
September 29, 2006



Acquisition

Commercial Contracting for the Acquisition
of Defense Systems
(D-2006-115)

Department of Defense
Office of Inspector General

Quality

Integrity

Accountability

Additional Copies

To obtain additional copies of this report, visit the Web site of the Department of Defense Inspector General at <http://www.dodig.mil/audit/reports> or contact the Secondary Reports Distribution Unit at (703) 604-8937 (DSN 664-8937) or fax (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Office of the Deputy Inspector General for Auditing at (703) 604-9142 (DSN 664-9142) or fax (703) 604-8932. Ideas and requests can also be mailed to:

ODIG-AUD (ATTN: Audit Suggestions)
Department of Defense Inspector General
400 Army Navy Drive (Room 801)
Arlington, VA 22202-4704

DEPARTMENT OF DEFENSE

hotline

To report fraud, waste, mismanagement, and abuse of authority.

Send written complaints to: Defense Hotline, The Pentagon, Washington, DC 20301-1900
Phone: 800.424.9098 e-mail: hotline@dodig.mil www.dodig.mil/hotline

Acronyms

FAR	Federal Acquisition Regulation
FASA	Federal Acquisition Streamlining Act
GAO	Government Accountability Office
IG	Inspector General
HMMWV	High Mobility Multi-Purpose Wheeled Vehicle
TACOM	Tank-Automotive and Armaments Command



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

September 29, 2006

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

SUBJECT: Report on Commercial Contracting for the Acquisition of Defense Systems
(Report No. D-2006-115)

We are providing this report for review and comment. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments we revised Recommendation 1. We request that the Under Secretary of Defense for Acquisition, Technology, and Logistics provide comments on the revised recommendation by October 30, 2006.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to AudACM@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Rudolf Noordhuizen at (703) 604-8959 (DSN 664-8959) or Mr. Chrispian M. Brake at (703) 604-9094 (DSN 664-9094). See Appendix E for the report distribution. The team members are listed on the inside of the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink that reads "Richard B. Jolliffe".

Richard B. Jolliffe
Assistant Inspector General
Acquisition and Contract Management

Department of Defense Office of Inspector General

Report No. D-2006-115

September 29, 2006

(Project No. D2005-D000AB-0203.000)

Commercial Contracting for the Acquisition of Defense Systems

Executive Summary

Who Should Read This Report and Why? Acquisition and contracting personnel within DoD and the Military Departments should read this report because it addresses matters that should be considered when making determinations that items are commercial and awarding contracts to obtain commercial items.

Background. The Federal Acquisition Streamlining Act of 1994 (Public Law 103-355, October 13, 1994) establishes a statutory preference for commercial items and the procedures to be used when acquiring commercial items. The act has enabled the Government to have maximum access to competitive commercial markets and to commercial technologies. In addition, it simplifies the process for acquiring goods and services, with the intention of reducing acquisition costs. Finally, it provides the framework for a revision of Part 12 of the Federal Acquisition Regulation.

Section 4201 of the National Defense Authorization Act for Fiscal Year 1996 (Public Law 104-106, February 10, 1996) amended the commercial item exception to the requirement that contracting officers obtain certified cost or pricing data to substantiate price reasonableness determinations. This amendment broadened the exception to apply to all commercial items. Previously, it applied only to those commercial items for which there was an “established catalog or market price” through sales “in substantial quantities to the general public.”

The commercial item definition is broad. In general, goods can be obtained as commercial items if they are not real property and have been sold, or offered for sale, to the general public or to nongovernmental entities for nongovernmental purposes. In addition, the definition includes items that are not yet available in the commercial market but will be available in time to satisfy the Government’s delivery requirements. The commercial item definition also includes items that have modifications of a type available in a commercial marketplace or minor Government-unique modifications that will not alter the nongovernmental function of the commercial item. Finally, the commercial item definition includes services if the services are being provided to support an item that has been designated commercial and similar services are being provided to the general public and the Government at the same time under similar terms and conditions.

Results. This audit included 86 contract actions on 42 DoD contracts for commercial items issued during FYs 2003 and 2004. The value of these actions was approximately \$4.4 billion and each action reviewed was awarded for \$15 million or more. Contracting officials did not adequately justify the commercial nature of 35 of 42 (83 percent) commercial contracts for defense systems and subsystems awarded in FYs 2003 and

2004. As a result, contracting officials inappropriately awarded contracting actions that did not achieve the benefits of buying truly commercial products and relinquished price and other oversight protections under the Truth in Negotiations Act that would have allowed better visibility to establish fair and reasonable prices.

Management Comments and Audit Response. The Under Secretary of Defense for Acquisition, Technology, and Logistics nonconcurred with the recommendation to instruct contracting officers to only determine items to be commercial when sufficient commercial sales history to the general public is provided. The Under Secretary of Defense for Acquisition, Technology, and Logistics stated that this was not within the realm of the law which only requires items to be offered for sale, lease, or license to the general public. The Under Secretary of Defense for Acquisition, Technology, and Logistics also disagreed that cost or pricing data should be obtained when commercial sales history is not available citing that this was prohibited by section 2306a (b), title 10, United States Code. We believe the commercial item definition is broad and has allowed contracting officials to award contracts for defense systems and subsystems that had no commercial market. To limit this misuse of the definition and to gain more control in ascertaining fair and reasonable prices restriction should be placed on the commercial item exception found in section 2306a (b), title 10, United States Code by requiring that commercial items be sold in substantial quantities to the general public to qualify for exemption from submittal of certified cost or pricing data. As a result, we have revised Recommendation 1 to have the Under Secretary of Defense for Acquisition, Technology, and Logistics propose a legislative change to the exception requirement. The Under Secretary of Defense for Acquisition, Technology, and Logistics concurred with the recommendation to require contracting officials to document their decisions to award commercial contracts. We request that the Under Secretary of Defense for Acquisition, Technology, and Logistics provide comments on the final report by October 30, 2006.

Table of Contents

Executive Summary	i
Background	1
Objectives	3
Review of Internal Controls	3
Finding	
Military Departments Use of Commercial Acquisition Procedures	5
Appendixes	
A. Scope and Methodology	14
B. Prior Coverage	15
C. Contract Actions Reviewed and Audit Results	16
D. Examples of Major Defense Acquisition Programs Acquired as Commercial Items	21
E. Report Distribution	30
Management Comments	
Under Secretary of Defense for Acquisition, Technology and Logistics	32

Background

This audit was initiated as a result of issues identified in prior DoD Inspector General (IG) audits related to the acquisition of commercial items. Specifically this report addresses the application of the Federal Acquisition Regulation (FAR) when acquiring defense systems and subsystems.

Federal Acquisition Streamlining Act of 1994. The Federal Acquisition Streamlining Act of 1994 (Public Law 103-355) (FASA) was signed into law on October 13, 1994. FASA establishes a statutory preference for commercial items and establishes the procedures to be used when acquiring commercial items. FASA has enabled the Government to have maximum access to competitive commercial markets and to commercial technologies. In addition, FASA simplifies the process for acquiring goods and services, with the intention of reducing acquisition costs. Finally, FASA provides several guidelines for acquiring commercial items and services, all of which have been incorporated into FAR Part 12, “Acquisition of Commercial Items.”

Clinger-Cohen Act of 1996. Sections 4001 through 4402 and sections 5001 through 5703 of the National Defense Authorization Act for Fiscal Year 1996 (Public Law 104-106, February 10, 1996), as amended, are collectively known as the Clinger-Cohen Act of 1996. Section 4201 of the Clinger-Cohen Act amends the commercial item exception to the requirement that contracting officers obtain certified cost or pricing data to substantiate price reasonableness determinations. The amendment broadens the exception to apply to all commercial items. Prior to this amendment, the commercial item exception only applied to those items for which there was an “established catalog or market price” through sales “in substantial quantities to the general public.” This change made it easier to justify items as commercial even when a commercial market had not been established.

Under Secretary of Defense Goals. The Under Secretary of Defense for Acquisition and Technology issued a commercial acquisition policy memorandum on January 5, 2001, that established two goals. The first goal was for each Military Department and Defense agency to double the value of FAR Part 12 contract actions awarded by FY 2005, using FY 1999 as the baseline. The second goal was for the Military Departments and Defense agencies to increase the number of FAR Part 12 commercial contract actions to 50 percent of all Government contracts awarded by the end of FY 2005.

Commercial Item Defined. As defined in the FAR, a commercial item can be an item other than real property that has been sold, or offered for sale, to the general public; an item that is based on evolving technology that is not yet available in the commercial marketplace, but that will be available in time to satisfy the Government’s requirement; an item that requires modifications that are usually available in the marketplace; or an item that requires minor modifications of a type not customarily available in the commercial marketplace that meet Government requirements and do not alter the nongovernmental function or physical characteristics of the commercial item. A commercial item can also be a nondevelopmental item that has been developed at private expense, and that is sold to multiple State and local governments.

Services can be acquired as commercial items when they are provided in support of goods acquired as commercial items. Services that are unrelated to commercial items, but that are offered for sale, or are sold competitively in substantial quantities in the commercial marketplace, can also be acquired by the Government under the regulations of FAR Part 12.

Commercial Item Handbook. The Under Secretary of Defense for Acquisition, Technology, and Logistics issued the Commercial Item Handbook (the Handbook) in November 2001, to provide guidance on acquiring commercial items. The Handbook provides clarification on the commercial item definition and provides details on the commercial item acquisition process, including conducting market research, making commercial item determinations, and conducting price analysis. The Handbook also provides samples of a commercial item checklist and a market research report that contracting officials can use to determine whether commercial items are available to meet the Government's needs. Lastly, the Handbook provides contracting officials with examples of documented evidence that should be included in the contract files to support their decisions to award contracts for commercial items.

Recent Legislation. The Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005, Section 818, "Submission of Cost or Pricing Data on Noncommercial Modifications of Commercial Items," (Public Law 108-375) states,

(a) INAPPLICABILITY OF COMMERCIAL ITEMS EXCEPTION TO NON-COMMERCIAL MODIFICATIONS OF COMMERCIAL ITEMS.—Subsection (b) of section 2306a of title 10, United States Code, is amended by adding at the end the following new paragraph:

(3) NONCOMMERCIAL MODIFICATIONS OF COMMERCIAL ITEMS.—

(A) The exception in paragraph (1)(B) does not apply to cost or pricing data on noncommercial modifications of a commercial item that are expected to cost, in the aggregate, more than \$500,000 or 5 percent of the total price of the contract, whichever is greater.

...

(b) EFFECTIVE DATE AND APPLICABILITY.—Paragraph (3) of section 2306a of title 10, United States Code . . . shall take effect on June 1, 2005, and shall apply with respect to offers submitted, and to modifications of contracts or subcontracts made, on or after that date.

Recent DoD IG Reports. The DoD IG issued two reports in 2004 that identified inappropriate commercial acquisition strategies for defense systems.

DoD IG Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," March 29, 2004, states that the Air Force plan to lease Boeing KC-767A tanker aircraft did not meet the statutory definition of a commercial

item. No commercial market existed through which contracting officials could establish reasonable prices by the forces of supply and demand.

DoD IG Report No. D-2004-102, "Contracting for and Performance of the C-130J Aircraft," July 23, 2004, states that the Air Force used an unjustified commercial item acquisition strategy to acquire the C-130J aircraft and, further, that the Air Force conditionally accepted 50 aircraft at a cost of \$2.6 billion even though none of the C-130J aircraft met commercial contract specifications or operational requirements. The Air Force used a commercial acquisition strategy for this acquisition even though no commercial version of the plane existed and sales of the C-130J were for Government programs.

Objectives

Our overall audit objective was to determine whether contracting officials were complying with FAR Part 12 when acquiring defense systems and subsystems. Specifically, we evaluated the market research conducted by the contracting offices, the justifications used to determine that systems or subsystems met the commercial item criteria, and the basis for establishing price reasonableness. We also evaluated the management control program as it related to the overall audit objective.

See Appendix A for a discussion of the scope and methodology and Appendix B for prior coverage related to the objectives.

Review of Internal Controls

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.¹

Scope of the Review of the Management Control Program. We reviewed the adequacy of management controls as they applied to the audit objective.

¹ Our review of internal controls was done under the auspices of DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996. DoD Directive 5010.38 was canceled on April 3, 2006. DoD Instruction 5010.40 was reissued on January 4, 2006 as "Manager's Internal Control (MIC) Program Procedures."

Because we did not identify any material weaknesses, we did not assess management's self-evaluation.

Adequacy of Management Controls. The management controls we reviewed were adequate; we identified no material management control weaknesses.

Military Departments Use of Commercial Acquisition Procedures

Contracting officials did not adequately justify the commercial nature of 35 of 42 (83 percent)² commercial contracts for defense systems and subsystems awarded in FYs 2003 and 2004. This occurred because contracting officials:

- used loopholes in the broad commercial item definition to justify acquiring defense systems and subsystems without determining that a commercial market exists, and
- misapplied the commercial item definition to fit their acquisition situation and otherwise did not document their rationale for using commercial item acquisition procedures.

As a result, contracting officials inappropriately awarded contracting actions that did not achieve the benefits of buying truly commercial products and relinquished price and other oversight protections under the FAR that would have allowed better visibility to establish fair and reasonable prices.

Use of Commercial Item Definition

Contracting officials for the Army, Navy, and Air Force used FAR Part 12, “Acquisition of Commercial Items,” to acquire defense systems and subsystems. We reviewed 86 contract actions on 42 contracts (each awarded in amounts greater than \$15 million) to acquire these systems and subsystems during FYs 2003 and 2004. (See Appendix C for a listing of the 86 contract actions reviewed.) Based on our review, 35 of the 42 contracts (83 percent) should not have been awarded using commercial acquisition procedures because the defense systems and subsystems did not meet the commercial item definition or did not represent a true commercial product. Commercial item determinations normally are made prior to the award of a contract. However, contracting officials issued modifications and delivery orders while using the original commercial item determination. The table shows the number and value of contracts awarded and the number and value of contracts that were inadequately justified, summarized by Military Department.

²The percentage is not to be used as a projection against the total population of commercial contracts awarded in FYs 2003 and 2004. This percentage reflects the contracts we judgmentally selected for review.

Summary of Commercial Contracts Reviewed

	<u>Awarded Contracts</u>	<u>Value (millions)</u>	<u>Inadequately Justified Contracts</u>	<u>Value (millions)</u>	<u>Percent Contracts</u>
Army	17	\$2,157	13	\$1,827	76.5
Navy	8	342	7	311	87.5
Air Force	<u>17</u>	<u>1,891</u>	<u>15</u>	<u>1,362</u>	88.2
Total	<u>42</u>	<u>\$4,390</u>	<u>35</u>	<u>\$3,500</u>	83.3

Benefits of Buying Commercial Items

When contracting officials are developing an acquisition strategy, they should perform market research to identify items that are available in a commercial marketplace that will satisfy the requirements of the program. Buying commercial products eliminates the need to develop costly and time-consuming military specifications to satisfy DoD needs when an item is already available in the commercial marketplace. By choosing to purchase items that are readily available, the Government obtains the benefits of state-of-the-art technology and products while saving on the limited financial resources for research and development. A primary benefit of buying commercial items is the establishment of a market price through sales to the general public. In these cases, the Government does not have to go through the time-consuming process of establishing fair and reasonable prices by other means. Another benefit of acquiring commercial items is the integration of the defense and commercial industrial bases, which is beneficial for the Nation's security and economy, and that, in the end, results in spending taxpayer dollars in a prudent manner. Other benefits of buying commercial items include a reduced risk associated with developing new items, more rapid deployment, proven capability, and increased competition.

Military Departments Interpretation of Commercial Item Definition

Contracting officials for the Military Departments used the broad commercial item definition to justify acquiring defense systems and subsystems that did not achieve the benefits of buying truly commercial items. Buying inadequately justified commercial items without receiving any of the associated benefits outlined above achieves nothing for the Government. Contracting officials also misused the commercial item definition to acquire defense systems or subsystems.

Broad Commercial Item Definition. The commercial item definition is broad and includes items that are of a type customarily used by the general public or nongovernmental entities, items that are offered for sale, and items that have modifications of a type available in a commercial marketplace or that have minor Government-unique modifications. Contracting officials for the Military Departments have used loopholes within these broad categories without adequate justification to support the availability in the commercial marketplace for these defense systems and subsystems. Justifying items that do not provide readily available technology and have no established commercial market does not provide the benefits that the Government is trying to achieve from making these acquisitions.

Acquiring “Of a Type” Items. The commercial item definition states that a commercial item can be any item of a type (or similar to) customarily used by the general public. This allows contracting officials to award commercial contracts for items that are similar to what is sold in a commercial market. Contracting officers used this portion of the broad definition to justify an item to be similar to a commercial item. For example, two contract actions awarded for V-22 aircraft engines were not adequately justified within the commercial item definition. Modifications P00091 and P00102 to contract N00019-95-C-0209 were awarded to acquire engines for the V-22 *Osprey* aircraft. The total value of these two contract actions was \$93.2 million. The engines were determined to be commercial because they were considered to be items similar to engines sold in a commercial market. The contracting officer stated that the V-22 engines were 90 percent common to engines sold in the commercial market. However, the contract files did not contain enough evidence to support the 90 percent similarity to engines being sold to the general public, or that the stated 10 percent difference did not materially affect the nature or cost of the item. Without adequate justification of the 90 percent it is impossible to determine whether the V-22 engines are of a type and truly similar to the commercial versions. (For information related to the V-22 *Osprey* aircraft and engines, see Appendix D.)

Offered and Available For Sale. Based on the current law, an item does not have to be sold in substantial quantities; in fact, it does not have to be sold at all to be considered a commercial item. When FASA was implemented in 1994, commercial items had to be sold in substantial quantities to the general public in order to qualify for the commercial item exception to the Truth in Negotiations Act requirements. Having sales in substantial quantities provides an appropriate basis to establish a fair and reasonable price, one of the primary benefits of issuing a contract for commercial items. The Clinger-Cohen Act of 1996 broadened the commercial item exception to include items that are merely offered for sale to the general public. It also broadened the exception to include items that were not yet available in the commercial market, but that would be in time to satisfy the Government’s delivery requirements. Contracting officers relied on this part of the definition to justify that items were commercial if they were offered for sale to the public. They also relied on this part of the definition to justify that items would be available in the future without supporting that a proven commercial market existed. Air Force contracting officials used this portion of the definition to award four contract actions for the Joint Primary Aircraft Training System during FYs 2003 and 2004. According to contracting officials, the commercial version of this aircraft existed on paper in the form of

drawings and specifications. The Joint Primary Aircraft Training System was considered to be commercial because the drawings and specifications constituted the aircraft being available for sale without establishing interest from the commercial market for this system. Since the commercial version of the aircraft only existed on paper, the Government received no benefit from the commercial designation and did not obtain proven capabilities or market-established pricing. (See Appendix D for information regarding the Joint Primary Aircraft Training System.)

Modified Commercial Items. When items that are available in the commercial marketplace cannot meet DoD needs, contracting officials have the authority to acquire items that either have modifications or can be modified from the commercially available item. The commercial item definition includes two types of modifications:

- modifications of a type available in a commercial marketplace, and
- minor modifications of a type not customarily available in the commercial marketplace that meet Government requirements and do not alter the nongovernmental function or physical characteristics of the commercial item.

Contracting officials at the Army's Tank-automotive and Armaments Command (TACOM) issued \$1.3 billion worth of commercial contract actions during FYs 2003 and 2004. They used FAR Part 12 procedures to acquire various versions of the High Mobility Multi-purpose Wheeled Vehicle (HMMWV). They consider the HMMWV to be equivalent to the Hummer® H1, which is sold to the general public. The contractor developed the HMMWV at the Government's expense several years before the commercial variant was developed. An extensive amount of work is required to convert the military HMMWV to the commercial HUMMER® H1 sold to the general public, including adding a roof, doors, windows, air conditioning, and insulation for both sound and heat.

In addition, the contractor's Web site clearly states that the HMMWV is not available for sale to the general public:

The HUMVEE®³ was designed for a military mission and was not designed to meet civilian safety standards. [The contractor] does not endorse nor support the sales of military vehicles to the general public or private entities. [The contractor] further opposes any use of these military vehicles by individuals or entities outside the military context for which the vehicles are designed. [The contractor] does not sell military vehicles or service parts for military vehicles to the general public.

(For additional information regarding the various commercial contracts related to the HMMWV program, please refer to Appendix D.)

³The HMMWV, pronounced HUMVEE®, refers to the military vehicle. The HUMMER® H1 is the commercial vehicle.

Using the term “modified commercial items” and the more nebulous “modifications of a type available in a commercial marketplace” broadens the universe of what can be bought under commercial acquisition procedures but does not provide the associated benefits. The definition states that contracting officials should consider the value and size of modifications when determining whether a commercial item contains minor modifications. The commercial item definition does not quantify the term “minor” and allows broad discretion to the contracting officer to make this determination. Contracting officials frequently stated that the defense systems and subsystems that they acquired contained minor Government-unique modifications, but failed to provide evidence that compared the characteristics of the commercial item and the military item. For example, modification P00014 to contract F33657-02-C-0017 obligated funding for lease and insurance costs related to two C-40 aircraft for FY 2004. The contracting officer considered the C-40 series of aircraft to be commercial items because they are modified versions of the commercial 737-700 Business Jet. However, evidence in the contract file showed that the communications systems were enhanced, seats were removed, the lavatories were upgraded, and the tail of the aircraft was modified to accommodate additional space in the crew rest area. The contracting officer did not document how the modifications to C-40s were minor. In addition, the contracting officer did not document the extent of the modifications that would be required to convert the commercially available 737-700 Business Jet into the militarized C-40 aircraft. Without such a comparison, it is difficult, at best, to determine whether the modifications were indeed minor.

Use of the Commercial Item Definition. In addition to taking broad discretion with the definition, in some cases contracting officials misapplied the commercial item definition to consider items to be commercial. Contracting officials awarded commercial contract actions for defense systems and subsystems that were sold only to other foreign governments for military purposes. The contracting officials considered these acquisitions to be sales to the general public. Also, contracting officials awarded commercial contract actions for logistical support and training services for various aircraft. The services were determined to be commercial because the aircraft the services supported were designated as commercial items. However, the designation of the aircraft as commercial was unjustified. Contracting officials also determined that items were commercial because the overall system included integrated off-the-shelf items that were combined to form the system.

During FY 2003, the Air Force issued modification P00050 to contract F04701-00-C-0011. The contracting office issued this modification to exercise the option for the third Wideband Gapfiller Satellite. The modification was valued at \$150 million. The contracting officer’s justification for awarding this as a commercial contract was that the function of the satellite and not the satellite itself was a commercial item. The commercial item definition does not state that an item is commercial based on the function it provides. The contracting officer did not determine that there would be a commercial market for this item. In addition, if an item is to provide commercial benefits, it should provide available state of the art technology as well as be available for rapid deployment. The launch of the first satellite is at least 2 years behind its initial scheduled date and is not

scheduled to take place until June 2007. (For additional information regarding the Wideband Gapfiller Satellite, see Appendix D.)

Nongovernmental Entity. FAR 2.101, “Definitions,” clearly states that a commercial item is an item that is used by the general public or by nongovernmental entities for purposes other than Government purposes. Contracting officers have misused the term nongovernmental entities and determined nongovernmental entities to include any government entity outside the United States. For example, the Air Force issued contract F19628-03-C-0043 to acquire the MPN-14K radar system on behalf of the Government of Taiwan. The contracting officer stated that the MPN-14K had been sold to the South Korean and Turkish governments and considered these sales to be commercial sales even though this radar system is unique to the military. As a result of not providing legitimate commercial sales, the government did not receive the benefit of a fair and reasonable price established by a commercial market.

Services. Contracting officials have misused the definition to award commercial contract actions for services based on their association with previously justified commercial items. The commercial item definition does include services, if the services are being provided to support an item that has been designated commercial and similar services are provided to the general public and the Government at the same time under similar terms and conditions. Contracting officials have awarded contracts for services without properly designating that the item the service was supporting was commercial. For example, the Air Force issued modification P00097 to contract F33657-00-C-0118 for logistical support and training efforts for the C-130J aircraft. The contracting officer considered these services to be commercial because the C-130J had been acquired as a commercial item. DoD IG Report D-2004-102 concluded that the commercial classification of the C-130J was flawed and unsupported. Therefore, any justification to consider associated services commercial based on supporting the aircraft would also be flawed. The contracting officer made no attempt to show that similar services were also provided to the general public. (For additional information regarding the various commercial contract actions related to the C-130J aircraft, see Appendix D.)

Commercial Off-the-Shelf. Contracting officials have used FAR Part 12 acquisition procedures and justified defense systems and subsystems as commercial items because the system was composed of commercial off-the-shelf products. For example, the Air Force issued six contract actions to acquire the Theater Deployable Communications system. While the components that make up the end unit may be commercial, this did not provide justification that the end unit was commercial. According to contracting officials, the Internet servers, switches, and routers that make up the system are items that are readily available in the commercial market. However, when assembled, the commercial off-the-shelf products become one collective unit that was not commercial. There is no single company that provides the end unit in its entirety for the commercial market nor were there any documented commercial sales of the end unit to establish a fair and reasonable price. The contracting officer needs to make the justification of an item as commercial based on the totality of the product.

Commercial Item Determination. Out of the 35 commercial contracts that were inadequately justified, 18 had no documented rationale to justify the commercial classification of the defense systems and subsystems being procured. Contracting officials are not required to document their decisions to use FAR Part 12. In our opinion they should document their decisions to use FAR Part 12 and include supporting evidence in the contract file. Our opinion is supported by the Commercial Item Handbook, which provides contracting officials with examples of documented evidence that should be included in the contract file to support their decisions to award commercial item contracts. Some contracting officials at the Aeronautical Systems Center did not document their decisions to use FAR Part 12. They believed that because they were part of the Commercial Derivative Systems Squadron they were excluded from documenting their rationale to use FAR Part 12. They stated that everything acquired by that division was commercial. For example, they awarded contract F33657-03-C-2051 to acquire an E-10A aircraft. There was no documentation in the contract file as to how the E-10A was considered to be commercial. The documentation in the contract files only provided evidence that the E-10A was a 767-400ER, which is a commercial aircraft sold by The Boeing Company. Without documented evidence, we cannot determine that the E-10A is a commercial item as defined by FAR Part 2.101. To further compound the problem, the contracting officer used research and development funding to acquire the E-10A. Contracting personnel concluded that using research and development funding for this acquisition was appropriate because the E-10A would be used as a research test bed. We believe this is inappropriate when procuring items that are truly commercial. By spending research and development resources on items that are purportedly available in the commercial marketplace, DoD does not get the benefits of readily available technology in the commercial marketplace and does not save scarce research and development funds.

Price Reasonableness Determination. The contracting officer has the responsibility to ensure that commercial items are bought at fair and reasonable prices. Contracting officials are prohibited from obtaining certified cost or pricing data when contracting for commercial items. Instead contracting officials should rely on market-based pricing supported by evidence of commercial sales to determine fair and reasonable prices. When making price reasonableness determinations for commercial items, contracting officials are limited to the amount of cost data that can be obtained from the contractor to support their determination. For example, the Navy awarded contract action N00019-01-C-0071 P00016 to procure the seventh C-40 aircraft. The contracting officer did not obtain evidence from the contractor to prove the item had been sold to the general public. This information could have been used to make a price reasonableness determination. The contracting officer only had access to aircraft prices published on the contractor's Web site. The fact that a price exists on a contractor's Web site or in a catalog does not ensure a fair and reasonable price. FAR Part 13.106-3, "Award and Documentation," states that inclusion of a price in a catalog does not in and of itself establish fairness and reasonableness of the price. If the contracting officer had sales data or cost or pricing data, a reasonable price could have been negotiated for the seventh aircraft, as well as for future aircraft buys such as the eighth C-40 aircraft procurement in FY 2004 under P00021 of the same contract.

Conclusion

Contracting officials for the Military Departments awarded \$3.5 billion in commercial procurements for defense systems and subsystems that were not supported by documentation that justified a commercial procurement. DoD did not receive the benefits of readily available commercial technology, competitive prices established by the commercial marketplace, or the other benefits that would normally be associated with acquiring commercial items. Instead, the Government relinquished its right to cost or pricing data and other oversight procedures contained in the Federal Acquisition Regulation.

Contracting officials are prohibited from obtaining certified cost or pricing data when they use FAR Part 12 commercial acquisition procedures. By awarding these as commercial actions, contracting officials limited their ability to ensure that fair and reasonable prices were paid on these contract actions.

The Government lost oversight and control over the development and quality of the defense systems and subsystems when it awarded commercial contract actions. In addition, the Government's rights were compromised because it had no access to contractor facilities to monitor and inspect products prior to the product's delivery.

Recommendations, Management Comments and Audit Response

Revised Recommendation. As a result of management comments, we revised Recommendation 1 for the Under Secretary of Defense for Acquisition, Technology, and Logistics to propose a legislative change to the commercial item exception.

We recommend that the Under Secretary of Defense for Acquisition, Technology, and Logistics:

1. Propose a legislative change to amend Section 2306a (b), title 10, United States Code to state that the commercial item exception to submission of certified cost or pricing data shall only apply for the acquisition of commercial items that *are sold in substantial quantities to the general public.*

Management Comments. The Under Secretary of Defense for Acquisition, Technology, and Logistics nonconcurrent with the original recommendation. The Under Secretary of Defense for Acquisition, Technology, and Logistics stated that the definition of a commercial item found in Part 2.101 of the Federal Acquisition Regulation does not require sufficient sales to the general public for an item to be considered a commercial item. Part 2.101 of the commercial item definition only requires that items be offered for sale, lease, or license to the general public. He stated that Section 2306a (b), title 10, United States Code, prohibits the requiring of cost and pricing data for commercial item acquisitions.

Audit Response. We recognize that the commercial item definition only requires that items be offered for sale, lease, or license to the general public. This has been the requirement for commercial items since its inception in 1994 with the Federal Acquisition Streamlining Act. However, originally exceptions from the submission of certified cost or pricing data only applied to items sold in substantial quantities to the general public. The intent of our original recommendation was to provide a basis to restrict the misuse of the broad commercial item definition. Our report provides instances in which the items procured under the broad definition did not provide an adequate basis for price reasonableness or were inappropriate because no commercial market existed. Buying items commercially should provide the government assurance that it is buying products that are readily available in the marketplace at a fair and reasonable price that is established through sales to the general public. Our revised recommendation will continue to allow flexibility to consider items with no proven commercial market to be considered commercial for whatever purpose it serves, but will restrict the certified cost or pricing exception to items with a proven commercial market. As a result we have revised Recommendation 1. We request that the Under Secretary of Defense for Acquisition, Technology, and Logistics provide comments on Recommendation 1 by October 30, 2006.

2. When commercial item determinations are made, these determinations should be in writing and included in the contracting file.

Management Comments. The Under Secretary of Defense for Acquisition, Technology, and Logistics concurred and stated that a Defense Procurement and Acquisition Policy letter would be issued within the next sixty days requiring a written determination that the commercial item definition has been met for acquisitions exceeding \$15 million.

Audit Response. The Under Secretary of Defense for Acquisition, Technology, and Logistics comments conform to requirements and no additional comments are required.

Appendix A. Scope and Methodology

We performed this audit from May 2005 through July 2006 in accordance with generally accepted government auditing standards.

We identified a universe of 175 contract actions valued at \$8.4 billion. From this universe we excluded contract actions used to acquire spare parts and services, as well as fuel and other commodities which did not constitute “defense systems.” In a few, limited cases, we did review contract actions issued to acquire these items, but only when they were related to an item that was considered to be a “defense system.” During this audit, we judgmentally selected remaining high dollar actions including 86 contract actions related to 42 contracts to acquire defense systems. The values of these actions totaled \$4.4 billion. We defined a contract action to be a basic contract, a delivery order, or a modification to either a basic contract or delivery order. The actions selected for review were each valued at \$15 million or more.

We reviewed contracts and such supporting documentation as commercial item determinations, price negotiation memorandums, market research reports, and sole-source justifications and approvals. The documents reviewed dated from October 1994 through April 2005. In addition, we interviewed contracting officers, their managers, and other officials within contracting offices.

Use of Computer-Processed Data. We queried the individual contract action reporting (DD 350) databases for FYs 2003 and 2004 to determine the universe of commercial contract actions issued during those years to acquire defense systems. We judgmentally selected contracts based on these queries, and then traveled to various contracting offices to review the files for each selected contract.

We compared the information obtained through queries of the individual contract action reporting (DD 350) databases with the information contained in the contract files at the various sites visited, and found no significant discrepancies.

Government Accountability Office High-Risk Area. The Government Accountability Office (GAO) has identified several high-risk areas in DoD. This report provides coverage of the Weapons Systems Acquisition and Contract Management high-risk areas.

Appendix B. Prior Coverage

During the last 5 years, GAO and the DoD IG have issued seven reports discussing commercial contracting practices. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

GAO

GAO Report No. GAO-02-502, “DoD Needs Better Guidance on Granting Waivers for Certified Cost and Pricing Data,” April 22, 2002

DoD IG

DoD IG Report No. D-2006-093, “Contracting and Funding for the C-130J Aircraft Program,” June 21, 2006

DoD IG Report No. D-2006-075, “Acquisition of the Joint Primary Aircraft Training System,” April 12, 2006 (FOUO)

DoD IG Report No. D-2004-102, “Contracting for and Performance of the C-130J Aircraft,” July 23, 2004

DoD IG Report No. D-2004-064, “Acquisition of the Boeing KC-767A Tanker Aircraft,” March 29, 2004

DoD IG Report No. D-2004-012, “Sole-Source Spare Parts Procured From an Exclusive Distributor,” October 16, 2003

DoD IG Report No. D-2001-129, “Contracting Officer Determinations of Price Reasonableness When Cost or Pricing Data Were Not Obtained,” May 30, 2001

Appendix C. Contract Actions Reviewed and Audit Results

<u>Location/ Contract Number</u>	<u>Contract Action</u>	<u>Value</u>	<u>Item Acquired</u>	<u>MR</u>	<u>CID</u>	<u>PR</u>
<u>ARMY</u>						
<u>AMCOM, Redstone Arsenal, AL</u>						
W58RGZ-04-C-0053	Basic	\$ 19,380,000.00	T703-AD-700A engines	-	X*	-
<u>CECOM, Fort Monmouth, NJ</u>						
DAAB07-97-D-L021	D.O. 0032 Mod 04	33,370,729.00	DSSMP	X	X*	-
	D.O. 0034 Mod 05	19,351,839.00	DSSMP	X	n/a	-
DAAB07-97-D-L024	D.O. 0113	16,677,860.00	DSSMP	X	X*	-
DAAB07-01-D-M010	D.O. 0025	18,302,991.00	Talon radio system	-	-	-
W15P7T-04-D-L205	D.O. 0001	15,004,335.00	Receivers	-	X*	X
<u>RDECOM, Aberdeen Proving Ground, MD</u>						
DAAD13-03-C-0031	P00011	15,185,637.65	M22 chemical agent alarms	-	X*	X
	P00017	25,780,966.58	M22 chemical agent alarms	-	n/a	X
DAAD13-03-C-0042	P00003	22,683,224.00	Emergency responder equipment and training	-	-	-
<u>TACOM, Warren, MI</u>						
DAAE07-00-C-S019	P00100	21,935,280.00	HMMWV Up-Armor	X	X*	-
	P00103	35,675,000.00	HMMWV Up-Armor	X	n/a	-
	P00105	29,185,582.00	HMMWV Up-Armor	X	n/a	-
	P00107	24,339,643.00	HMMWV Up-Armor	X	n/a	-
	P00117	55,203,282.00	HMMWV Up-Armor	X	n/a	-

Note: See the footnotes at the end of the appendix.

<u>Location/ Contract Number</u>	<u>Contract Action</u>	<u>Value</u>	<u>Item Acquired</u>	<u>MR</u>	<u>CID</u>	<u>PR</u>
DAAE07-00-C-S019	P00127	\$ 55,950,173.00	HMMWV Up-Armor	X	n/a	-
	P00143	100,821,742.00	HMMWV Up-Armor	X	n/a	-
	P00145	93,238,340.00	HMMWV Up-Armor	X	n/a	-
DAAE07-00-D-T021	D.O. 0007	45,156,030.00	RTCH vehicles	X	-	-
DAAE07-01-C-S001	P00156	20,615,114.73	HMMWVs	X	X*	X
	P00166	35,964,355.71	HMMWVs	X	n/a	X
	P00170	74,360,297.56	HMMWVs	X	n/a	X
	P00173	77,582,082.19	HMMWVs	X	n/a	X
	P00180	48,981,014.55	HMMWVs	X	n/a	X
	P00187	42,409,998.85	HMMWVs	X	n/a	X
	P00282	15,526,835.74	HMMWVs	X	n/a	X
	P00304	19,575,405.18	HMMWVs	X	n/a	X
	P00347	24,502,850.68	HMMWVs	X	n/a	X
	P00348	112,891,643.58	HMMWVs	X	n/a	X
	P00354	39,571,065.00	HMMWVs	X	n/a	X
	P00356	60,161,118.72	HMMWVs	X	n/a	X
	P00362	16,887,272.18	HMMWVs	X	n/a	X
	P00377	59,198,313.24	HMMWVs	X	n/a	X
	P00387	45,506,724.75	HMMWVs	X	n/a	X
	P00447	118,219,740.74	HMMWVs	X	n/a	X
	P00560	215,590,917.91	HMMWVs	X	n/a	X
	P00572	115,573,952.77	HMMWVs	X	n/a	X
DAAE07-02-D-S030	D.O. 0002	18,902,375.00	HMMWV engines	X	X*	X
DAAE07-02-D-T031	D.O. 0002	17,924,495.52	HEMTT tires	X	X*	X
DAAE07-03-C-S045	Basic	17,559,040.00	LSB & FBS	X	X*	X
DAAE07-03-D-S067	D.O. 0001	22,735,671.00	M872A4 trailers	-	X	-
W56HZV-04-C-0355	Basic	20,429,521.11	HMMWV engines	X	X	-
W56HZV-04-C-0439	Basic	25,090,387.20	HMMWV armor kits	X	X	-
W56HZV-04-D-0181	D.O. 0001	120,125,150.07	Iraqi infantry equipment	-	-	-
	D.O. 0003	<u>123,555,477.60</u>	Iraqi infantry equipment	-	n/a	-
Army Subtotal	44	\$ 2,156,683,475.81		35	13	24

Note: See the footnotes at the end of the appendix.

<u>Location/ Contract Number</u>	<u>Contract Action</u>	<u>Value</u>	<u>Item Acquired</u>	<u>MR</u>	<u>CID</u>	<u>PR</u>
<u>NAVY</u>						
<u>NAVAIR, Patuxent River NAS, MD</u>						
N00019-95-C-0209	P00091	\$ 42,460,000.00	V-22 engines	X	X	-
	P00102	50,760,000.00	V-22 engines	X	n/a	-
N00019-01-C-0071	P00016	61,000,000.00	C-40A aircraft	X	X*	X
	P00021	62,000,000.00	C-40A aircraft	X	n/a	X
N00019-04-D-0001	D.O. 0003	26,795,298.33	KC-130J spares	X	X*	X
<u>NSWC, Crane, IN</u>						
N00164-04-D-4803	D.O. 0001	17,627,380.20	MNVS	X	X*	X
N00164-04-D-8508	D.O. 0002	15,978,701.97	BNVS	X	X	-
<u>SPAWAR, North Charleston, SC</u>						
N65236-04-D-3119	D.O. 0001	15,754,859.00	Satellite terminals	X	X	X
<u>NAVICP, Philadelphia, PA</u>						
N00383-00-D-007J	D.O. 0013	15,730,458.00	APU/TLS	-	-	-
	D.O. 0014	15,292,174.00	APU/TLS	-	n/a	-
N00383-04-C-008M	Basic	18,999,184.00	KC-130J engines	-	X	-
Navy Subtotal	11	\$ 342,398,055.50		8	7	5
<u>AIR FORCE</u>						
<u>ASC, Wright- Patterson AFB, OH</u>						
F33657-00-C-0018	P00093	\$ 17,497,662.00	C-130J QECA	X	X	X
	P00097	42,656,266.00	C-130J ICS	X	n/a	X

Note: See the footnotes at the end of the appendix.

<u>Location/ Contract Number</u>	<u>Contract Action</u>	<u>Value</u>	<u>Item Acquired</u>	<u>MR</u>	<u>CID</u>	<u>PR</u>
F33657-00-C-0044	P00020	\$ 19,300,354.00	C-130J MATS	X	X	X
	P00023	23,682,000.00	C-130J MATS	X	n/a	X
F33657-00-D-2118	D.O. 0009	49,509,776.00	T-38 PMP	-	X	-
	D.O. 0010	42,399,539.00	T-38 PMP	-	n/a	-
F33657-01-C-0022	P00011	169,987,608.00	JPATS	X	X*	X
	P00013	40,122,966.00	JPATS	X	n/a	X
	P00037	227,985,573.00	JPATS	X	n/a	X
	P00046	55,972,029.00	JPATS	X	n/a	X
F33657-01-C-0025	P00003	23,696,045.00	TSS	-	X	-
	P00008	19,965,693.00	TSS	-	n/a	-
F33657-01-D-0013	D.O. 0059	22,425,000.00	C-40/C-32 CESS	X	X*	X
	D.O. 0061	54,162,908.00	C-40/C-32 IFS	X	n/a	X
F33657-02-C-0006	Basic	140,098,476.00	C-17A engines	-	-	-
	P00001	306,268,620.00	C-17A engines	-	n/a	-
	P00002	29,106,350.00	C-17A engines	-	n/a	-
F33657-02-C-0017	P00014	18,588,311.00	C-40B/C aircraft lease	X	X*	X
F33657-02-D-2011	D.O. 0031	84,113,017.00	C-37A aircraft	X	X*	X
	D.O. 0032	17,304,602.00	C-37A aircraft	X	n/a	X
F33657-03-D-2051	Basic	20,000,000.00	E-10A aircraft	X	X*	X
FA8629-04-C-2350	P00002	54,280,292.00	MK32B-902E aerial refueling pods/pylons	-	-	-

ESC, Hanscom AFB,**MA**

F19628-02-D-0008	D.O. 0003	54,166,543.00	TDC	-	X	X
	D.O. 0004	37,061,739.00	TDC	-	n/a	X
	D.O. 0007	21,528,056.00	TDC	-	n/a	X
	D.O. 0009	16,887,966.00	TDC	-	n/a	X
F19628-02-D-0009	D.O. 0006	16,112,505.00	TDC	-	X	-
F19628-02-D-0014	D.O. 0028	23,494,834.00	TCAS/TAWS	-	X	-
F19628-03-C-0043	Basic	74,433,113.00	MPN-14K Radar System	X	X	X

Note: See the footnotes at the end of the appendix.

<u>Location/ Contract Number</u>	<u>Contract Action</u>	<u>Value</u>	<u>Item Acquired</u>	<u>MR</u>	<u>CID</u>	<u>PR</u>
FA8726-04-D-0004	D.O. 0002	\$ 8,557,531.00	TDC	X	X	-

**SMC, Los Angeles
AFB, CA**

F04701-00-C-0011	P00050	150,000,000.00	WGS	-	X	X
Air Force Subtotal	31	\$ 1,891,365,374.00		16	15	20

Total: 86 \$ 4,390,446,905.31 59 35 49

X Annotates inadequate documentation in the contract file to support decisions made by contracting officials.

* Annotates no documentation was included in the contract file.

n/a Annotates the CID was conducted on the basic contract award; therefore, the modifications and delivery orders were not applicable.

Acronyms and Abbreviations

AFB	Air Force Base.	HMMWV	High Mobility Multi-Purpose Wheeled Vehicle.	QECA	Quick Engine Change Assemblies.
ASC	Aeronautical Systems Center.	ICS	Interim Contractor Support.	RDECOM	Research, Development, and Engineering Command.
APU/TLS	Auxiliary Power Unit/Total Logistics Support.	IFS	Integrated Fleet Support.	RTCH	Rough Terrain Container Handler.
Aviation and Missile Command.		JPATS	Joint Primary Aircraft Training System.	SMC	Space and Missile Systems Center.
BNVS	Binocular Night Vision System.	LSB	Logistics Support Bridge.	SPAWAR	Space and Naval Warfare Systems Command.
CID	Commercial Item Determination.	MATS	Maintenance and Aircrew Training System.	TACOM	Tank-Automotive and Armament Command.
CESS	Communication Equipment Subscription Service.	MR	Market Research Determination.	TAWS	Terrain Awareness and Warning System.
CECOM	Communications-Electronics Command.	MNVS	Miniature Night Vision Sight.	TCAS	Traffic Alert and Collision Avoidance System.
D.O.	Delivery Order.	n/a	Not Applicable.	TDC	Theater Deployable Communications.
DSSMP	Digital Switched System Modernization Program.	NAS	Naval Air Station.	TSS	Tower Simulation System.
ESC	Electronics Systems Center.	NAVAIR	Naval Air Systems Command.	WGS	Wideband Gapfiller Satellite.
FBS	Float Bridge System.	NAVICP	Naval Inventory Control Point.		
HEMTT	Heavy Expanded Mobile Tactical Truck.	NSWC	Naval Surface Warfare Center.		
		PMP	Propulsion Modernization Program.		
		PR	Price Reasonableness Determination.		

Appendix D. Examples of Major Defense Acquisition Programs Acquired as Commercial Items

A Major Defense Acquisition Program is defined in DoD Instruction 5000.2, “Operation of the Defense Acquisition System,” as a program which is:

... estimated by the [Under Secretary of Defense for Acquisition, Technology, and Logistics] to require an eventual total expenditure for research, development, test, and evaluation (RDT&E) of more than \$365 million in fiscal year (FY) 2000 constant dollars or, for procurement, of more than \$2.190 billion in FY 2000 constant dollars.

High Mobility Multipurpose Wheeled Vehicle

The High Mobility Multipurpose Wheeled Vehicle (HMMWV) was developed at the Government’s expense starting in 1983 as a replacement for the Jeep.

The current production contract, DAAE07-01-C-S001, was issued by the Army’s Tank-automotive and Armaments Command in November 2000, and is the fifth production contract used to acquire HMMWVs.



Source: United States Army

Figure 1. High Mobility Multipurpose Wheeled Vehicle

Several HMMWV variants use a common chassis, including cargo/troop carriers, armament carriers, ambulance carriers, and shelter carriers. Because of its versatility, the HMMWV has become the standard light tactical vehicle within DoD. Through June 2005, DoD had acquired more than 150,000 HMMWVs. The Army administers the production contract, but the Navy, the Air Force, and

the Marine Corps have all used it to obtain HMMWVs. These vehicles have also been sold to friendly nations through the Foreign Military Sales process.

The commercial variant, originally known simply as the HUMMER®, and more recently as the HUMMER® H1, was first sold to the public in 1992. In a May 2006 announcement, General Motors, the owner of marketing rights for the commercial variant, stated that the HUMMER® H1 would no longer be available for sale. Prior to being discontinued, the vehicle's sales occupied only a small niche in the automotive industry, with sales totaling to approximately 12,000. During the time it was available for sale to the general public, the HUMMER® H1 would start on the same assembly line as the military-unique HMMWV, but then would go to a second assembly line to make it fit for use by civilians. It was on this second assembly line that such parts as doors, windows, and a roof were added. There were several other enhancements applied to the commercial variant as well, including both anti-lock brakes and air conditioning.

We reviewed the production contract described above, as well as four additional contracts related to the HMMWV.

Contracting officers at TACOM issued contract DAAE07-00-C-S019 to acquire the Up-Armor applied to HMMWVs. The contractor for contract DAAE07-01-C-S001, described above, produces the M1114 chassis, which is then provided as Government-furnished equipment to a second contractor that applies the armor. The enhanced chassis for the M1114 Extended Capacity Vehicle was developed to enable the vehicle to perform at an acceptable level after the addition of armor plating. Armor plating is needed because most HMMWVs contain only rudimentary protection against rocket propelled grenades and improvised explosive devices. The armor must be added to the vehicle by the contractor before the vehicles are delivered to the warfighter.

The Army issued contract W56HZV-04-C-0439 to acquire HMMWV armor kits. These armor kits are significantly less expensive than the Up-Armor described above and can be added to the vehicle in-theater. Another benefit is that the kits can be applied to the unenhanced, baseline HMMWV variant.

Contracting officers at TACOM also issued two contracts, DAAE07-02-D-S030 and W56HZV-04-C-0355, to obtain HMMWV engines.

Wideband Gapfiller Satellite

The Air Force issued contract F04701-00-C-0011 in January 2001 to acquire several Wideband Gapfiller Satellites. These satellites are based on the commercially available Boeing 702 satellite bus, but, as with all satellites, both the bus and the payload are customized to fit the requirements of the customer.

The basic contract award contained approximately \$117 million for nonrecurring engineering (research), with options included for up to six satellites. The contracting office exercised the options for the first two satellites in January 2002, with delivery planned for January 2004, or approximately 24 months after the award of the options. That office exercised the option for the third satellite in November 2002, with delivery planned for the third quarter of FY 2005.

According to program officials, the program office had no funding to add to this contract during FY 2004, and, as a result, the options for the fourth, fifth, and sixth satellites expired before being exercised. The officials also stated that to acquire these additional satellites, they would pursue negotiations on a new contract, this time under a more traditional FAR Part 15 arrangement. This new contract was awarded on February 17, 2006. The basic contract was valued at approximately \$150 million, and will be used to acquire nonrecurring engineering (research) and long-lead parts for the fourth satellite. They also stated the satellites themselves will be ordered in the future, based on the availability of funding.



Source: Boeing Satellite Systems

Figure 2. Wideband Gapfiller Satellite

Despite the award of the most recent contract, the original satellites have not yet been delivered. There have been several delays, for different reasons, the most

recent of which moved the anticipated launch of the first satellite to June 2007. The launches of the second and third satellites have been delayed until December 2007 and May 2008, respectively.

Joint Primary Aircraft Training System

The Aeronautical Systems Center issued contract F33657-01-C-0022 on December 28, 2001, for the production of T-6A *Texan II* aircraft, as well as associated ground-based training systems, for use by the Air Force's Air Education and Training Command.

The current contract is the third used to acquire these aircraft. The contracting office issued the first contract under FAR Part 15, "Contracting by Negotiation," for Lot 1 through Lot 8, to fulfill a joint Air Force-Navy requirement. In December 2000, the contracting office removed Lots 7 and 8 from the original FAR Part 15 contract and placed them onto a new FAR Part 12 contract, at the direction of the then Principal Deputy Assistant Secretary of the Air Force for Acquisition and Management.



Source: United States Air Force

Figure 3. Joint Primary Aircraft Training System

The current contract was issued to acquire Lot 9 and included options for Lots 10 through 13. This contract was issued under FAR Part 12, following the precedent set with Lots 7 and 8. The unit prices for the aircraft increased substantially between Lot 8 and Lot 9.

Each lot corresponds to the deliveries to be made in a particular year, with Lot 13 being acquired during FY 2006. Recently, in its response to another DoD IG audit, the Air Force stated that it intends to pursue a more traditional FAR Part 15 contract to satisfy any future requirements for this system.

[NOTE: More in-depth coverage of this program is provided in DoD IG report, "Acquisition of the Joint Primary Aircraft Training System" (DoD IG Report No. D-2006-075), issued on April 12, 2006.]

C-130J *Hercules* Cargo Aircraft

The C-130J is the latest addition to the C-130 fleet, entering service in February 1999. It incorporates state-of-the-art technology that is intended to reduce manpower requirements, lower operating and support costs, and provide life-cycle cost savings over earlier C-130 models.



Source: United States Air Force

Figure 4. C-130J *Hercules* Cargo Aircraft

Since the contract used to produce C-130J aircraft was recently reviewed in-depth during another DoD IG audit, we did not review any actions used to produce the aircraft. Instead, we reviewed contract actions used to acquire other, associated items, such as contractor logistics support, engines, training systems, and spare parts.

The Air Force used contract F33657-00-C-0018 to acquire two different items. They issued modification P00093 to acquire Quick Engine Change Assemblies, while they used modification P00097 to acquire Contractor Logistics Support. The same contracting office issued two modifications, P00020 and P00023, on contract F33657-00-C-0044 to obtain Maintenance Aircrew Training Systems.

Two Navy contracting offices used commercial contracts to acquire items related to the KC-130J variant used by the Marine Corps. The Naval Air Systems Command used contract N00019-04-D-0001 to obtain spare parts for this aircraft, while the Naval Inventory Control Point, Philadelphia, used contract N00383-04-C-008M to obtain engines for these aircraft.

Section 135 of the National Defense Authorization Act for Fiscal Year 2006 (Public Law 109-163) contained a provision that required the Air Force to use FAR Part 15, rather than Part 12, for the acquisition of any C-130J aircraft acquired after FY 2005. This new requirement only applies directly to the C-130J aircraft; we are not aware of any plans by either the Air Force or the Navy to review the use of FAR Part 12 for the other, related contracts described above.

[NOTE: More in-depth coverage of the C-130J program is provided in DoD IG Report No. D-2004-102, "Contracting for and Performance of the C-130J Aircraft," July 23, 2004. See also DoD IG Report No. D-2006-093, "Contracting and Funding for the C-130J Aircraft Program," June 21, 2006, which addresses a set of allegations provided to the Defense Hotline regarding the C-130J program.]

Engines for the V-22 *Osprey* Joint Advanced Vertical Lift Aircraft

The Naval Air Systems Command is responsible for issuing contracts related to the acquisition and maintenance of both variations of the aircraft, the MV-22 aircraft operated by the Marine Corps, and the CV-22 aircraft used by the Air Force for special operations missions.



Source: United States Navy

Figure 5. V-22 *Osprey* Joint Advanced Vertical Lift Aircraft

While the V-22 *Osprey* aircraft has not, in its entirety, been determined to be a commercial item, the program office has determined that the engines attached to the aircraft (a subsystem) are commercial items, and has used contract N00019-95-C-0209 to acquire them.

Engines for the C-17A *Globemaster III* Advanced Cargo Aircraft

The C-17A *Globemaster III* is the newest cargo aircraft to enter the airlift force. It is capable of rapid strategic delivery of troops and all types of cargo to main operating bases or directly to forward bases in the deployment area. The aircraft is powered by four, fully reversible, Federal Aviation Administration-certified F117-PW-100 engines, the same engine currently used on the Boeing 757.



Source: United States Air Force

Figure 6. C-17A *Globemaster III* Advanced Cargo Aircraft

Contract F33657-02-C-0006 was issued to obtain these engines. We reviewed the basic contract and two modifications, P00001 and P00002.

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Director, Acquisition Resources and Analysis
Director, Defense Procurement and Acquisition Policy
Under Secretary of Defense (Comptroller)/Chief Financial Officer
Director, Program Analysis and Evaluation
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Assistant Secretary of the Army (Acquisition, Logistics, and Technology)
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Research, Development, and Acquisition)
Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

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

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Homeland Security and Governmental Affairs

House Committee on Appropriations

House Subcommittee on Defense, Committee on Appropriations

House Committee on Armed Services

House Committee on Government Reform

House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform

House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform

House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Under Secretary of Defense for Acquisition, Technology, and Logistics Comments

Final Report
Reference



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

SEP 13 2006

MEMORANDUM FOR PROGRAM DIRECTOR, ACQUISITION AND CONTRACT
MANAGEMENT DIRECTORATE, DODIG

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS *CMR 9/14/06*

SUBJECT: Response to DoDIG Draft Report Project D2005-D000AB-0203.000,
"Commercial Contracting for the Acquisition of Defense Systems"

As requested, I am providing responses to the general content and
recommendations contained in the subject report.

General Content:

The technical findings of this report, particularly in regard to summary findings in Appendix C, point out instances of inadequate documentation in the contract files to support decisions made by contracting officials in regard to market research, commercial item determinations, and price reasonableness determinations. We understand the comments made by DoDIG, however, the question of inadequacy is judgmental. Judgments regarding the adequacy of documentation are left to the Contracting Officers. FAR 10.002(a) states that "Agencies should document the results of market research in a manner appropriate to the size and complexity of the acquisition." FAR 15.406-3(a)(11) requires "Documentation of fair and reasonable pricing." Nevertheless, the DoDIG comments have merit, and we will issue reaffirming guidance with regard to ensure that our Contracting Officers properly document the decisions that they make.

As discussed in the recommendations, there is no current requirement for documenting commercial item determinations. As these are, by their nature, subjective determinations, absent errors in fact or failure to comply with prescribed procedures, the Contracting Officers' determinations as to the appropriateness of the documentation are considered evident by their decision to award.

We will continue our efforts to emphasize the importance of well considered price reasonableness determinations that we have discussed in regard to the Hamilton Sundstrand audit (case D2005-D000CH-0183) and to take action as discussed in response to the specific recommendations of this report that we believe will adequately address the concerns regarding market research and commercial item determination documentation.



Recommendations:

DoDIG Recommendation #1: When procuring defense system and subsystems, contracting officers should only determine an item to be commercial when sufficient commercial sales history to the general public provided by the contractor is adequate to support a price reasonableness determination. When this condition is not met, contracting officials should request certified cost or pricing data since the exemption is not granted.

DPAP Response: Nonconcur. Contracting Officers are required to use Part 12 of the Federal Acquisition Regulation (FAR) for the acquisition of supplies or services that meet the definition of commercial items at 2.101. The FAR definition, which is the same as that contained in the Federal Acquisition Streamlining Act of 1994, only requires that an item “has been offered for sale, lease, or license to the general public.” With the exception of services, the definition does not require sufficient sales to the general public adequate to support a price reasonableness determination. Exceptions to requiring submission of certified cost or pricing data are provided at 10 U.S.C. 2306a (b). In particular, 10 U.S.C. 2306a (b)(1)(B) prohibits the requiring of certified cost or pricing data “for the acquisition of a commercial item.”

Therefore, Contracting Officers can not request certified cost or pricing data. Notwithstanding the above, we have enumerated steps being taken to improve and clarify proper pricing techniques for non-competitive commercial acquisitions and clarify the policies regarding the use of other than cost or pricing data to support price reasonableness determinations during the discussions regarding the Hamilton Sundstrand audit.

DoDIG Recommendation #2: When commercial item determinations are made, these determinations should be in writing and included in the contracting file.

DPAP Response: Concur. A DPAP Policy letter will be issued within the next sixty days requiring a written determination that the commercial item definition has been met for acquisitions exceeding \$15 million, which is consistent with the congressional reporting requirement in Section 817 of the Bob Stump National Defense Authorization Act for Fiscal Year 2003 (Public Law 107-314) for commercial item exceptions to the Truth in Negotiations Act, 10 U.S.C. 2306a. This policy letter will be subsequently implemented in the Defense supplement to the Federal Acquisition Regulation.

If you have any questions regarding this memorandum, please contact my point of contact Mr. Andrew C. Obermeyer, at 703-697-6710 or at Andrew.Obermeyer@osd.mil.



Shay D. Assad
Director, Defense Procurement
and Acquisition Policy

Team Members

The Acquisition and Contract Management Directorate, Office of the Deputy Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

Richard B. Jolliffe
Bruce A. Burton
Rudolf Noordhuizen
Chrispian M. Brake
George Ford
Patrick Sampson
Amber M. Lyons
Meredith Johnson