2014

DoDIG Report No. DODIG-2014-106, "Military Sealift Command Oversight of Excess Spare-Parts Inventory and Purchases for Sealift Program Roll-On/Roll-Off Ships Needs Improvement," September 9, 2014

DoDIG Report No. DODIG-2014-088, "Defense Logistics Agency Aviation Potentially Overpaid Bell Helicopter for Sole-Source Commercial Spare Parts," July 3, 2014

DoDIG Report No. DODIG-2014-064, "Improved Management Needed for the F/A-18 Engine Performance-Based Logistics Contracts," April 25, 2014

DoDIG Report No. DODIG-2014-054, "Defense Logistics Agency Land and Maritime Paid Too Much for High Mobility Multipurpose Wheeled Vehicle Repair Parts," April 4, 2014

DoDIG Report No. DODIG-2014-038, "Air Force Life Cycle Management Center Could Not Identify Actual Cost of F119 Engine Spare Parts Purchased From Pratt and Whitney," February 10, 2014

DoDIG Report No. DODIG-2014-020, "U.S. Army Contracting Command Did Not Obtain Fair and Reasonable Prices for Communications Equipment," December 5, 2013

DoDIG Report No. DODIG-2013-090, "Improved Guidance Needed to Obtain Fair and Reasonable Prices for Sole-Source Spare Parts Procured by the Defense Logistics Agency (DLA) From the Boeing Company," June 7, 2013

DoDIG Report No. D-2011-104, "Prices and Escalation Issues Weaken the Effectiveness of the Army Contract with Sikorsky to Support the Corpus Christi Army Depot," September 8, 2011

DoDIG Report No. D-2011-061, "Excess Inventory, and Contract Pricing Problems Jeopardize the Army Contract with Boeing to Support the Corpus Christi Army Depot," May 3, 2011

DoDIG Report No. D-2011-042, "Lean Six Sigma Project - Defense Logistics Agency/Honeywell Long-Term Contract Model Using One-Pass Pricing for Sole-Source Spare Parts," February 18, 2011

Management Comments

Defense Logistics Agency Comments



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

AUG 31 2015

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE INSPECTOR GENERAL

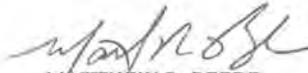
SUBJECT: Response to DoD IG Draft Report "Improvements Needed in the Defense Logistics Agency's Evaluation of Fair and Reasonable Prices for C-130 Aircraft Spare Parts" (Project No. D2015-D000AH-0057.000)

DLA has been the subject of five commercial pricing audits published since April 2014. The DoD IG has identified issues relating to commercial item determinations and commercial item pricing which will benefit DLA and the Department. Of the 19 recommendations in the five audits, DLA concurred on 14, partially concurred on two and non-concurred on only 3 recommendations. To comply with the recommendations, DLA established quality assurance processes, provided training to our 1102s, performed additional internal reviews, and reviewed contracting officers' performance. Additionally, DPAP issued proposed changes in DFARS language to address issues raised by DOD IG regarding commercial item acquisitions.

I am concerned with Finding A "DLA Aviation Overpaid for Commercial Spare Parts and Services." DLA's contracting officers put a remarkable amount of work into obtaining data-other-than-cost-and-pricing data from United Technologies Aerospace Systems (UTAS). The contracting officers properly elevated the issue to the Head of the Contracting Activity on several occasions. DLA Aviation provided extensive documentation to the audit team supporting these efforts as well as documentation supporting their analysis. Your report details these efforts with respect to "22 instances where UTAS was nonresponsive or evasive with DLA Aviation's request to obtain information to support proposed prices as fair and reasonable." However, the report finding that DLA's "Efforts to Obtain Cost or Pricing Data Were Not Effective or Efficient" mischaracterizes the extensive efforts DLA went through to obtain cost or pricing data.

When the contracting officers obtained the data, they did an outstanding job of asking detailed questions of the data, performing price and cost analysis, and negotiating each of the issues contained in Recommendations A.1 and A.2., i.e. forward pricing rates, service fees, material and labor rates, Derco-managed items and incentive metrics. The basis of price reasonableness for each area is thoroughly documented in the Final Price Negotiation Memorandum.

Attached is the DLA's response to the subject Draft Report. We appreciate the opportunity to review and comment on the finding and recommendations. The point of contact for this audit is [REDACTED] DLA Office of the Inspector General, [REDACTED] email: [REDACTED]


MATTHEW R. BEEBE
Director, DLA Acquisition

Attachment:
As stated

Defense Logistics Agency Comments (cont'd)

2

Recommendation A.1: The Department of Defense Inspector General recommends that the Director, Defense Logistics Agency (DLA), direct the Head of the Contracting Activity require the contracting officer to:

Recommendation A.1.a: Perform appropriate market research, including requesting Government engineering reviews, to determine whether a commercial item determination is appropriate before a solicitation is issued for follow on supply support contracts in accordance with Federal Acquisition Regulation (FAR) and Defense Logistics Agency Directive (DLAD) Subpart 12.1.

DLA Response A.1.a: Concur. DLA will perform appropriate market research, including requesting Government engineering reviews, to determine whether a commercial item determination is appropriate before a solicitation is issued for the follow on UTAS contract. However, DLA does not agree with the auditor's use of commercial sales as the basis of commercial item determination. As DLA stated in prior commercial spare part audits, there is currently no percentage of commercial sales requirements in the FAR or DFAR to use as a basis of commercial item determinations. For the follow-on contract, DLA will follow FAR market research and commercial item determinations that are in place at the time of the solicitation.

Recommendation A.1.b: Request field-pricing assistance from Defense Contract Management Agency (DCMA) cost-and-pricing analyst for sole-source commercial supply support contracts immediately after it is determined that information is not available or insufficient to determine a fair and reasonable price in accordance with FAR 15.404-2(a).

DLA Response A.1.b: Non-concur. The discussion under the heading "Requests for DCMA Cost or Pricing Support Were Too Late" does not accurately reflect two important points. First, the auditors' statements give the impression that the contracting officer had complete and useable data when UTAS submitted their proposal in February 2013 and did nothing until October 25, 2013. That is misleading. Appendix B of the draft report states, "UTAS delayed, denied or provided insufficient data." Further, it is noted the DoD IG, "identified 22 instances where UTAS was nonresponsive or evasive with DLA Aviation's request." Therefore, the contracting officers did not have complete data to send to DCMA until November 2013. Second, the auditors state a "DCMA cost and price analyst had access to UTAS's business systems." The auditors fail to mention that for commercial acquisitions the analyst must obtain permission from UTAS to access their system that contains cost/pricing data. The contracting officers requested field pricing assistance from DCMA immediately after they received a useable data-other-cost-and-pricing data in accordance with FAR 15.404-2(a), therefore no further action is required.

Recommendation A.1.c: Apply the indirect rates from the most current DCMA-approved forward-pricing-rate recommendations (FPRR) or forward-pricing-rate-agreement (FPRA) when performing cost analysis to evaluate contractor price proposals for sole-source commercial supply support contracts and verify the indirect rates in the final proposal submission are current.

DLA Response A.1.c: Non-concur. As stated on page 18 of the Draft Report, UTAS submitted their final proposal on May 8, 2014. DCMA provided updated FPRR on April 14, 2014. The contracting officers had completed 15 months of requests and negotiations with UTAS, including negotiating rates. To restart negotiations on updated recommended rates would have provided no

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Defense Logistics Agency Comments (cont'd)

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benefit. From the auditors own calculations using the 2014 recommended rates, any potential overpayments are offset by underpayments, the difference is a nominal \$128,000 for three years. Additionally, there is no FAR requirement that the contracting office verify indirect rates in the final proposal submission are current, as the costs are not certified.

Recommendation A.1.d: Perform proper cost analysis to determine price reasonableness by evaluating cost components included in the service fee on the sole-source commercial supply support contracts.

DLA Response A.1.d: Non-concur. The analysis performed on this acquisition closely aligns with FAR 15.404-1(b)(v), comparison with independent government cost estimates. Price reasonableness was properly determined based on analysis that showed the cost of the government performing the services would be significantly higher when compared with the cost of UTAS performing these same services. Therefore, proper analysis was performed and no additional action is necessary.

Recommendation A.1.e: Re-evaluate pricing for Derco-managed items before exercising the first option year on the United Technologies Aerospace System (UTAS) contract SPE4AX-14-D-9417 until UTAS provides the results of cost or price analyses of Derco prices that would support a fair and reasonable price.

DLA Response A.1.e: Non-concur. The Draft Report states the DLA "accepted material base prices paid by Derco without adequate justification that the prices were fair and reasonable." DLA does not agree with this statement. The Final Price Negotiation Memorandum documents the fact that Derco provided their purchase history to the contracting officer, the DLA Cost & Pricing analysts performed an analysis and the contracting officer questioned Derco's range pricing from their supplier and obtained lower prices. The Draft Report cites three examples of instances where Derco obtained lower prices from their suppliers after contract award and bases this recommendation on those three examples. DLA disagrees that these examples warrant a re-evaluation of Derco managed items prior to the first option year. DLA will follow the process outlined in the contract for the price redetermination process at 30 months after award.

Recommendation A.1.f: Modify the UTAS contract to raise the current delivery incentive metric above the minimum performance standard of 98 percent of orders delivered within 48 hours of demand.

DLA Response A.1.f: Concur. This was accomplished with Modification P00032, dated July 9, 2015.

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Recommendation A.2: The Department of Defense Inspector General recommends that the Director, Defense Logistics Agency (DLA), direct the Head of the Contracting Activity to require the contracting officer to determine whether to:

Recommendation A.2.a: Include FAR 52.215-20 Alternate IV clause in solicitations when it is reasonably certain that data-other-than-certified cost or pricing data will be required for the acquisition of commercial items to:

- (1) Require contractors to submit data-other-than-certified cost or pricing data to include: commercial sales invoices of the same or similar items, direct wage rates, estimated labor hours, indirect cost rates, estimated labor hours, indirect cost rates, subcontractor price quotes and purchase order history, and results of cost or pricing analysis of subcontractor prices at all tiers.
- (2) Require the contractor's submission of the requested data in FAR 52.215-20 Alternate IV clause to be a condition of an acceptable proposal.

DLA Response A.2.a (1) and (2): Non-concur. These recommendations follow the discussion on DLA's numerous and prolonged requests to UTAS for data-other-than-certified cost or pricing data. The Draft Report states "UTAS officials' efforts delaying or denying the requested data were consistent with UTAS's commercial item contracting policy for Government contracts." Therefore, there is no basis for the DoD IG's assumption that UTAS would have provided the data if the above language was included in the solicitation.

Moreover, FAR 15.402(a)(3) states "Contracting officers shall obtain the type and quantity of data necessary to establish a fair and reasonable price, but not more data than is necessary. Requesting unnecessary data can lead to increased proposal preparation costs, generally extend acquisition lead time, and consume additional contractor and Government resources." The requirement for contractors to submit "direct wage rates, estimated labor hours, indirect cost rates, estimated labor hours, indirect cost rates" for every acquisition of commercial items is in conflict with this section of the FAR. Therefore DLA also non-concurs with requiring submission of that same data as a condition of an acceptable proposal.

Recommendation A.2.b: Insert an economic-price-adjustment (EPA) clause in competitive solicitations for supply support that allows for adjustments to unit prices when subcontractor cost substantially change during the contract performance period.

DLA Response A.2.b: Non-concur. This recommendation follows a discussion of two examples where SupplyCore obtained lower prices from their supplier after contract award. DLA does not agree that the cited examples are significant enough to warrant a requirement for contracting officers to insert (EPA) clause in competitive solicitations.

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Defense Logistics Agency Comments (cont'd)

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Recommendation B: The Department of Defense Inspector General recommends that the Director, Defense Logistics Agency (DLA), direct the Head of the Contracting Activity to:

Recommendation B.1: Require contracting officers to obtain sufficient data-other-than-certified cost or pricing data and conduct adequate cost analysis to determine price reasonableness for sole-source spare parts in accordance with FAR 15.4 "Contract Pricing" and DLA Aviation Acquisition Procedures Part 15, "Contracting by Negotiation."

Recommendation B.2: Revise DLA Aviation Acquisition Procedure, Part 15 to require contracting officers to:

- a. Establish average indirect rates based on the contractor's historical indirect rates for the last 3 years when Defense Contract Management Agency-approved rates are not available.
- b. Apply the historically based average rates to material cost and labor hours, once verified for analysis of proposed prices as fair and reasonable.

DLA Response Recommendation B.1, B.2.a and B.2.b: Partially-concur. The finding and associated recommendations relate to specific purchases by the Lockheed Martin Integrated Supplier Team (IST) at DLA Aviation. With respect to recommendation B.1, DLA agrees that the contracting officers in the Lockheed Martin IST did not request sufficient data-other-than-certified cost or pricing data and did not conduct adequate cost analysis to determine price reasonableness. With respect to B.2, DLA Aviation has conducted training with the Lockheed Martin IST. The training was quite extensive in reviewing material cost, labor hours, FPRR, FPRA and profit. The training provided specific examples of Lockheed Martin proposals, step-by-step analysis of the proposals and negotiation tips. The training went beyond the IG recommendation for revisions to DLA Aviation Acquisition Procedure (AP), Part 15. DLA requests the DoD IG consider this training as responsive to the recommendations, in lieu of revising the DLA Aviation AP, Part 15.

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Acronyms and Abbreviations

CID	Commercial Item Determination
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation
DLA	Defense Logistics Agency
DORRA	DLA Office of Operations Research and Resource Analysis
FAR	Federal Acquisition Regulation
FPRR	Forward Pricing Rate Recommendations
NSN	National Stock Number
PGI	Procurement, Guidance, and Information
UTAS	United Technologies Aerospace System
VPV	Virtual Prime Vendor
WR-ALC	Warner Robins Air Logistics Center

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