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

REPORT
NO. 91-003

October 9, 1990

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS)
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Final Report on the Survey of Long Lead Contracting for Production (Project No. 0CD-0049)

## Introduction

This is our final report on the survey of Long Lead Contracting for Production for your information and use. The Contract Management Directorate performed the survey from February to June 1990. The objectives of the survey were to determine if DoD activities followed established policies and appropriation act authority regarding long lead contracting and if they used this method of contracting in an effective and efficient manner. The survey also evaluated applicable internal management control procedures. Other objectives were to determine if long lead contracts were definitized and if contractors provided adequate cost and pricing data to support the cost of long lead items. There is over $2 billion per year obligated for long lead contracts.

## Discussion

For the three contracts reviewed the Services complied with the wording and intent of the DoD annual appropriations act by properly using the funds for long lead contracting to purchase parts, components, and materials. Except for the Air Force, the Services did not establish specific internal control procedures for long lead funding. Instead, the Services used the standard procurement internal control procedures. These internal controls were adequate to ensure compliance with applicable laws and regulations. In addition, the three contracts reviewed were definitized.

During our review a subcontractor had not provided cost and pricing data to support the cost of long lead items. The Defense Contract Audit Agency (DCAA) had brought this to the attention of the prime contractor who agreed to require cost and pricing data from the subcontractors. DCAA officials stated that they were following up on this issue. At another location, a contractor may have submitted inaccurate and incomplete cost and pricing data to support long lead items. We referred this issue to the resident DCAA office for further review.

Based on our survey results, no additional audit effort is considered necessary.

## Scope of Survey

For the survey, we selected three major Service acquisition programs with long lead funds appropriated for fiscal years 1987, 1988, and 1989. According to DoD's June 30, 1989, Selected Acquisition Report, the total of long lead funds appropriated for the three programs during these fiscal years was over $786 million from $7 billion appropriated for long lead programs. We visited three procurement offices, two prime contractors, and three subcontractors during the survey. Enclosure 1 lists the activities visited or contacted.

DoD Directive 7200.4, "Full Funding of DoD Procurement Programs," establishes the criteria used in the survey. This directive requires that advance procurement requests for long lead items be limited to the end items in major procurement appropriations. The components, materials, parts, and effort budgeted for long lead items shall be relatively low when compared to the total end item cost. Also, the directive requires that advance procurement budgets represent at least the termination liability for the long lead items.

We reviewed the contract statement of work to determine if long lead items were limited to the appropriate end items. Also, we reviewed the contracts to determine if the long lead item costs were low when compared to the total cost of the end item, and whether they contained the termination liability clause.

The economy and efficiency audit was made from February to June 1990 and was conducted in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary.

## Internal Controls

We evaluated internal controls used by the Services to procure long lead items. The evaluation included reviews of budgeting procedures and policies and procedures related to long

lead procurements. We found no material internal control weaknesses in the use of long lead procurement funds.

## Background

DoD obligates over $2 billion per year for long lead items in its more than 100 major programs. These funds are used when it is necessary to initiate work prior to the award of a complete contract. Long lead items can only be contracted for when advance procurement funds for the items have been budgeted, authorized, and appropriated.

FAR 17.101, "Multiyear Contracting," states that advance acquisition is an exception to the full funding policy. This section allows acquisition of long lead items in a fiscal year prior to the fiscal year when the end item is to be purchased.

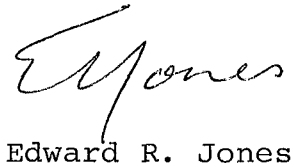
## Prior Audit Coverage

There have been no prior audits of long lead contracting for production.

## Report Staffing

We provided a draft of this report to the addressees on July 23, 1990. Because there were no recommendations, no comments were required of management, and none were received. Since there are no unresolved issues, written comments to this report are not required.

We appreciate the courtesies and cooperation extended to the audit staff. The audit team members are listed in Enclosure 2. Copies of the final report will be distributed to the activities listed in Enclosure 3. If you desire to discuss this final report, please contact Mr. Paul Granetto, Program Director, at (703) 693-0573 or Ms. Macie Hicks, Project Manager, at (703) 614-6273.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force

## ACTIVITIES VISITED OR CONTACTED

### Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics), Washington, DC

### Army

Assistant Secretary of the Army (Financial Management), Washington, DC
U.S. Army Aviation Systems Command, St. Louis, MO
U.S. Army Plant Representative Office, Mesa, AZ
U.S. Army Plant Representative Office, Culver City, CA

### Navy

Assistant Secretary of the Navy (Financial Management), Washington, DC
Naval Sea Systems Command Headquarters, Arlington, VA

### Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Aeronautical Systems Division, Dayton, OH
U.S. Air Force Plant Representative Office, Long Beach, CA

### Defense Contract Audit Agency

Headquarters, Alexandria, VA
Resident Office, McDonnell Douglas, Mesa, AZ
Resident Office, Douglas Aircraft, Long Beach, CA

### Defense Logistics Agency

Headquarters, Alexandria, VA

### Contractors

McDonnell Douglas Helicopter Company, Mesa, AZ
ALCOA Composites, Composite Structures Division, Monrovia, CA
McDonnell Douglas Company, Culver City, CA
Teledyne Ryan Aeronautical, San Diego, CA
Douglas Aircraft Company, Long Beach, CA
Martin Marietta Orlando Aerospace, Orlando, FL

## AUDIT TEAM MEMBERS

David K. Steensma, Director
Paul G. Granetto, Program Director
Macie J. Hicks, Project Manager
Donney J. Bibb, Team Leader
Henry P. Hoffman, Team Leader
Jerry E. Bailey, Auditor
William D. Anderson, Auditor
Kevin E. Richardson, Auditor