

Appendix A

Commercial Spare Parts Purchased on a Corporate Contract, Office of the Inspector General, Department of Defense, Report No. 99-026, January 13, 1999

Page 12 shows how the “NSNs” (National Stock Numbers) specifying the items in question are blacked out – the taxpayer who bought the items doesn’t get to see what he or she was overcharged for.

Prices for Commercial Spare Parts

Analysis of DoD Allied Commercial Prices. For the items reviewed, DLA supply centers paid higher prices for commercial spare parts on the Allied corporate contract when compared to previous noncommercial prices for the same items. The supply centers then failed to effectively implement the intended buying and inventory management practices designed to offset the higher commercial prices. When only the price of the items was considered, DLA paid Allied "commercial" prices for spare parts that were \$5.5 million (54.5 percent) higher than previous DoD "noncommercial" prices for the same items. See Appendix A, methodology, for explanation of cost impact analysis.

Table 1 details commercial versus noncommercial prices. The supply centers began using the contract for commercial items in February 1996, comparative prices for noncommercial items were from orders placed any time between October 1, 1990 and prior to the issuance of the order for commercial items (except for those orders identified as "Old Data," prior to October 1, 1990).

Table 1. DoD Allied Commercial Prices Were Higher Than Previous DoD Noncommercial Prices

Basis for Price Reasonableness of Noncommercial Price	Number of NSNs	DoD Allied Commercial Prices		Noncommercial Prices		Total Price Increase	Percent Increase
		Total	Total (1998 dollars)	Total (1998 dollars)	Total Price Increase		
Price Analysis	91	\$3,308,951	\$3,414,258	\$2,168,278	\$1,245,980	57.5	
Cost Based	68	3,917,463	4,043,213	2,836,071	1,207,142	42.6	
Breakout	43	844,945	870,151	545,921	324,230	59.4	
Surplus and Dealers	32	306,868	316,662	224,277	92,385	41.2	
Files not available	114	4,525,612	4,646,935	3,061,732	1,585,203	51.8	
Old Data (prior to Oct. 1, 1990)	70	2,325,453	2,381,992	1,306,870	1,075,122	82.3	
Total	418	\$15,229,292	\$15,673,211	\$10,143,149	\$5,530,062	54.5	

Buying Commercial Spare Parts

When the data in Table 1 is sorted by fiscal year, the DoD Allied commercial items procured in FY 1997 show a higher percent increase (60.1 percent) than those procured in FY 1996 (45.8 percent). This 14.3 percent increase is cause for concern and could impact the reasonableness of the DoD Allied commercial prices and the method of support (DVD versus stock) if the trend continues. Market research performed by DCMC for corporate contract SPO700-98-D-9701 showed that many private companies made their purchase decisions based on forecasted demand and production lead time, similar to the Government (when purchasing items for stock not DVD). These companies purchased economic order quantities because the company's experience has been that the value of the inventory increased at a much higher rate than the cost of storage; namely, the value of the parts increases frequently at up to 10 percent annually, while the cost of stocking the parts is less than that.

Table 2 shows a higher percent increase for commercial items purchased in FY 1997 than commercial items purchased in FY 1996. This table reflects data from 70.4 percent of the total FY 1996 delivery orders and 55.3 percent of the total FY 1997 delivery orders.

Fiscal Year	Number of NSNs	DoD Allied Commercial Prices		Noncommercial Prices		Total Price Increase	Percent Increase
		Total	Total (1998 dollars)	Total	Total (1998 dollars)		
1996	154	\$5,548,193	\$5,777,922	\$3,961,604	\$1,816,318	45.8	
1997	264	9,681,099	9,895,289	6,181,545	3,713,744	60.1	
Total	418	\$15,229,292	\$15,673,211	\$10,143,149	\$5,530,062	54.5	

Buying Practices for Commercial Spare Parts

Implementing Effective Buying Practices. DSCC, DSCR, and DISC failed to effectively implement the intended buying practices for commercial spare parts on the contract with Allied. Although the intent of the contract was appropriate, the intended buying and inventory management practices were not implemented because the supply centers failed to:

- remove breakout items and other Allied spare parts with significant price increases from the contract;
- determine whether the contract delivery times would support customer requirements without stocking items;
- implement procedures to use direct vendor delivery (DVD); and
- provide Allied with reasonably accurate demand forecasting, coordinate proposed commercial product improvements with the item managers, users, and engineering support activities, and establish metrics to monitor Allied's performance on the contract.

Intended Use of the Contract. DISC was the supply center responsible for awarding the contract which was designed to include only those items that were "sole source" to Allied. The contract prices were negotiated with Allied at a discount from the Allied commercial catalog (DoD Allied commercial prices). As part of the justification for the contract, DISC included production lead-time savings (PLT) associated with Allied maintaining and distributing inventory. Reducing PLT generates cost savings by allowing DoD to carry less inventory. It was intended that 95 percent of the contract would be implemented using DVD procedures so that the parts would be shipped directly from Allied to the DLA customers (or users). DISC calculated that this PLT/DVD savings ranged from 20 to 40 percent of the item acquisition cost. Allied calculated the minimum PLT/DVD saving to be █████ percent of the acquisition cost (Appendix C). The PLT/DVD savings were a major factor in the DISC contracting officer's determination that the contract constituted a best value to the Government when price, quality, and delivery were considered. Both Allied and DLA determined that the trade-off in paying higher catalog prices was justified by lower costs to manage, stock, and deliver the parts. In addition, two of the DoD Functional Area Reform Goals determined in the Government Performance and Results Act (GPRA) are reducing average order to receipt time by 50 percent and reducing supply inventory by \$12 billion. The contract with Allied, properly executed, would help achieve these reform goals.

Breakout Items and Prices for Other Allied Spare Parts

Spare Parts Breakout. Although the contract was intended only for the purchase of sole-source Allied spare parts (parts that Allied controls the technical data rights to), the supply centers used the contract to procure items that could have been procured from the actual manufacturers at lower prices. Table 1 shows 43 of the 418 NSNs reviewed that are not sole-source Allied parts and which can be procured from the actual manufacturers at significantly lower prices. DLA supply centers need to determine which items on the contract are not sole-source Allied parts and procure those items from the actual manufacturers when that is determined to be the best value for DoD and its customers.

Buying Commercial Spare Parts

During the audit, DISC took corrective action to remove breakout items from the contract. (These items are not included in Table 1.) Although these items are being stocked by DLA, the savings associated with procuring the parts from the actual manufacturers and stocking them appears to be the best value for DoD and DLA customers.

Table 3 shows parts that DISC procured from Allied on the contract; items that before the contract were, and are again, being procured from the actual manufacturers at significantly lower prices. For the 10 different NSNs, DISC saved 141 percent by breaking out the items and purchasing them from the actual manufacturers.

NSNs	Breakout Quantity	Breakout Price (1998 dollars)		1998 Allied DoD Commercial Price		Difference	
		Unit	Total	Unit	Total	Total Dollar	Percent
	560	\$59.19	\$33,146	\$251.69	\$140,946	\$107,800	325.2
	130	63.89	8,306	251.69	32,720	24,414	293.9
	79	783.82	61,922	956.30	75,548	13,626	22.0
	300	52.80	15,840	79.65	23,895	8,055	50.9
	1,000	19.58	19,580	47.30	47,300	27,720	141.6
	225	187.79	42,253	280.13	63,029	20,777	49.2
	358	122.47	43,844	166.87	59,739	15,895	36.3
	500	48.81	24,405	350.30	175,150	150,745	617.7
	250	81.82	20,455	238.05	59,513	39,058	190.9
	1,150	16.15	18,573	23.20	26,680	8,108	43.7
	225	100.02	22,505	197.55	44,449	21,944	97.5
Total			\$310,829		\$748,969	\$438,142	141.0

Allied Commercial Price Concessions. During the audit DSCR obtained price concessions for three NSNs on the contract where the reasonableness of the commercial price was questioned (see Table 4).

For NSN [REDACTED], DSCR obtained the price concession based on price analysis. The price concessions for the other two NSNs were based on cost analysis of information other than cost or pricing data provided by Allied. Although the price concession ([REDACTED] percent) for the first part warrants removing the part from the contract and using another contract vehicle to procure and stock the item; it is questionable whether the price concessions for the other two parts sufficiently offset PLT/DVD savings associated with the contract, and warrant buying and stocking the items. DLA supply centers need to determine which