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STATEMENT OF

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BEFORE THE

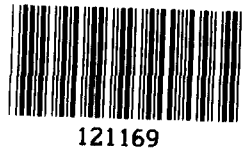
SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY

GOVERNMENT OPERATIONS COMMITTEE

HOUSE OF REPRESENTATIVES

ON

DOD's High Dollar Spare Parts Breakout Program



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Mr. Chairman, and members of the Subcommittee:

We are pleased to be here today to discuss the General Accounting Office's work concerning the Department of Defense's High Dollar Spare Parts Breakout Program.

We strongly support the intent of the Breakout Program which is to improve DOD's procurement of replenishment spare parts through greater use of competition or direct purchase from the actual manufacturers. However, we believe improvements are needed in the implementation of the program in order to make the program more effective.

In summary, various audits and reviews of the Services' breakout efforts by GAO and others have identified numerous and diverse problems inhibiting breakout efforts. As a result, although the program has brought about some significant savings, much more can be accomplished by strengthening the management of this program.

The value of spare parts bought by DOD each year is in the billions. In FY 1982, we estimate that DOD spent over $10 billion on spare parts. Given this enormous expenditure, it is essential that DOD and the Services make every effort to purchase these spare parts in the most economical and efficient manner possible.

The benefits from competing Government procurements have long been recognized. These benefits include lower prices, less chance of collusion, the potential for reduced leadtime, and better awareness of what alternatives the marketplace has to offer. The Defense Acquisition Regulation states that the Services shall use competition to the maximum extent practical.

In 1969, the Department of Defense issued the joint regulation establishing the High Dollar Spare Parts Breakout Program. The intent of the Breakout Program is to reduce the number of spare parts which are being purchased on a sole-source basis from prime equipment contractors, and to procure them instead either competitively or through direct purchase from the actual manufacturer. If the breakout is done correctly, there should be a reduction in the dollars spent for spare parts after deducting appropriate cost offsets. These offsets include any additional costs to the Government for administering the Breakout Program, qualifying new contractors, and competing the procurement. In addition, it should be recognized that purchase prices may vary because of quantity discounts and inflation.

Several recent reviews and audits performed by GAO, the Naval Audit Service, and the Defense Inspector General, have shown that if the Services are successful in breaking out high dollar value spare parts, savings can be substantial.

Because data on the DOD breakout program has not been maintained in one central location, we cannot state the value of replenishment spare parts which are being obtained competitively, through direct purchase, or sole-source from a prime contractor who is not the actual manufacturer. However, the bulk of the parts we examined were being purchased without competition.

Data on breakout efforts at the five Air Force logistics centers for aircraft engine replenishment spare parts showed that only about 1 percent of the funds spent in fiscal years 1981 and

1982 on spare parts were from a prime who was not the actual manufacturer. But, these figures are understated because we examined many items classified as "direct purchase from the actual manufacturer" that should have been classified as purchased "sole-source from a prime who is not the actual manufacturer."

PROBLEMS IN THE BREAKOUT PROGRAM

Several audits and reviews of the Breakout Program have identified a variety of problems which are inhibiting breakout efforts. These problems can be classified as either technical data, personnel, or system problems.

Data problems

For breakout efforts to be successful, the Government must have accurate, complete, current, and legible engineering or item description data and rights to use the data for competition or direct procurement.

In our recent review of the Breakout Program at the Air Force's Oklahoma City Air Logistics Center, we found that the Center was not being aggressive enough in determining whether the prime contractor's restrictive legends on technical data were justified. In most cases, restrictive legends can prevent procurements from other than the prime contractor. The Defense Inspector General's recent review of breakout efforts also showed that the Services lack adequate policy and procedural requirements covering receipt and acceptance of technical data.

Personnel problems

A shortage of personnel dedicated to the Breakout Program also seems to be inhibiting breakout efforts. In our review of

Army breakout efforts, we were told by an Army official that his breakout efforts were impeded because he had insufficient staff to review items for breakout and that breakout review had the lowest priority. Personnel shortages were also cited in the Naval Audit Service's breakout review.

A major consideration in conducting breakout reviews is deciding whether to assign engineers and technicians to do these reviews. Operating officials repeatedly cited the critical and urgent nature of their other engineering work as a reason for limiting breakout effort. This other work included failure analysis, repair and maintenance work and system modifications. Balanced against these factors was the little personal or organizational benefit to be derived from a successful breakout effort.

System problems

One of the most difficult problems is identifying the actual manufacturer of a spare part. An effective procedure for identifying the actual manufacturers of spare parts is lacking. Without this knowledge it is extremely difficult for a breakout effort to be successful. Presently, the Defense Acquisition Regulation does not require a prime contractor to identify subcontractors who do not generate parts data. This makes it difficult to determine whether there is a subcontractor, who it is, and what contribution, if any, the prime makes in producing a spare part.

The objective of the Breakout Regulation is to require the earliest possible identification and screening of spare parts in order to determine the optimum procurement methods, particularly competition or direct purchase. The selection of spare parts to be screened for breakout should be an adjunct to initial provisioning to the maximum practical extent.

In its recent review, the Defense Inspector General found that breakout reviews were done too late in the life cycle of a weapons system because of the way responsibilities are assigned between organizations. The logistic support organization has more incentive to breakout procurements than do the system procuring commands. The advantages of lower unit cost, faster delivery times, and better quality items derived through competition accrue primarily to the logistic support activity. But, waiting to apply the breakout process until the support responsibility actually passes to the designated logistic support activity can delay the breakout review for several years. This deprives the Services of the savings and other advantages that accrue on the many buys of components that occur in the intervening period. It would seem advisable, therefore, to have logistic support activities perform the initial breakout reviews on major components as soon as adequate information is available.

The Defense Inspector General's impression from talking to officials responsible for breakout programs was that there was resistance at the operating levels to breaking out items to competition. This is in spite of what DOD policies state and in spite of the many audits, congressional reviews and other reports

highlighting the problem. The primary operating command emphasis is understandably on high rates of readiness, particularly in the short term. By comparison, the saving of money on individual buys and the possibility that the money saved could buy a greater quantity of needed items in the future is something viewed as a relatively distant and uncertain benefit. Until this perception at the operating level is changed, it will be difficult to achieve a much better rate of competition through the breakout process.

Mr. Chairman, this concludes my prepared statement. My associates and I will be happy to answer any questions at this time.

GROSS SAVINGS RESULT FROM BREAKOUT

When parts are broken out, the change in price may be substantial. We call the change in price alone "gross savings" because other factors must be considered such as the cost to the Government for (1) administering the breakout program, (2) qualifying new contractors, and (3) competing the procurement. In addition, gross savings may have been affected by quantity discounts and inflation.

In our recent review of breakout efforts at the Air Force Oklahoma City Air Logistics Center (OC-ALC) we found the following examples of gross savings resulting from breakout.

	Sole-Source Buys Before Breakout		Competitive or Direct Buys After Breakout		Unit Gross Savings		
Sample Part	QTY	Unit Price	QTY	Unit Price	Price	%	Total
#15 Support	26	$14,960	61	$7,240	$7,720	52%	$470,920
#58 Seal	382	2,020	164	647	1,373	68%	225,172

Note: Information as of April 1, 1983 shows even larger savings.

Part	Most Recent Price	% Savings
#15	$6,310	58%
#58	476	76%

Attachment I

Our review of 14 spare parts broken out by the Army (TSARCOM) for the first time in fiscal year 1982 or the first quarter of fiscal year 1983 demonstrates that significant savings can be realized when the most optimum procurement methods are used. Our examination of the contract files related to the procurement of these 14 spare parts disclosed that due to breakout:

--Gross savings ranged from about $2,450 to $1 million.

--Total gross savings amounted to $2.16 million.

For example, in August 1981, TSARCOM awarded a sole-source contract for 46 items at a unit price of approximately $15,400 amounting to a total purchase value of about $708,000. The prime contractor was not the actual manufacturer. Subsequently, TSARCOM made a decision to breakout the spare part and compete it. On the next procurement in October 1982, TSARCOM requested bids and received offers of about $15,300 and $11,000 per unit for 228 units. Considering the differences in unit prices paid on prior sole-source award and the subsequent competitive purchase, TSARCOM obtained gross savings of $1 million from a combination of breakout efforts and possibly a quantity discount.

Attachment I

The Naval Audit Service, NorthEast Region, in its audit of the Ships Parts Control Center(SPCC) and the Aviation Supply Office (ASO) found that gross savings of as much as 76 percent of the purchase price could be achieved with a successful breakout effort. The Naval Audit Service cited the following examples:

Item identification number	Date of breakout report	Savings	Percent of savings over old unit cost
786-0308	2-23-81	$11,844	39 %
572-1358	12-03-80	34,408	76 %
216-1813	11-19-80	4,800	32 %
092-5413	10-27-80	135,421	62 %
346-6492	4-02-80	32,854	55 %
949-8428	4-25-80	15,225	28 %

Attachment II

SELECTED DEFINITIONS FROM THE DEPARTMENT OF DEFENSE JOINT REGULATION HIGH DOLLAR SPARE PARTS BREAKOUT PROGRAM MARCH 1969.

Part 2 - Definition of Terms

1-201.1 Spare Parts. Spares and repair parts, reparable and consumable, purchased for use in the maintenance, overhaul, and repair of equipment such as ships, tanks, guns, aircraft, missiles, ground communications and electronic systems, ground support and associated test equipment. As used in this Regulation, except when distinction is necessary, it includes items, spares, parts, repair parts, subassemblies, components, and subsystems, but excludes end items such as aircraft, ships, tanks, guns and missiles.

1-201.4 Replenishment Procurement. The purchase of spare parts following initial provisioning procurement.

1-201.5 Hi-Dollar Value Replenishment Spare Parts. Any spare part included in those items ranked in descending order of annual buy value (computed by multiplying the unit price times annual buy quantity) which represent at least eighty percent (80%) of all dollars expected to be spent in the 12-month period when measured in descending order from the highest annual buy value item.

1-201.9 Competition. Spare parts purchased by means of solicitation and receipt of offers from two or more responsible sources presumed to be acting independently to

secure the order, by offering or negotiating the most favorable price, quality, and delivery terms; or by means of formally advertising the requirement to all known qualified sources.

1-201.10 Direct Purchase. The noncompetitive procurement of an item from the actual manufacturer or vendor. This includes a noncompetitive procurement from a prime contractor who is the actual manufacturer of the item.

1-201.12 Procurement Method Codes (PMCs). Numbers used to denote the procurement status of spare parts, as follows:

(i) PMC 1. Items screened and found to be already competitive.

(ii) PMC 2. Items screened and determined for the first time to be suitable for competitive procurement.

(iii) PMC 3. Items screened and found to be procured directly from the actual manufacturer or vendor, including a prime contractor who is the actual manufacturer.

(iv) PMC 4. Items screened and determined for the first time to be suitable for direct purchase from the actual manufacturer or vendor rather than the original prime contractor for the end items which these parts support.

(v) PMC 5. Items screened and determined not suitable for competitive procurement or direct purchase and which, therefore, continue to be procured from a prime contractor who is not the actual manufacturer.

1-201.15 Savings. The reduction in dollars spent for spare parts purchased for the first time either competitively or by direct purchase breakout, after deduction for appropriate cost offsets, whether by initial provisioning procurement or replenishment procurement.

1-201.19 Design Control Activity. The activity having responsibility for the design, preparation, and maintenance of engineering drawings and other technical data for a given spare part. The design control activity may be a prime contractor, a Government activity, a vendor, or others.

1-201.20 Breakout. The improvement in the procurement status of an item resulting from deliberate management action. Examples are (i) the competitive procurement of an item previously purchased noncompetitively and (ii) the direct purchase of an item previously purchased from a system prime contractor who is not the actual manufacturer of the item.

1-300 Methods of Procurement.

1-300.1 Competition. All procurements, whether by formal advertising or by negotiation, shall be made on a competitive basis to the maximum practicable extent.

1-300.2 Direct Purchase. When competitive procurement is not feasible, every effort will be made to purchase spare parts directly from actual manufacturers of the items.

1-301 Sources of Supply. Contracts are to be awarded only to sources who have established their technical and financial qualifications to perform in accordance with the

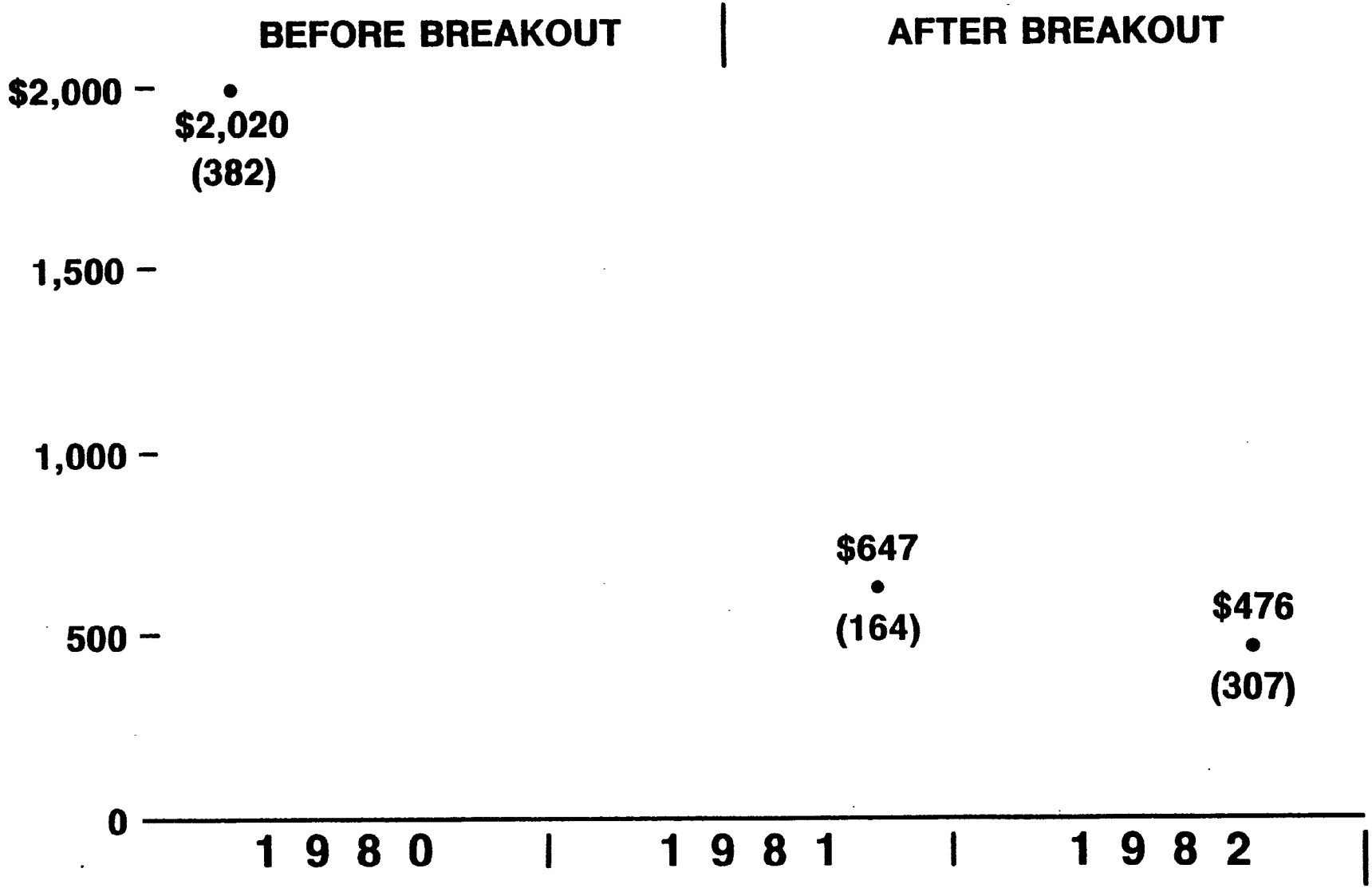
Government's requirements for timely delivery of reliable spare parts. Breakout to competition or direct purchase is not to be undertaken at the risk of impairing the safe, reliable and effective operation and timely support of the equipments and systems in which the items are to be used.

1-302 Early and Selective Screening. The objective of this Regulation requires the earliest possible identification and screening of spare parts which account for the preponderance of spare parts procurement dollars in order to determine the optimum procurement methods, particularly the potential for breakout to competition or direct purchase. The selection of spare parts to be screened for breakout should be made as an adjunct to initial provisioning to the maximum practicable extent.

1-309 Quality Control and Inspection.

(c) Some conditions which often preclude breakout on initial provisioning procurements are unstable equipment design, lack of reliable overhaul and replacement factors, limited time to place orders for timely delivery, lack of an adequate data package, and the need for a prime contractor's configuration control. When these impediments do not exist or when DOD activities can assume some of the basic responsibility for ensuring that items delivered by the manufacturer are configured to the latest design change and that adequate inspection and quality control procedures are employed, significant savings can be achieved by breakout.

SAMPLE PART 58
$ PRICE PER UNIT
(# UNITS)

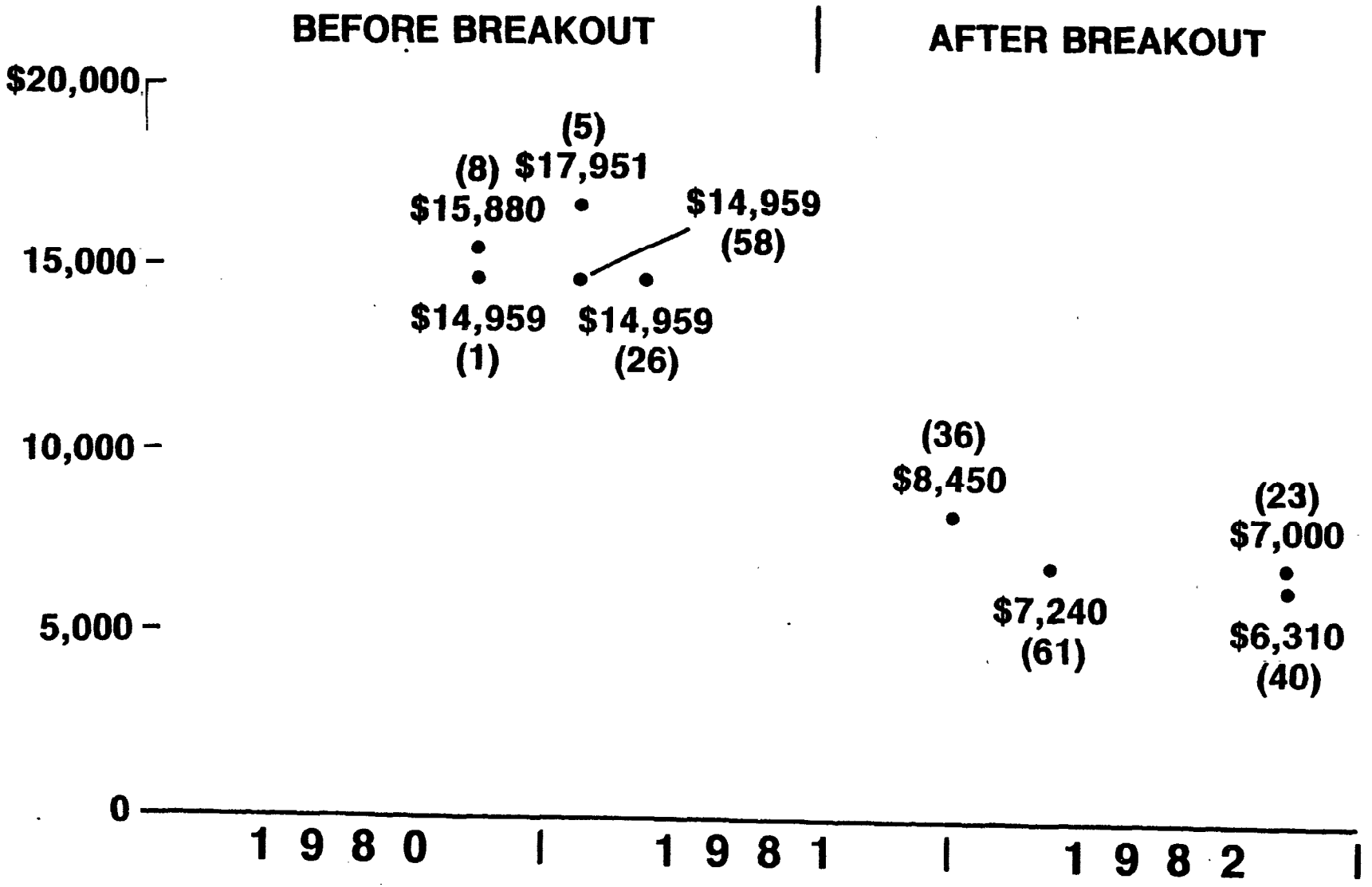


Attachment III

Attachment III

SAMPLE PART 15
$ PRICE PER UNIT

(# UNITS)



Attachment III

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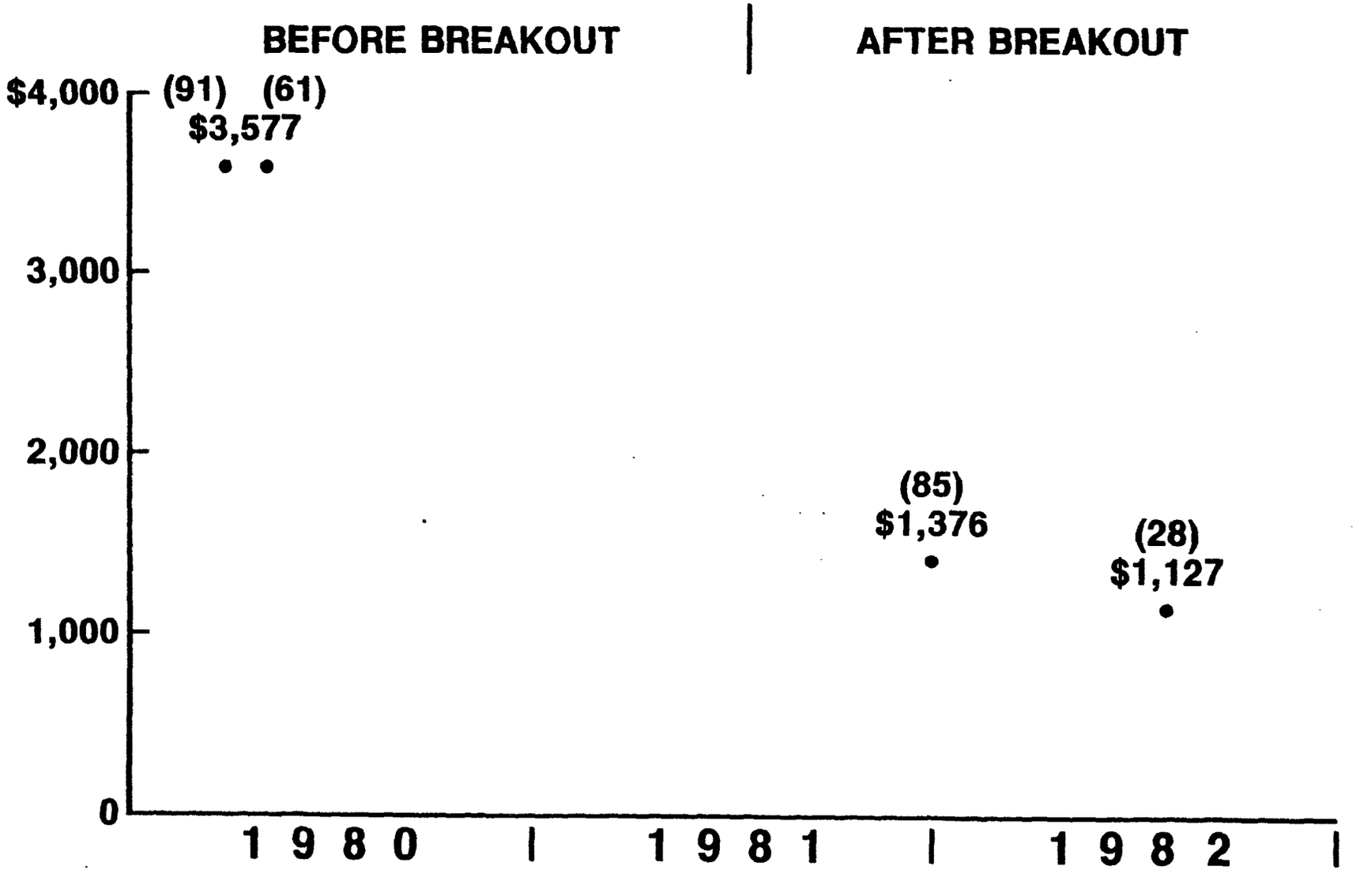
SAMPLE PART 1
$ PRICE PER UNIT
(# UNITS)



Attachment III

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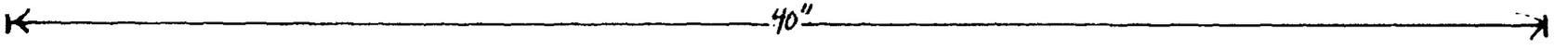
SAMPLE PART	NAME	USED IN AIRCRAFT ENGINE	AIRCRAFT
1	BAFFLE	P&W TF30	F-111
15	SUPPORT	P&W TF30	F-111
58	SEAL	P&W TF33	B-52H C-141 E-3A



Attachment III