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REPORT TO  
THE CONGRESS OF THE UNITED STATES

NEW PROCEDURES ADOPTED  
TO IMPROVE MANAGEMENT OF  
CONTRACTOR-OPERATED MESSING  
AND  
MERCHANDISING SERVICES  
AT KWAJALEIN MISSILE TEST SITE

B 152598

DEPARTMENT OF DEFENSE

LAW BRANCH  
THE ARMY LEGAL



BY  
THE COMPTROLLER GENERAL  
OF THE UNITED STATES

JULY 1967

7/18/67

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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-152598

<sup>18</sup>  
JUL 19 1967

To the President of the Senate and the  
Speaker of the House of Representatives

The General Accounting Office has reviewed records relating to contractor-operated messing and merchandising activities at the Army's missile test site at Kwajalein in the Marshall Islands. The review disclosed, as shown in the accompanying report, a loss of about \$1.6 million during a 2-year period ended in February 1966, chiefly because prices charged to customers were too low.

The contractor operated, in addition to the messing facilities, a commissary, retail store, laundry, barber shop, beauty shop, snack bar, and liquor store and clubs at Kwajalein. Under the contract terms, costs to the contractor--Global Associates of Oakland, California--in operating these facilities were to be reimbursed by the Government. The Government would subsequently recover its cost through revenues derived from charges to consumers.

The Department of Defense concurred with our findings and advised us that the Army agreed that the contractor should take steps to ensure that losses in messing and merchandising would be recovered by revised pricing; that the contractor should establish in its accounting records a reserve for losses on disposition of obsolete, damaged, or spoiled merchandise; and that the Army should review the contractor's buying and storage records to reduce future losses on merchandise.

In addition, the Department of Defense stated that our findings and its letter of comment would be furnished to the military departments calling attention to the need for reviewing messing and merchandising at other similarly remote locations.

We believe that the corrective actions taken or proposed by the Department of Defense and the Department of the Army should, if properly implemented, help to ensure that costs incurred in this and similar contractor operations of messing and merchandising activities will be recovered in charges to customers.

B-152598

This report is being issued so that the Congress may be informed of steps being taken by the Department of Defense to strengthen controls over contractor-operated support activities at **isolated** military installations.

Copies of this report are being sent to the Director, Bureau of the Budget; the Secretary of Defense; and the Secretaries of the Army and Navy.

A handwritten signature in black ink, reading "James B. Stewart". The signature is written in a cursive style with a prominent initial "J".

Comptroller General  
of the United States

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REPORT ON  
NEW PROCEDURES ADOPTED  
TO IMPROVE MANAGEMENT OF  
CONTRACTOR-OPERATED MESSING

MERCHANDISING SERVICES  
AT KWAJALEIN MISSILE TEST SITE  
DEPARTMENT OF DEFENSE

INTRODUCTION

The General Accounting Office has reviewed certain aspects of the administration of Department of the Army cost-plus-incentive-fee contract DA-01-021-AMC-90004(Y) awarded to Global Associates, Oakland, California, for the logistics support of Department of Defense missile and related test programs at the Kwajalein test site in the Marshall Islands. Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53); the Accounting and Auditing Act of 1950 (31 U.S.C. 67); and the authority of the Comptroller General to examine contractors' records, as set forth in contract clauses prescribed by 10 U.S.C. 2313(b).

Services provided by Global under the contract include transportation, repair and maintenance of equipment, security and fire protection, hospitalization, education, messing, and merchandising. Total contract costs for the 2-year period ended February 28, 1966, amounted to about \$37 million. We examined records maintained by the contractor in support of costs and revenues for that period, with emphasis on those records relating to the contractor-operated messing and merchandising activities which we considered to be in need of particular attention. Costs reported by the contractor in the operation of the messing and merchandising activities during the period totaled about \$12 million.

## BACKGROUND

A 1-year contract was awarded to Global Associates by the Department of the Navy in December 1963. The contract provided, in effect, for a phase-in period beginning in December 1963 with Global progressively assuming increasing responsibilities until it assumed complete responsibility for all support functions on March 1, 1964. The contract, effective for the period March 1, 1964, through February 28, 1965, included options providing for the extension of the contract for two additional 1-year periods.

On July 1, 1964, responsibility for the Kwajalein test site was transferred to the Department of the Army and administration of the contract was transferred to the Army's NIKE-X Project Office (NXPO), Redstone Arsenal, Alabama. The NXPO subsequently exercised the first 1-year option and negotiated extensions which carried the period of the contract through September 30, 1966.

Under the contract terms, the contractor was to be reimbursed for all costs incurred in its base-support operations, as approved by the contracting officer. The costs of operating the messing facilities and the merchandising activities, however, were to be subsequently reimbursed to the Government by revenues derived from charges to consumers. The merchandising activities included a commissary, retail store, laundry, barber shop, beauty shop, snack bar, and retail liquor store as well as clubs.

As to these two types of contractor activities, after an initial trial period during which actual operating costs could be determined, the contractor was to establish prices in the messes which would enable the messes to be self-supporting. The contract provided, also, that prices for the merchandising activities be established to provide a profit which would be used to partially

defray recreational costs. The messing prices established by the contractor were subject to review and approval by the contracting officer.

In March 1966, the Kwajalein nonindigenous population, excluding transients, was **3,273** which comprised 1,755 employees of various Government contractors and subcontractors, 102 military and civilian Government employees, and **1,416** dependents.

The principal officials of the Department of Defense and of the Departments of the Army and Navy responsible for administration of the activities discussed in this report are listed in appendix I.

## FINDING

### NEED FOR PROCEDURES TO ENSURE REALISTIC PRICING STRUCTURE AND TO PROMOTE ECONOMICAL INVENTORY MANAGEMENT PRACTICES

During the 2-year period ended in February 1966, costs incurred in the operation of the messing and merchandising activities by Global Associates exceeded revenues derived from sales of food and merchandise by about \$1.6 million.

In our opinion, the implementation by the Army and the Navy of procedures to ensure establishment of realistic resale prices and more economical management of inventories could have avoided the incurrence of the greater portion of the excess costs. We have since been advised by the Department of Defense that action has been initiated to develop procedures which should minimize future Losses.

### Meal charges insufficient to recover costs incurred in operation of messes

The request for proposals issued to all interested bidders specified that the total cost of food and services for subsistence in the messes would be recovered. In the negotiations with Global Associates, it was agreed that during a phase-in period and continuing through the initial 90 days of the contract (up to June 1964), fixed meal rates would be in effect for Global Associates **employees** pending a determination of the actual costs of operating the messes.

The fixed meal rates set during the trial period (\$1.50 and \$2 a day for the general and executive messes, respectively) were the same as those that had been specified for the prior contractor's employees but were from \$1 to \$2 a day lower than the rates

charged to personnel of other contractors. The prior contract did not require that the messes be operated on a self-sustaining basis.

The fixed meal rates of \$1.50 and \$2 a day were known to be substantially less than the prevailing cost of meals under the preceding contractor's operations. Meal rates needed to effect full cost recovery had since 1961 ranged from \$2.50 to \$3.50 in the general mess and from \$3 to \$3.60 in the executive mess. Nevertheless the Navy acquiesced in the charging of the lower rates.

During the initial 90 days of the contract while the fixed meal rates were in effect, the unrecovered messing costs totaled about \$343,000.

The contract provided that after the trial period Global Associates would recover in the price of meals charged to the diners the total cost of the food and services involved in preparation of the meals. Dining customers included employees of Global Associates, employees of other contractors, and Government personnel.

Global Associates, in correspondence with the Navy, requested relief from the contract requirement that, effective June 1, 1964, it recover **mess-operating costs**, because of the impact that it anticipated meal rate increases **would** have on employee morale. The request was denied.

For the period beginning in June 1964 and continuing through February 1966, during which the contractor was required to recover the messing costs, the costs reported by Global Associates as applicable to the operation of the messes exceeded revenues by about \$260,000. The deficit arose from the contracting officer's having approved meal rates which were inadequate to recover losses incurred in prior quarters when actual costs had exceeded estimated costs. We found that instructions of the Army governing logistic

support of the Kwajalein test site did not provide for recoupment of operating losses incurred in the messes during prior periods.

After we brought the matter to the attention of the contracting officer, he stated that, beginning October 1, 1966, when the new logistics support contract became effective he would require that the contractor establish meal rates designed not only to cover anticipated costs of the ensuing quarter but also to recover losses of the prior quarter,

In addition, we found that costs of about \$361,000 which related to the messing operations for the period June 1964 through February 1966 had been charged to the Government by the contractor as part of its reimbursable base-support costs. This widened the disparity between the actual costs incurred in the messing operations and the meal rates. These costs included \$60,500 for butchering, \$97,500 for janitorial duties, \$65,300 in bakery operations, \$6,500 in losses of spoiled food, and \$81,400 in employees' fringe benefits. Also, in September 1964, Global Associates began to charge to base-support costs the cost of trimmings which were removed from meat issued to the messes (at an assigned value of \$1 a pound). The total cost of the meat-trimming transfers in this period was about \$50,500.

Apparently these cost transfers were made by the contractor as part of its effort to reduce the mess-operating costs so that prospective meal rate increases to its employees would be minimized. The contracting officer approved the meal rates but did not request an audit of the contractor's accounting procedures by the resident auditors to determine that all costs were properly being allocated to the messes. An audit of the accounting procedures should have revealed the cost transfers and provided the contracting officer

with a more informed and reliable basis for determining the true operating costs prior to approving the meal rates.

In summary, our review of the records showed that about \$964,000 of costs incurred in the operation of the messes had not been recovered in charges to customers. To some extent, an increase in resale prices in the messes might have served to increase the Government's costs under some of the contracts in effect at Kwajalein in cases where employees' meal costs were included in contractors' charges to the Government. (Statistics reviewed indicated that about 38 percent of the meals were consumed by employees of contractors other than Global Associates.) However, even after allowing for this factor, we estimate that the Government could have avoided incurring unrecovered costs of about \$600,000 by better administration of the contract provisions governing the operation of the messes.

After we discussed our findings with the contracting officer, he directed his representative at Kwajalein to ensure that janitorial, butchering, and bakery costs applicable to the messing operations be recovered in consumer prices. The practice of charging costs of spoiled food, fringe benefits, and meat trimmings to base support was discontinued by the time we left the audit site.

The contracting officer stated that he was aware of the need for more adequate and timely review of the data supporting the contractor's quarterly meal price proposals, so that any inaccuracies in the cost information **would** be brought to his attention before he approved the quarterly meal rates. He stated that, to accomplish this, he had directed his representative at Kwajalein to require the local Defense Contract Audit Agency staff to review and report on the accuracy of the cost data before he forwarded the proposal to **NXPO** for approval.

### Costs excluded from merchandising activities

Section N of the contract and implementing financial procedures required that sales prices established by the contractor for retail goods and services be sufficient to recover all directly related merchandising costs (except certain maintenance, repair, and utility costs) and to provide a profit to partially defray costs of recreational activities for island residents.

The contractor reported profits of about \$540,000 from merchandising activities for the period February 1964 through February 1966, which were used to partially defray costs of recreational activities. In computing the profits, however, the contractor, with the approval of the Navy and NXPO, excluded certain operating costs of about \$617,000 as described herein. If appropriate accounting procedures had been used, operations from merchandising activities would have shown a loss and necessitated an increase in the resale prices of merchandise available for sale in order to recover all directly related costs as intended by the contract.

The greatest portion of the unrecovered costs consisted of losses on the sale of damaged and slow-moving merchandise at below-cost prices and on the disposal of damaged or deteriorated food items. The contractor's accounting records were adjusted to show the transfer of this merchandise from a merchandising activity cost to a base-support cost for which the contractor was entitled to full reimbursement.

In January 1964, prior to assuming responsibility for merchandising operations from the prior contractor, Global Associates was directed by the Commander, Pacific Missile Range, to conduct merchandise sales at substantially reduced prices. In accordance with the Commander's directions, Global Associates cleared the warehouse

and retail stocks of damaged, deteriorated, and slow-moving merchandise which had accumulated during the period of the previous contract and placed this merchandise on sale at below-cost prices, The loss on the sale of this merchandise totaled about \$255,000.

The stated justification for authorizing the sale was that such a sale would enable Global to commence operations without obsolete or damaged merchandise. We were informed by the NXPO contracting officer that NXPO did not want to assume responsibility for the loss in inventory value when it took over administration of the Global Associates contract.

NXPO, however, during the period **July 1964** through February 1966, authorized the contractor to dispose of additional merchandise without charging the loss on the disposition to the merchandising activities. The unrecovered cost of these items totaled about \$295,000, of which about \$179,000 related to commissary items and \$116,000 to general merchandise items.

The commissary items which were disposed of at a total loss consisted of meat trimmings, spoiled produce, and damaged or deteriorated groceries. Among the items disposed of from the commissary and provisions warehouse during August 1965 were hundreds of cases of canned evaporated milk, over a hundred cases of boxed groceries, and thousands of pounds of produce--all of which had either spoiled, incurred damage, or exceeded shelf life.

The unrecovered cost on general merchandise, which included a physical inventory adjustment of about \$10,000, covered items that either had been disposed of at a total loss or had been sold through special sales at below-cost prices. For example, we noted that such items as expensive jewelry, photographic equipment, and tape recorders had been sold at prices about 50 percent below cost.

In our review, we did **not** determine if the losses experienced on commissary and merchandising items were in excess of losses normally experienced in such types of operations. We believe, however, that permitting the contractor to charge the losses to base support would not encourage constant review and improvement of buying and storage procedures, since the underlying causes and responsibility **for** the losses would not be identified as areas for management attention.

NXPO officials informed us that they would not approve any future losses on the sale or disposal of merchandise which might be incurred either in commissary items or in merchandising items. They stated, however, that they had not made a determination regarding the accounting treatment of losses resulting from deterioration of merchandise in the warehouses before issuance to these activities.

We also identified about \$67,000 worth of merchandising equipment which had been charged to base support during the period July 1, 1964, through February 28, 1966. This amount included about \$41,600 for laundry equipment and about \$26,100 for such items as cooking equipment, cash registers, reach-in refrigerators, and a dishwasher. Although the contract provided that the cost of merchandising equipment would be charged to merchandising activities and would be recovered in the prices established for goods and services, the NXPO contracting officer, upon assuming administration of the contract on July 1, 1964, directed the contractor to charge such equipment to base support.

The project manager stated that the decision to charge merchandising equipment to base support was intended to alleviate a temporary situation and that he generally agreed with our position

that merchandising equipment should be purchased **from** merchandising profits. He stated, however, that exceptions might be justified if equipment costs caused prices to be increased to the extent that morale problems were created.

Agency and contractor comments

At the conclusion of this review, we brought our findings and certain specific proposals to the attention of the Secretary of Defense and of representatives of Global Associates and invited their comments. The Deputy Assistant Secretary of Defense (Procurement) in reply forwarded a memorandum from the Army with which his office concurred. This reply and attachment appear as appendix 11. The contractor's reply is attached as appendix III.

The Army concurred in the reported amount of unrecovered costs incurred in the operation of the messing and merchandising facilities at the Kwajalein test site under the subject contract. In accordance with our proposals, the Army agreed that Global should establish procedures to ensure that losses in messing and merchandising **are** recovered in resale prices and that the Army should **review** the contractor's buying and storage procedures to reduce further **losses** on merchandise.

The Army also accepted our proposal that the contractor establish in its accounting records a reserve for **losses** on the disposition of obsolete, damaged, or spoiled merchandise, so that the full cost of a disposal action would be distributed over an extended period and resale price increases designed to recover such losses could be kept at nominal levels.

In acting on our proposal that the Department of Defense give attention **to** the need for reviewing messing and merchandising activities at other locations, the Deputy Assistant Secretary stated

that copies of our report and his reply would be furnished to the military departments for this purpose.

We had also proposed that losses on the disposition of merchandise in the warehouses be recovered in prices to customers. The Army estimated the value of the warehoused merchandise, disposed of in the 2-year period we reviewed, at about \$200,000. Both the Army and the contractor took exception to this proposal for the same basic reasons.

The Army stated that such losses were due to uncontrollable factors causing spoilage, such as refrigeration failures, transportation delays, and climate. It is the opinion of the Army that losses of this nature, which are uncontrollable and no fault of the contractor, should not be borne by the merchandising operations and ultimately by the support personnel at the test site. The Army did agree, however, that contractor procedures should preclude the return of spoiled, damaged, and obsolete items from messing and merchandising activities to warehouses and charging such items as base-support cost.

We concur with this position to the extent that circumstances clearly show that the losses are beyond the contractor's control. In such cases, sufficient documentation should be maintained to adequately explain the circumstances of the spoilage.

Global Associates, in its comments, maintained that it had always attempted to comply with its understanding of the contract requirements. It contended, however, that the location's remoteness and the climate did not allow for the most efficient equipment and food conservation procedures. The contractor also raised the question of the effect of increased meal costs on its ability to retain its present personnel at the current wage levels. It stated,

however, that it was revising its procedures as requested by the Army. We noted that Global Associates had accepted a contract in July 1966 under which it undertook to continue its activities at Kwajalein for a 3-year period.

Conclusion

We believe that the corrective actions taken or proposed by the Department of Defense and by the Department of the Army should, if properly implemented, help to ensure that nonrecoverable costs incurred in this and similar contractor operations of messing and merchandising activities will be held to a minimum.

**APPENDIXES**

PRINCIPAL OFFICIALS OF  
THE DEPARTMENT OF DEFENSE AND  
THE DEPARTMENTS OF THE ARMY AND NAVY  
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF DEFENSE</u>		
SECRETARY OF DEFENSE:		
Robert S. McNamara	Jan, 1961	Present
ASSISTANT SECRETARY OF DEFENSE (INSTALLA- TIONS AND LOGISTICS) :		
Paul R. Ignatius	Dec. 1964	Present
Thomas D. Morris	Jan. 1961	Dec. 1964
DEPUTY ASSISTANT SECRETARY OF DEFENSE (PROCUREMENT):		
John M. Malloy	Apr. 1965	<b>Present</b>
Graeme C. Bannerman	Jan. 1961	Apr. 1965
<u>DEPARTMENT OF THE ARMY</u>		
SECRETARY OF THE ARMY:		
Stanley R. Resor	July 1965	Present
Stephen Ailes	Jan. 1964	July 1965
ASSISTANT SECRETARY OF THE ARMY (INSTALLA- TIONS AND LOGISTICS) :		
Dr. Robert A. Brooks	Oct. 1965	<b>Present</b>
Daniel M. Luevano	July 1964	Sept. 1965
A. Tyler Port (acting)	Mar. 1964	June 1964

PRINCIPAL OFFICIALS OF  
THE DEPARTMENT OF DEFENSE AND  
THE DEPARTMENTS OF THE ARMY AND NAVY  
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT (continued)

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF THE NAVY</u>		
SECRETARY OF THE NAVY: Paul H. Nitze	Nov. 1963	Present
ASSISTANT SECRETARY OF THE NAVY (INSTALLA- TIONS AND LOGISTICS): Graeme C. Bannerman	Feb. 1965	Present
Kenneth E. Belieu	Feb. 1961	Feb. 1965



OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, O.C. 20301

INSTALLATIONS AND LOGISTICS

CA

1 MAR 1967

Honorable Frank H. Weitzel  
Assistant Comptroller General  
of the United States  
United States General Accounting Office  
Washington, D. C. 20548

Dear Mr. Weitzel:

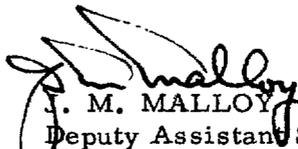
This is in response to your letter to the Secretary of Defense dated December 2, 1966 with reference to the administration of Department of the Army contract DA-01-021-AMC-90004 (Y) with Global Associates for the logistic support of operations at the Kwajalein Test Site in the Marshall Islands. (OSD Case #2543). Your letter finds that prices charged by Global Associates for messing and merchandising activities for contractor and Government personnel, were insufficient to recover a loss of about \$1.6 million for operation of these activities during *the* two-year period ending in February 1966.

Attached is a copy of a memorandum from the Army in this matter with which this office concurs. The Army agrees Global should publish procedures to insure that losses in messing and merchandising should be recovered in establishing resale prices; that a reserve for losses on disposition of obsolete, damaged or spoiled merchandise be established in the contractor's accounting records; and that the Army should review the contractor's buying and storage records to reduce future losses on merchandise. As indicated in the Army statement, action has been initiated in accordance with these recommendations.

Your report further recommended that the Department of Defense give attention to the need for reviewing messing and merchandising activities at other locations. Copies of your letter and this reply will be furnished to the military departments for this purpose.

Your interest in this matter is appreciated.

Sincerely yours,

  
J. M. MALLOY  
Deputy Assistant Secretary  
of Defense (Procurement)

Enclosure



DEPARTMENT OF THE ARMY  
OFFICE OF THE ASSISTANT SECRETARY  
WASHINGTON, D.C.

9 JAN 1967

MEMORANDUM FOR THE ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS)

**SUBJECT:** GAO Letter Report on "Administration of Department of Army Contract DA-01-021-AMC-90004(Y) with Global Associates for Logistic Support at the Kwajalein Test Site" (OSD Case #2543)

1. This memorandum is in response to your request that the Department of Army furnish comments regarding the Army position to the subject General Accounting Office (GAO) letter report (OSD Case #2543).
2. The Army concurs in the GAO findings regarding unrecovered costs of \$1.6 million in the operation of messing and merchandising facilities at the Kwajalein Test Site under the subject contract. These losses consist of approximately \$964,000 of excess messing costs over revenues, and approximately \$617,000 of unrecovered costs relating to merchandising activities.
3. The Army also acknowledges that the GAO discussion regarding "Meal Charges Insufficient to Recover Loss of \$964,000 Incurred in the Operation of the Messes", "Unrecovered Losses of \$617,000 Relating to Merchandising Activities", and "Equipment Costs not Recovered in Charges to Customers" is substantially correct.
4. The Army generally concurs in the GAO conclusions with exception to the comment, "With respect to losses on the disposition of merchandise in warehouses, however, we believe that the procedures governing the contractor's operation at Kwajalein should require that these losses, as well, be recovered in the prices to customers". Approximately \$200,000 of general merchandise losses occurred due to uncontrollable factors causing spoilage, such as refrigeration failures, unavoidable enroute delays of government aircraft transporting fresh fruits and vegetables, adverse impact of the test site climate on certain types of perishables, and perishables in marginal condition upon arrival by government ship. It is the opinion of the Army that losses of this nature, which are uncontrollable and of no

SUBJECT: GAO Letter Report on "Administration of Department of Army Contract DA-01-021-AMC-90004(Y) with Global Associates for Logistic Support at the Kwajalein Test Site" (OSD Case #2543)

fault of the contractor, should not be borne by the merchandising operations and ultimately the support personnel at the test site. The Army does agree that contractor procedures should preclude returning of spoiled, damaged and obsolete items from messing and merchandising operations to warehouses and charging such items as base support cost.

5. The Army also concurs in the GAO recommendations. Actions taken and/or planned which are considered responsive to the **GAO recommendations** are:

a. The GAO recommends that Global published procedures specifically state that losses incurred in the sale or other disposition of merchandise are considered as a cost to be recovered in establishing resale prices. In this regard, the financial management procedures applicable to this contract are being revised to include a provision that retail prices of general merchandise items be calculated on a basis to effect full recovery of cost, including losses incurred, except as indicated in par. 4. The contracting officer also directed that effective October 1, 1966, messing losses be recovered in subsequent quarters through increased charges for meals.

b. The GAO recommends that consideration be given to having the contractor establish in its accounting records a reserve for losses on the disposition of obsolete, damaged, or spoiled merchandise with predetermined monthly charges, based on actual experience in a representative period. Global Associates has established in its accounting records such a reserve. During May 1966, the contractor established, within its accounting records, a reserve for losses in the inventory resulting from obsolete, damaged, or spoiled merchandise. The monthly accrual rate, applied to gross sales, is based on industry analyses and actual historical cost experience. In connection with the reserve, a predetermined factor has been added to the selling price of merchandise operations to recover applicable costs. Establishment of a similar reserve for the messing operation is currently under study.

c. The GAO further recommends that the Army review the contractor's buying and storage practices with a view of finding some means of reducing future losses on the sale and other disposition of merchandise. In this respect, the contracting officer and the Defense Contract Audit Agency, as part of a continued contract administration program have intensified the

**SUBJECT: GAO Letter Report on "Administration of Department of Army Contract DA-01-021-AMC-90004(Y) with Global Associates for Logistic Support at the Kwajalein Test Site" (OSD Case 12543)**

**review of the contractor's buying, storage and merchandising practices with a view of reducing future losses.**

A handwritten signature in black ink, appearing to read "T. Pore", with a horizontal line extending to the right.

**Tyler Pore  
Deputy Assistant Secretary of the Army  
(Installations and Logistics)**



# GLOBAL ASSOCIATES

P O. BOX 12156 • 2150 FRANKLIN STREET • OAKLAND, CALIFORNIA 94604 • 415 - 834-8242

GA-1395

MGS/cg

January 13, 1967

Comptroller General of the  
United States  
Government Accounting Office  
Washington, D. C. 20548

Attention: Mr. Frank H. Weitzel  
Assistant Comptroller General

Reference: General Accounting Office Letter,  
B-152598, dated December 2, 1966

Dear Sir:

Global Associates appreciates **your** invitation to comment on **the** referenced letter to the Secretary of **Defense** regarding the operation of certain messing and merchandising activities under Department of **the Army** Contract DA-01-021-AMC-90004(Y) for the logistics support **of** operations at Kwajalein Test Site. We have given **very** careful attention to your letter and **trust our** comments will be helpful to you.

We also appreciate the **fairness** and objectivity of **your** letter in generally recognizing the **distinction** between operations during the transitional **period**, **in** which **we** and the **Army** had to **cope** with unusual **problems** inherited **from** the prior contractor, and operations during the later period of the contract.

Your letter first **reports** that messing rates charged to Global Associates **employees** at KIS from March, 1964, through February, 1966, were insufficient to recover a loss of \$964,000 incurred in the operation of the messes. **Your** letter indicates that this amount **is** the **sum** of three components:

\$343,000	Unrecovered costs incurred during an initial transitional <b>period when messing rates were fixed by the Government</b> in the contract at the amount charged <b>the prior contractor's</b> employees.
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APPENDIX III

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Comptroller General  
Government Accounting Office  
Washington, D. C.

GA-1395  
MGS/cg  
January 13, 1967

\$260,000	Unrecovered costs incurred between June, 1964, and February, 1966, because quarterly messing rates were not set to recover prior period losses.
\$361,000	Costs charged to base support rather than to the cost of food and services.

Evaluation of the last two items involves interpretation of the rather general contractual requirement that messing rates from June, 1964, "be calculated to recover the cost of food and services." The procedures established by Global Associates to comply with that requirement were consistent with the understanding on which the contract was let and represented a conscientious effort at all times to comply with the requirement as we reasonably interpreted it and as it was interpreted by the cognizant Government officials. Furthermore, as your letter indicates, we have now adjusted our procedures to comply with changing interpretations by the Government.

In considering the prior practice, however, it is obvious that "the cost of food and services" is a phrase which must be interpreted, and the interpretation should take into account the factual situation at Kwajalein. From the inception of the contract, the Government instructed Global to distinguish between costs directly attributable to food and its preparation and serving, on the one hand, and costs of related base logistic support, on the other.

The bakery, butchering and meat trim activities cited in your letter are peculiarly affected by the remote location of the Kwajalein site and its relatively small population. The remoteness of Kwajalein makes it necessary to provide such services as a substitute for procurement in the United States, but the size of the island population precludes utilization of the most efficient equipment and procedures. Similarly, the remoteness of the site and its special climate conditions result in unavoidable spoilage of food. All of these special factors influenced the original interpretations of Global and the Government which allowed these costs to be charged to base support. We do not feel these earlier interpretations were unreasonable, but, as reported in your letter and as indicated above, we have now adjusted our procedures to accommodate the more recent interpretations and recover the additional costs.

We disagree, however, with the stated intention of the Contracting Officer to require the establishment of quarterly messing rates designed to recover losses of prior quarters. The contract provides only that rates be "calculated" to

Comptroller General  
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Washington, D. C.

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recover the cost of food and services. This requires our best estimate, and the Contracting Officer's, in advance as to each quarter's costs, made in the light of prior experience but not weighted by costs actually incurred in a prior period. Many factors beyond our control, principally island population and number of meals served, then influence the extent to which the estimate approximates, exceeds or falls short of experienced costs during the quarter. That is the nature of an estimate and that is the interpretation, consistent with the prior practice of both the Navy and the Army, on which we based our proposal, including our maximum wage rates.

We feel that your office and the Department of Defense should recognize that changes in the cost-recovery requirement which have the effect of increasing meal costs to our employees can create a serious problem unless they are accompanied by increases in wage rates or other forms of compensation. Employees are recruited and retained on the basis of representations by Global as to the total compensation and expenses they can expect at Kwajalein. Obviously, these representations are based on wage rates, fringe benefits and cost-recovery policies then in effect. Later increases in messing rates which are unrelated to increased food costs can only cause serious employee morale and retention problems which are contrary to the interests of both Global and the Government.

Furthermore, this discussion of changing interpretations which increase meal costs to our employees serves to dramatize the most basic underlying problem created by the contract requirement for recovery of messing costs. It may be appropriate, therefore, to suggest that this underlying problem be reconsidered in connection with your review, and that of the Secretary of Defense, of the question of recovery of messing costs.

To the best of our **knowledge**, Global Associates is the **only** contractor at **KTS** that does not either pay directly or reimburse to its employees the cost of their meals at KTS. The economic impact of the requirement that messing costs be recovered therefore falls on Global's employees alone. The effect of the requirement is clearly and simply to subject the real compensation of Global's employees to unpredictable variations, both absolutely and in relation to the compensation of other employees at KTS. Because the employees have no choice of dining facilities, this discriminatory treatment of Global's employees is unfair, and, consequently, it adversely affects employee morale which is detrimental to accomplishment of the KTS mission; it may even present questions of legality under the Service Contract Act of 1965.

## APPENDIX III

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Your letter also reports unrecovered costs of \$617,000 related to merchandising activities, principally resulting from loss on the below-cost sale of certain merchandise and losses on the disposal of damaged or deteriorated food items.

We agree that, with respect to merchandise that has been transferred to the commissary and merchandising activities, there should be no occasion in the future to charge such losses to base support, as was authorized by the Government in exceptional circumstances in the past. The original sale described in your letter involved only merchandise that was obviously defective or overstocked at the time Global took over the inventories from the prior contractor, selected on a visual basis. Because no inventory records, usage rate data or other records or procedures were available from the prior contractor, there followed a long period during which Global gained experience with the stock, established records and purged the inventories of less obvious items of damaged, deteriorated and slow-moving merchandise.

Despite the continuing efforts to dispose of the surplus stock accumulated by the prior contractor, the markdown and shrinkage losses reported in your letter for the merchandising and commissary activities combined, after the original sale, amounted to only \$295,000, or 2.73 per cent of the \$10,800,000 volume of activity during that period. It must also be recognized in evaluating Global's performance in this area that our Commissary items present a particularly difficult problem because of climate and physical conditions at Kwajalein which result in rapid, unavoidable spoilage of food and resale merchandise,

In addition, we have now established, as your letter recommends, a reserve against losses on the disposition of commissary or retail store merchandise in order to distribute such losses over a period of time and avoid any sharp impact on pricing. Our reserve is established at 1.25 per cent of gross sales, with our experienced losses running at approximately 0.8 per cent. We understand that this compares very favorably with post exchange averages which we understand to be 1.60 to 1.85 per cent and civilian retail store averages of approximately the same.

However, with respect to merchandise that must be disposed of, because of damage or deterioration, before issuance to the commissary or merchandising activities, we feel that in the unique circumstances of KTS these are properly costs of base support, not susceptible to control by the merchandising operations, and should not be recovered from the merchandising customers. The need to transport perishables for long distances, shipping delays, breakdown of aircraft and of refrigeration equipment aboard ship, the Kwajalein climate and limited storage facilities on site all result in considerably greater spoilage than might be experienced in other locations, despite all efforts to keep such spoilage to a minimum.

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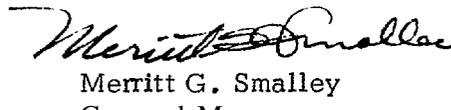
We feel that Global's record of care and conscientious improvement in this area, which is receiving continued emphasis, together with supervision of our storage practices by the Army, can be anticipated to continue to minimize commissary and merchandising losses, and it is neither necessary nor fair to impose these costs on our employee-customers. The performance incentive provisions of the contract provide any additional impetus that might be considered desirable in this regard. Global's effectiveness is continually reviewed by Government representatives, and, with incentive provisions on performance in these areas, it is evident that any failure to meet the necessary standards of operation is quickly reflected in a loss of "incentive" fee. Considering this, it is obviously in Global's best interest to maintain its performance in these areas at the highest possible levels.

Be assured that Global's buying and storage practices, along with all our other operating procedures, are under continual review and that we will continue to exert every effort to hold operating costs to a minimum, to comply in every respect with our contractual requirements and to maintain the highest possible standards consistent with the Army's requirements and the conditions which exist at this unusually remote island community.

As indicated in the General Accounting Office letter B-152598, dated December 2, 1966, to the Secretary of Defense, copies were sent to the Secretary of the Army; the Secretary of the Navy; the Commanding General, Army Materiel Command; the Project Manager, Nike-X Project Office; Headquarters Office, Defense Contract Audit Agency; and the Regional Manager, San Francisco Region, Defense Contract Audit Agency. For their information, Global is also sending copies of its comments to those who have received copies of the referenced letter.

Sincerely yours,

GLOBAL ASSOCIATES

  
Merritt G. Smalley  
General Manager