

DOCUMENT RESUME

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Report to Sen. Jacob K. Javits; by H. L. Krieger, Director, Federal Personnel and Compensation Div.

Contact: Federal Personnel and Compensation Div.

Organization Concerned: Department of the Air Force; Department of the Army.

Congressional Relevance: Sen. Jacob K. Javits.

Questions were asked and responses given on matters relating to the transfer of operations of military clothing sales stores (MCSS) to the Army and Air Force Exchange Service (AAFES). Did a recent Air Force review adequately address claims made by the insignia industry and were AAFES-operated MCSS experiencing insignia shortages or delays? The review did not address the claims but identified accounting and inventory management problems, including stock overages and shortages. Actions taken and planned by AAFES were considered responsive. Claims that the transfer would jeopardize the insignia industry and that the Defense Personnel Support Center could not properly manage procurements were not thought to be generally supportable. How cost effective is the transfer? Although the Air Force found its transfer cost effective, the Army decided against having AAFES operate its MCSS; an indepth evaluation was not necessary. Should the Army follow the Air Force's example of transferring MCSS operations to AAFES? This question, as well as other alternatives, will be considered in planning future work in the area. (HTW)



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FEDERAL PERSONNEL AND
COMPENSATION DIVISION

B-133177

May 15, 1978

The Honorable Jacob K. Javits
United States Senate

Dear Senator Javits:

On May 12, 1977, you requested advice on matters relating to the transfer of operations of military clothing sales stores (MCSS) to the Army and Air Force Exchange Service (AAFES). Specifically you asked:

- Whether a recent Air Force review of the AAFES operation of Air Force MCSS adequately addressed certain claims made by the insignia industry and whether the AAFES operated MCSS were experiencing any insignia shortages or delays.
- How cost effective is the transfer of the insignia sales to AAFES considering the possible harm it may cause the insignia industry?
- Whether, in light of the above findings, the General Accounting Office believes the Army should follow the Air Force's example of transferring MCSS operations to AAFES.

The results of our inquiry are discussed in detail in the enclosure and are summarized here.

The Air Force's recent review of AAFES operated MCSS did not address the claims made by the insignia association, but the review did identify accounting and inventory management problems requiring attention, including stock overages and shortages. The Air Force considered the action taken and planned by AAFES to correct those identified management problems to be responsive, and the Office of the Secretary of Defense (OSD) stated that future transfers of clothing sale stores to AAFES operations will require prior review and approval of agreements by OSD to ensure adequacy of supply management practices.

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(963073)

Claims made by the Military Accessories Service Association indicated that

- the MCSS transfers will be disastrous to the insignia industry and jeopardize its existence,
- the Defense Personnel Support Center (DPSC) cannot procure additional items in an expeditious manner,
- DPSC appropriated fund items should not be placed in direct competition with AAFES commercially-procured items, and
- DPSC does not have the knowledge to properly manage procurements of insignia items thereby causing a substantial tax-dollar waste.

While these claims were not addressed during the Air Force's review the Air Force, DPSC, and AAFES believe the claims to be generally unsupported. Furthermore, the insignia industry's existence does not appear to be in jeopardy because there are other Government and commercial markets for their products and the Army has decided to continue operating MCSS apart from AAFES clothing departments.

Although the Air Force found its transfer cost effective, the Army has not been convinced that AAFES can operate its MCSS more economically and decided not to have AAFES operate them. In view of the Army's decision, your office agreed an indepth evaluation of the proposed Army transfer was not necessary at this time.

This office has a continuing interest in improving the economy of resale operations of the military departments. The question of whether the Army should follow the lead of the Air Force and transfer its MCSS to AAFES, as well as other alternatives, will be considered in planning future work in the area.

As arranged with your office, copies of this letter will be made available to others upon request.

Sincerely yours,



H. L. Krieger
Director

Enclosure

INTRODUCTION

The military departments operate military clothing sales stores (MCSS) on installations to sell issue type (standard) uniforms and accessories to officers and enlisted personnel at cost plus shipping (stock fund prices) as authorized by DOD Directive 7420.1. MCSS operating costs are paid with departmental operation and maintenance funds, and the standard items sold by the stores are procured from the Defense Personnel Support Center (DPSC) with stock funds. Army MCSS sales for fiscal year 1976 were \$38.8 million. Air Force sales for the same period were \$23.2 million.

The Army and Air Force Exchange Service (AAFES) operates military uniform departments in exchanges, which stock optional items (dress/formal uniforms and accessories, etc.) not sold in the MCSS. They also stock brand name items comparable to those sold in the MCSS. The merchandise is purchased from commercial vendors and sold at acquisition cost plus a markup for operating costs.

One of the major lines carried by the MCSS and AAFES is insignia. DPSC purchases all insignia for resale in MCSS on competitive contracts, all of which are set aside for small businesses. AAFES buys its insignia on a negotiated basis in order to maintain sources for military insignia. AAFES requires its insignia to be attractively packaged and stocked on its shelves by vendors. Members of the Military Accessories Service Association, whom are believed to be small businesses, are large suppliers of insignia to AAFES and on occasion were successful in obtaining contracts with DPSC to furnish insignia for resale in MCSS. AAFES purchases of insignia from association members totaled \$6 million during fiscal year 1976.

The Army and Air Force on several occasions dating back to 1956 have considered the proposal that AAFES operate MCSS for a management fee paid with appropriated funds. Such operations were promoted as a means of reducing appropriated fund operating costs of MCSS and releasing military personnel to military line duties. Proposed transfers of military clothing operations to the exchanges were halted mainly because of legal questions on funding and whether the military services had the authority to replace appropriated fund management with non-appropriated fund management.

In September 1972, AAFES established a study group to determine the feasibility and desirability of its assumption of the responsibility for operation and supervision of the Army and Air Force MCSS. The study group found such an operation was feasible and recommended that a test operation be conducted by the Army and Air Force for the purpose of (1) determining the effectiveness of AAFES procedures and customer service, and (2) the cost effectiveness of AAFES operations compared to in-house operations.

In 1973, test operations were approved by the Army and Air Force. An Air Force Steering Committee report on the AAFES test operation found the potential for substantial savings in money and manpower spaces (263 military and 255 civilian) would be realized, and that 70 percent of customers surveyed preferred the AAFES operation because of the increased service and convenience. For these reasons, the Air Force recommended the AAFES operation be implemented on a worldwide basis. The House Armed Services Committee and OSD later agreed.

The Army delayed taking a position on the test operation until February 1975 when it concluded there was no economic justification or operational benefit to be gained by transferring its MCSS operations to AAFES.

DID THE AIR FORCE'S REVIEW ADDRESS
INDUSTRY CONCERNS AND INSIGNIA SHORTAGES

The Air Force review of AAFES operated MCSS conducted in 1977 did not address the claims put forth by the insignia association. The review did identify accounting and inventory management problems requiring attention, including stock overages and shortages. The Air Force auditors concluded the problems were due primarily to the magnitude of the MCSS operation and the limited number of experienced AAFES managers with a thorough understanding of inventory controls. The Air Force considered the action planned and taken by AAFES to correct management problems to be responsive.

The concerns of the association member firms were addressed by the Air Force DPSC, and AAFES. They are discussed below.

Impact of Transfer on Insignia Industry and the Military Services

The insignia association claimed that since the Air Force transferred its MCSS operations to AAFES management, insignia association sales have dropped by 35-45 percent; and if similar action is taken by Army, the impact would be catastrophic to the insignia industry.

The insignia association members' welfare does not appear to be in jeopardy because there are other markets for their products, and the Army has decided to continue operating its MCSS apart from AAFES military clothing departments.

Furthermore, the Air Force reported the concern with collocated DPSC and commercially procured items is not considered wholly justified. Since the Air Force transferred its MCSS to AAFES, overall payments by AAFES to association member firms for goods purchased increased from \$5.2 million in calendar year 1975 to \$6 million in calendar year 1976. According to association members, sales to Air Force exchanges increased by 50 percent between calendar years 1975 and 1976, but sales were expected to decline 31 percent for calendar year 1977. Overall, association sales to Air Force exchanges have increased 4 percent between 1975 and 1977. Further declines in insignia sales to AAFES are not expected to occur because the Army has decided to continue independent MCSS operations.

Association member firms, all of which are believed to be small businesses, have a ready market in DPSC. DPSC officials told us all insignia purchases, except dress uniform button procurements, are set aside for small businesses. Thus, association member firms could provide insignia needs of the Department of Defense through either DPSC or AAFES. On occasion association member firms with manufacturing facilities have provided DPSC with small quantities of metal insignia. Also, association member firms are not precluded from selling in commercial markets to such organizations as police and fire departments, Scouts, etc.

Air Force officials believed there would be no impact on the Department if association member sources were not available because the association firms are primarily dealer/vendors rather than manufacturers of military insignia. AAFES could procure standard and optional insignia items directly from other vendors/manufacturers, or the Air Force could request DPSC to procure the items for subsequent sale in AAFES operated MCSS.

Timely Procurement of Insignia Items by DPSC

The insignia association claimed that DPSC could not procure in an expeditious manner the numerous special orders or new items furnished AAFES by association member firms. DPSC officials advised us that DPSC can supply all of the items now furnished by association member firms to AAFES in a timely manner provided military approval is received and the services make available complete specification data. Many of the insignia provided by association member firms are optional items with minimal quantity requirements and central stockage of such items may not be economical.

Association member concerns over the longer delivery times for DPSC procured items were found to be somewhat unfounded because delivery times of stocked DPSC insignia items would be comparable to those provided by the association member firms. Differences in delivery times are more apparent for "newly developed" items. DPSC purchases are subject to regulatory controls to which AAFES purchases from association member firms are not. DPSC is required by Armed Services Procurement Regulations to solicit on a competitive basis for a minimum of 20 days before awarding an insignia contract.

Because AAFES buys goods for resale with nonappropriated funds its purchases are not subject to the Armed Services Procurement Regulations and its contracting practices are more flexible. AAFES does not advertise for competition but buys on a competitive or sole source basis from identified sources and thus does not have to endure advertising delays. Furthermore, the time frames mentioned in the insignia association's correspondence of 120 days to 1 year for delivery of DPSC procured items are applicable to bulk procurements. Bulk procurements are based on the

services' estimated demands for insignia and may be for a few years' requirements. Purchases and delivery of smaller quantities can normally be accomplished in a 30-45 day time frame, which is comparable to that provided by the association member firms.

The case cited by the insignia association to illustrate its members ability to supply new items months before DPSC concerned the delivery of Air Force officer epaulets never before produced. DPSC explained that the specified fabric was not readily available so specifications and scheduled deliveries were revised and deliveries were in accordance with the new contract schedules.

Competition Between AAFES and DPSC Procured Items

The insignia association was concerned that using appropriated funds to pick up some of the costs of procuring and selling standard items placed AAFES procured items in an unfair competitive position.

DPSC procured items are less expensive than similar items procured by AAFES. The military services are permitted by 10 U.S.C. 2209 to procure and sell at acquisition price plus overhead, uniform articles designated by the service secretaries. Accounting and financing policies for the military services are established by DOD Directive 7420.1. The Directive stipulates that only certain overhead costs will be included in the pricing of stock fund materials and others shall be charged to appropriations for operations. Therefore the price an authorized customer will pay for DPSC procured items is less than the actual cost of the article at the point of sale.

The price differences between DPSC and AAFES procured insignia are not totally created by appropriated fund support for DPSC items. Other contributing factors such as AAFES and insignia association self-imposed policies and standards higher than those required by the military services, result in higher prices on AAFES procured insignia.

The Air Force and AAFES contend that such competition acts as a sales stimulus and offers customers a choice of products.

DPSC Procurement Management
Practices Do Not Appear Wasteful

The observation by insignia association member firms that the DPSC procurement management practices are wasteful could not be substantiated. The insignia association members apparently misunderstood the supply management techniques employed by the Defense logistics system which lead them to conclude excessive quantities of insignia were being purchased for the number of people authorized to wear them.

The cases cited by the association were extracted from a procurement forecast and a cover sheet of an invitation to bid issued by DPSC.

In one case the quantity appeared excessive for a single indicated item but the listing of items needed was for a category of all similar items described by the same generic nomenclature and not just one particular item.

In another case involving the invitation to bid on the identified insignia of "general officer," the quantity being procured was for an estimated 2-year requirement. Records revealed that demands for the identified item over the past year justified the quantities advertised.

IS THE TRANSFER COST EFFECTIVE?

Although the Air Force found its transfer cost effective, the Army has not been convinced that AAFES can operate its MCSS more economically. The Army reconsidered the proposal to transfer its MCSS to AAFES in 1976 and 1977. The studies pointed out that projected savings under AAFES management was difficult to estimate because reports of excessive inventories and out-of-stock conditions coupled with sales declines in AAFES operated MCSS indicated that AAFES may have to charge a higher management fee for the operation of the MCSS.

AAFES inventory management problems plus the complexity of Army MCSS operations resulted in the study groups recommending that:

--The transfer of Army MCSS not be considered.

--The overall cost effectiveness of in-house operations be improved.

--The transfer of MCSS to AAFES not be reconsidered until fiscal year 1979 at which time Air Force would have 2 years of experience.

SCOPE

We evaluated Army, Air Force, and AAFES studies of in-house controlled and AAFES operated MCSS, and reviewed the authority for such operations. We visited officials in the Defense Manpower, Reserve Affairs, and Logistics Office; DPSC; Army Deputy Chief of Staff for Logistics' Services Branch and Institute of Heraldry; and AAFES headquarters.