Audit Report

OFFICE OF THE INSPECTOR GENERAL

PACIFIC STARS AND STRIPES

Report No. 93-141 June 30, 1993

Department of Defense

Acronyms

AAFES	Army & Air Force Exchange Service
ABIF	Army Banking and Investment Fund
AFIS	American Forces Information Service
AFOSI	Air Force Office of Special Investigations
CINCPAC	Commander in Chief, U.S. Pacific Command
CPA	Certified Public Accountant
DCAA	Defense Contract Audit Agency
DoDI	Department of Defense Instruction
OMB	Office of Management and Budget
PS&S	Pacific Stars and Stripes

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

June 30, 1993

MEMORANDUM FOR SPECIAL ASSISTANT TO THE SECRETARY OF DEFENSE (PUBLIC AFFAIRS)
COMMANDER IN CHIEF, U.S. PACIFIC COMMAND
DIRECTOR, AMERICAN FORCES INFORMATION SERVICE
COMMANDER/PUBLISHER, PACIFIC STARS AND STRIPES

SUBJECT: Audit Report on the Pacific Stars and Stripes (Audit Report No. 93-141)

We are providing this final report for your information and use. It contains matters concerning the operations and internal controls of the Pacific Stars and Stripes organization. Comments on a draft of this report were received from management and were considered in preparing the final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Director, American Forces Information Service, is requested to provide final comments by August 31, 1993, on the portion of the finding and the recommendation that we revised based on comments we received on the draft report. Those comments must indicate concurrence or nonconcurrence with the revised finding and Recommendation 4. in Part II, propose corrective actions, and give the completion dates of proposed actions. Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment.

The courtesies extended to the staff during the audit are appreciated. The audit team members are listed inside the back cover. If you have any questions about this audit, please contact Mr. Raymond D. Kidd, Program Director, at (703) 614-1682 (DSN 224-1682). Appendix D lists the distribution of this report.

for Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Audit Report No. 93-141 June 30, 1993
(Project No. 2FH-5004)

AUDIT REPORT ON THE PACIFIC STARS AND STRIPES

EXECUTIVE SUMMARY

Introduction. The Pacific Stars and Stripes (PS&S) organization publishes a daily newspaper, The Stars and Stripes, for distribution to DoD personnel stationed in Japan, Korea, Guam, and at other DoD activities in the U.S. Pacific Command. The newspapers are distributed primarily through contractor-operated bookstores that also sell books and magazines. Stars and Stripes (comprising organizations in the Pacific and in Europe) is a DoD nonappropriated fund activity, but receives appropriated-fund support. The U.S. Army has been designated as the Executive Agent and is tasked with providing administrative and logistical support to PS&S.

Objective. This audit was made in conjunction with a request from the Air Force Office of Special Investigations (AFOSI) for audit assistance in its investigation of allegations of fraud and other improprieties concerning the PS&S organization. The AFOSI investigation was initiated at the request of the Pacific Stars and Stripes Commander/Publisher and Deputy Commander because of suspected wrongdoing and unauthorized business practices.

The objectives of the audit were:

o to assist the AFOSI in its investigation;

o to evaluate the effectiveness of internal controls and implementation of the Federal Managers' Financial Integrity Act; and

o to evaluate the recent audit by a Certified Public Accountant (CPA) firm to determine the extent of audit tests needed for us to ensure that obligations and costs complied with applicable laws; that funds, property, and other assets were safeguarded against waste, loss, unauthorized use, or misappropriation; and that revenues and expenditures of PS&S were properly recorded and accounted for.

Audit Results. PS&S was not operated efficiently because its managers had limited experience in managing DoD business operations and in establishing and enforcing the internal controls needed to operate efficiently. Command oversight had not been clearly established, and managers were not following applicable laws and regulations. Funds and property had not been safeguarded against waste and unauthorized use.

Internal Controls. A material internal control deficiency existed because the Federal Managers' Financial Integrity Act had not been implemented. Consequently, internal controls were not adequate to ensure that policies and procedures for operating a nonappropriated-fund business were implemented. The finding gives details of the weaknesses.

Potential Benefits of Audit. The audit should result in improved management, compliance with laws and DoD and Army guidance, and potential monetary benefits of about $1.6 million during the next 6 years (Appendix B).

Summary of Recommendations. Our recommendations, if implemented, will improve operations, internal controls, and compliance with laws and regulations.

Management Comments. We received comments from the Director, American Forces Information Service; the Commander in Chief, U.S. Pacific Command; and the Commander/Publisher, Pacific Stars and Stripes, through the Special Assistant to the Secretary of Defense (Public Affairs). Management concurred with Recommendations 1., 2., 3., and partially concurred with Recommendation 4. See Part II for a discussion of management comments and Part IV for the complete texts of management comments.

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This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, at (703) 614-6303 (DSN 224-6303).

Part I - Introduction

Background

Stars and Stripes, comprising organizations in the Pacific and European theaters, is a DoD nonappropriated-fund activity. The mission of the Pacific Stars and Stripes (PS&S) is to produce a quality, reasonably priced daily newspaper to help provide current news to DoD personnel and their dependents serving in the Pacific theater. Complementing the newspaper are PS&S bookstores and third-party outlets (military clubs, exchanges, etc.) that offer a wide selection of commercial publications. The newspaper is funded in part by income from direct sales, subscriptions, and advertising. Appropriated funds pay for the shipment of newsprint, ink, and commercial publications from the United States to Tokyo, Japan, while distribution from Tokyo to the sales locations outside Japan is normally provided by military airlift. The costs of assigned military personnel are also paid from appropriated funds. In FY 1991, appropriated fund expenditures totaled about $5.6 million. Revenue for operations in FY 1991 consisted of $3.2 million from newspaper sales, $18.5 million from resale of publications, and $1.7 million from advertising, job shop printing, etc. The Japanese government paid the salaries of 162 PS&S Japanese employees in FY 1991 and is scheduled to pay 100 percent of the salaries of all PS&S Japanese employees by FY 1995.

PS&S is under the operational direction of the Commander in Chief, U.S. Pacific Command (CINCPAC), Camp H. M. Smith, Hawaii. The PS&S Commander coordinates with, and receives support from, CINCPAC's staff, overseeing and directing matters pertaining to day-to-day operations headquartered in Tokyo. The American Forces Information Service, Alexandria, Virginia, provides policy and broad operational guidance to PS&S and is the DoD point of contact for PS&S matters in the United States. The U.S. Army is the designated Executive Agent, tasked with providing administrative and logistical support to PS&S.

The PS&S newspaper has a daily circulation of about 30,000 copies and is distributed in mainland Japan, Okinawa, Korea, Hong Kong, Guam, Djakarta, Bangkok, Kwajalein, and Diego Garcia. Service to the Philippines was discontinued on April 30, 1993. In 1991, PS&S had an operating loss of $1.5 million. Other income totaled $2.0 million, resulting in a net profit in FY 1991 of $586,000. Other income included $1.2 million from the government of Japan for payment of severance liabilities for Japanese nationals, and $.8 million primarily from interest on investments, sale of scrap materials, and disposal of assets.

Objectives

We were requested by the Air Force Office of Special Investigations (AFOSI) to assist in its investigation of alleged fraud and other improprieties in the PS&S organization. AFOSI's investigation was done at the request of the Pacific Stars and Stripes Commander/Publisher and Deputy Commander because of suspected wrongdoing and unauthorized business practices.

The objectives of our audit were:

- to assist the AFOSI in its investigation;

- to evaluate the effectiveness of internal controls and implementation of the Federal Managers' Financial Integrity Act; and

- to evaluate the recent audit by a Certified Public Accountant (CPA) firm to determine the extent of audit tests needed to ensure that obligations and costs complied with applicable laws; that funds, property, and other assets were safeguarded against waste, loss, unauthorized use, or misappropriation; and that revenues and expenditures of PS&S were properly recorded and accounted for.

Scope

During our survey, we learned that PS&S had not implemented the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255); therefore, further audit effort was not required to evaluate its implementation. We also determined that the CPA firm did not audit the PS&S FY 1991 financial data. Its effort was limited to compiling financial data from the Pacific and European Stars and Stripes to show the overall financial results of operations for the two activities. For the PS&S FY 1990 financial statements, a CPA firm made a balance sheet audit and expressed an unqualified opinion on the balance sheet in a January 25, 1991, report. Neither the FY 1990 nor FY 1991 Statement of Work required the CPA firm to make the necessary tests to ensure that obligations and costs complied with applicable laws and that funds, property, and other assets were safeguarded against waste, loss, unauthorized use, or misappropriation. Consequently, we extensively tested internal controls.

In addition to assisting the AFOSI, we followed up on prior audit and study recommendations made to improve management and operations to determine whether the recommendations had been implemented. Also, we evaluated the effectiveness and efficiency of the PS&S organization by discussing operations with management and operating personnel, examining and testing financial documents, and identifying management procedures at PS&S Headquarters. We also observed bookstore operations in Okinawa and in Tokyo. Our evaluation covered accounting procedures, contracting procedures, the use and control of assets, insurance coverage, employee entitlements, newspaper production, distribution of resale items, and ways to reduce appropriated-fund support.

Scope Limitations. We did not review the content or the technical aspects of the newspaper's publication, or the adequacy of contracting practices that military contracting centers used on behalf of PS&S. In addition, we did not evaluate the effectiveness of contractor operations or the qualifications, productivity, and training of PS&S employees.

Audit Period, Standards, and Locations. This economy and efficiency audit was made from May through October 1992 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. The documents reviewed were for FYs 1987 through 1992. Appendix C lists the activities we visited or contacted.

Investigation Assistance. At the request of the AFOSI, we provided the results of our assistance to them under separate cover. The AFOSI investigation was completed in March 1993.

Internal Controls

Controls Assessed. We assessed the internal controls needed to properly control sales income, distribution of the PS&S newspaper and commercial publications, debt payment and collection, funds and other assets, employee entitlements, and adherence to laws and regulations.

Internal Control Weaknesses. PS&S had not implemented the Federal Managers' Financial Integrity Act of 1982; Office of Management and Budget (OMB) Circular No. A-123, "Internal Control Systems," August 4, 1986; and DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. As a result, we found a material deficiency as defined by Public Law 97-255, OMB Circular No. A-123, and DoD Directive 5010.38. Important internal controls were missing, and established controls were ignored. Part II discusses the internal control weaknesses. If implemented, Recommendations 3.a., 3.c., 3.d., 3.e., 3.f., 3.h., 3.j., 3.k., 3.l., 3.p., and 3.q. will correct the material weaknesses we identified. A copy of the final report will be provided to the senior official responsible for internal controls at PS&S.

Prior Audits and Other Reviews

The last audit report issued by Government auditors was Defense Audit Service Report No. 79-131, "The Audit of the Pacific Stars and Stripes," August 27, 1979. Since that report, the American Forces Information Service has contracted with CPA firms to audit PS&S financial statements every other year. The Government auditors and the CPA firms made recommendations that, if implemented, would have improved PS&S operations. Further, an October 1987 study by a Stars and Stripes Advisory Task Force (the Rosen Commission) also made recommendations that, if implemented, would have improved PS&S operations. Appendix A summarizes findings from the prior audit reports and the Rosen Commission's study that are repeated in this report.

Part II - Finding and Recommendations

Pacific Stars and Stripes Operations

The Pacific Stars and Stripes (PS&S) organization was not operated efficiently. Managers had limited experience in managing DoD nonappropriated fund business activities, and in establishing and enforcing the internal controls needed to protect income and assets and to ensure efficient operations. The command's oversight had not been clearly established, and managers were not following applicable United States laws, DoD directives and instructions, and Army and Department of State regulations. Consequently, funds and property were not adequately safeguarded against waste, loss, unauthorized use, and misappropriation. Improvements in operations would save an estimated $302,000 annually.

Background

Although audits and evaluations of PS&S business operations had been commissioned by the American Forces Information Service, the recommendations made have been ignored for over a decade. In early 1991, a PS&S Deputy Commander with a background in DoD comptroller functions was assigned to PS&S. He determined that regulations establishing the responsibility for oversight of PS&S operations were unclear. He subsequently requested assistance from the Inspector General, U.S. Pacific Command, to develop guidance that clearly delineated the responsibilities for oversight. At the time of our audit, additional guidance was being prepared.

Operating the Nonappropriated Fund Activity

Both military and civilian managers were dedicated to effectively accomplishing the PS&S mission of providing news to DoD personnel serving in the Pacific theater. However, neither group implemented DoD's procedures for financial management of nonappropriated fund business activities or established the internal controls needed to ensure efficient operations. Discussion of the most significant operational shortfalls and internal control weaknesses follows.

Personnel Experience. With the exception of assigned military personnel, PS&S employees responsible for managing business operations were recruited from the private sector, rather than from DoD organizations. DoD

Instruction (DoDI) 5120.4, "DoD Newspapers and Civilian Enterprise Publications," November 14, 1984, states:

> The operations of the S&S (Stars and Stripes) newspapers shall be conducted similar to comparable commercial newspaper publishing, book and magazine resale, and job printing activities. Modern commercial business techniques and practices shall be used in the operation of S&S.

To ensure that commercial business techniques are followed, DoDI 5120.4 also requires that a military officer assigned to supervise Stars and Stripes business operations have a master's degree in business administration. However, a military supervisor is not required to have experience in nonappropriated fund business procedures or in DoD comptroller functions. Consequently, business decisions often were not based on application of sound business practices. Also, important decisions were not made in accordance with published DoD and Army guidelines. PS&S managers and operating personnel were generally unfamiliar with, and did not have ready access to, publications that set policy, procedures, and guidance, as issued by the Congress, the Office of Management and Budget, DoD, and the Army.

Federal Managers' Financial Integrity Act of 1982. The Federal Managers' Financial Integrity Act of 1982 had not been implemented by PS&S managers because they were unfamiliar with the requirements of DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, and Army Regulation 11-2, "Internal Management Control," September 14, 1990. Prior audits, inspections, and studies had not identified this shortfall. Consequently, PS&S managers had not documented and tested established internal controls and had not identified the areas that needed controls.

Newspaper Return and Loss Allowance. The Stars and Stripes newspaper return and loss allowance was excessive and was not based on historical data. To provide for increased sales, area distribution contractors were allowed to claim, without penalty, that as much as 25 percent of their monthly newspaper orders were returned or lost. The allowance excluded newspapers sold by subscription. There was no documentation available to show how the allowance had been determined. Contractors were assessed a penalty of 10 cents for each newspaper that exceeded the 25-percent allowance.

Our analysis of returned and lost newspapers for the period August 1, 1991, through July 31, 1992, by the area distribution contractor for the Korea, Okinawa, and Guam areas, showed that of the 5.41 million newspapers available for nonsubscription sales, about 1.24 million (23 percent) were reported as returned or lost. The return and loss rates by area closely approximated the established allowance. We analyzed newspaper sales made

during the 12-month period that ended June 30, 1992, and determined that the maximum monthly sales increase of the newspaper was about 8 percent. According to data from the area distribution contractors, newspaper losses accounted for about 4 percent of the unsold newspapers. Based on that analysis, we concluded that a return and loss allowance of 12 percent would allow for both increased sales and losses. Newspaper production could be reduced proportionally and would result in annual savings of about $99,000 in ink and newsprint.

The cost of overdistribution of the newspaper has been a continuing problem. Newspaper returns and losses were addressed in the Defense Audit Service's "Report on the Audit of the Pacific Stars and Stripes," August 27, 1979. That report recommended that the return and loss allowance be reduced from 22 percent to 14 percent. The PS&S Commander at the time responded that action would be taken to reduce the return and loss allowances to a more reasonable level. However, action was not taken. There was no DoD audit followup process at that time for Defense Audit Service reports.

Delayed Distribution. During the 12-month period ending July 31, 1992, the area distribution contractor in the Philippines reported that 312,000 (20 percent) of 1,526,000 newspapers ordered were not available for sale because the commercial printing firm delayed distributing the newspaper to the contractor. The newspapers that were distributed too late to be sold represented about $115,000 in potential sales. PS&S management did not determine the reason for the delays so that corrective actions could be taken. Although PS&S operations in the Philippines had been reduced to one small outlet by January 1993, PS&S was considering having the newspaper printed by a commercial printer in Korea. If a commercial printer is used again, newspaper printing and distribution should be closely monitored, and recourse should be taken if performance is unsatisfactory.

Inventories. PS&S managers did not enforce inventory procedures established in contracts and, as a result, did not ensure that sales receipts or merchandise were not diverted. Contractual terms required contractors, assisted by disinterested personnel assigned by the local military commanders, to make quarterly inventories of all magazines and semiannual inventories of hardcover and paperback books at bookstores, third-party sales outlets, and warehouses. Although not provided for in the contracts, PS&S Standing Operating Procedure 3-6, "Area Accounting Operations," May 21, 1991, required PS&S personnel to take the inventories at the end of each contract period.

We reviewed the inventory records available at PS&S for the inventories taken at six contractor sites during the period January 1, 1990, through June 30, 1992. During that period, there should have been a total of 30 semiannual

inventories and 30 quarterly inventories. Five semiannual inventories and five additional quarterly inventories should have been taken in each area. Table 1 shows, by area, the inventories taken.

Table 1. Inventories Taken by Area
January 1990 - June 1992

Area	Number of Quarterly Inventories	Number of Semiannual Inventories
Korea	1	3
Okinawa	1	3
Hong Kong	2	4
Guam	0	2
Philippines	0	3
Kwajalein	0	3
Totals	4	18

Inventory records showed that 6 of the 18 semiannual inventories taken were not made by disinterested persons. The records also showed that complete inventories of stocks in bookstores, warehouses, and third-party sales outlets were made for only 6 of the 18 semiannual inventories. When inventories were taken and shortages were identified, the shortages were recouped from contractor commissions. PS&S management relied primarily on end-of-contract inventories to identify inventory shortages, thereby providing the potential for contractors to divert sales receipts or merchandise to personal use for as long as 3 years. For example, when PS&S employees inventoried the magazines, paperback books, and hardcover books in Korea as of June 30, 1991, they identified an inventory shortage totaling $155,500. The prior inventory taken by the contractor was March 31, 1990.

Although PS&S required that inventories be verified by two independent counts, the control was negated. After recording the initial count of each item on an inventory control sheet, the sheet was given to the individual responsible for the second count. Since the results of the first count were provided, there was little incentive to recount. Good inventory procedures require that when performing a double-count inventory, neither counter should be aware of the other's results until the counts are compared to identify differences. When differences exist, a third count is required to determine the accurate count.

We also noted that when PS&S personnel made the inventories, the counts were made by the same personnel who were responsible for recording the inventories

on the financial records. Although we did not identify any wrongdoing, lack of separation of duties increases the risk for fraud.

Periodicals. In the Rosen Commission's report, "Stars and Stripes Advisory Task Force," October 1987, the commission recommended that, to reduce the costs of handling, inventorying, and managing unsold periodicals, PS&S should reduce the number of periodicals available for sale from 850 to the 200 best sellers. In response to this recommendation, PS&S management agreed that the selection of periodical titles was too large and said that the number of titles would be reduced. The Periodicals and Circulation Manager was responsible for selecting the periodicals and determining the number of each to be distributed to the area contractors and PS&S-operated bookstores. When we asked why the number of periodicals was not reduced, the Periodicals and Circulation Manager stated that, to serve military customers, a wide variety of titles should be offered for sale. As of August 1992, about 1,100 periodical titles were being distributed to the bookstores. The shelf space in the bookstores was limited, and enough space could not be dedicated to periodicals to display them properly. In an August 7, 1992, interoffice memorandum, the Periodicals and Circulation Manager complained that there was too little space in the Okinawa bookstores for periodicals. He stated that ". . .75 percent to 85 percent of the periodicals were displayed with less than 50 percent of the cover page visible, and 50 percent to 60 percent are packed on the stands so that no part of the cover pages are visible." Our observations of the bookstores in Okinawa and Japan, verified the Periodicals and Circulation Manager's observations. Bookstore operators told us that they, too, believed that too many different periodicals were being displayed but not sold. For example, in a bookstore in Japan, there were about 40 "adult" or "sophisticate" periodicals. The bookstore manager believed that, based on prior sales, customers would be satisfied with far fewer titles.

The Periodicals and Circulation Manager also ordered 40 to 50 percent more of each title than was needed, based on customer demand. This resulted in the unnecessary use of appropriated funds to pay for shipping the magazines from the continental United States to PS&S warehouses. Also, both PS&S and area distribution contractors' labor was used to handle, store, inventory, and manage the large volume of unsold magazines.

PS&S financial reports entitled "Cost of Periodical Sales" showed that for the 4 months ending May 30, 1992, $2.3 million (46 percent) of the $5.0 million in periodicals shipped to sales outlets were destroyed because they were not sold. When we discussed the percentage of magazines destroyed with the Periodicals and Circulation Manager, who was responsible for ordering periodicals from publishers, he was not concerned because there was no cost to PS&S. He stated that the publishers always gave PS&S credit for unsold periodicals. He was also unconcerned that appropriated funds were used to pay for transporting

unneeded periodicals from the continental United States to the PS&S warehouses, and that both PS&S and contractor personnel were involved in managing excessive shipments of periodicals.

Disbursing. Contrary to basic internal control procedures, PS&S accounting personnel were authorizing monthly disbursements of about $23,550 to 27 newspaper publishers in Japan without verifying that the purchase orders, receiving reports, and vendors' invoices agreed. Consequently, there was no assurance that disbursements made were for valid obligations for the goods received. Payments were based on reports from the area distribution contractors showing the number of newspapers received and sold. The circulation manager told us that rather than contracting with the 27 publishers to protect the interests of PS&S, the publishers' newspapers were handled by the various PS&S outlets on consignment. The publishers were advised by the Periodicals and Circulation Manager that vendors' invoices were unnecessary. Consequently, PS&S had only the data submitted by area distribution contractors to use in computing payments to the publishers and commissions to the area distribution contractors. Contracts with the publishers would have required purchase orders, receiving reports, and vendors' invoices in order to protect the interests of PS&S.

Similarly, PS&S personnel were paying for periodicals without comparing original vendors' invoices with copies of purchase orders, receiving and discrepancy reports, and quantities of periodicals returned to the vendors for credit. Personnel in the Periodicals and Circulation Department, rather than the Accounting Department, performed most of the functions normally accomplished by accounting technicians. The Periodicals and Circulation Department was responsible for determining the type and quantity of magazines to be ordered for sale by the bookstores. To prepare purchase orders, the Periodicals and Circulation personnel needed data concerning receipts, shipping overages and shortages, and returns. Those data and the vendors' invoices were sent to the Periodicals and Circulation Department. After needed data were extracted from the various forms, the vendors' invoices and discrepancy and return reports were sent to the Accounting Department, where, based on these limited data, payments were processed. Without purchase orders and receiving reports, accounting clerks could not verify that the quantities ordered and received were the same as those being billed on the vendors' invoices.

Distribution of USA Today. For the 12-month period ending May 30, 1992, the area distribution contractors for Korea, Okinawa, and the Philippines were paid $33,800 for labor and gasoline costs associated with distributing the USA Today newspaper. That payment was in addition to the $23,000 paid in commissions to the contractors for selling the newspaper. Commissions paid for newspaper sales are set so that contractors can recover costs and still make a reasonable profit; also, the terms of the distribution contracts clearly required

distribution contractors to provide gasoline for vehicles. Therefore, the $33,800 payment represented double payment for labor and improper reimbursement for gasoline.

A long-standing verbal agreement existed between the publishers of USA Today and the PS&S Periodicals and Circulation manager that the publishers would credit PS&S for the cost of distributing the newspaper. The distribution costs, as claimed by the area contractors, were deducted from the publisher's monthly invoice before the invoice was paid. The resulting income was passed on to the area distribution contractors rather than being used as an offset to PS&S operating costs. Defense Contract Audit Agency (DCAA) Report No. 7201-0A179114 (007), "Report on Review of Recorded Revenues and Expenses under Contract No. NAFKP2-88-C-CN-SO2, Asia Media Corporation, Seoul, Korea," October 1990, stated that the reimbursement of the contractor's labor and gasoline costs for distributing USA Today represented a double payment of labor costs and an inappropriate reimbursement for gasoline. DCAA auditors also believed that the commissions on the sale of USA Today adequately offset any handling costs. DCAA recommended that PS&S retain future payments made by the publishers of USA Today and reduce the contractor's commissions by the amount already paid.

When asked why the DCAA recommendation was not implemented, PS&S managers stated that since there was no cost to PS&S, they were not concerned about the payment. Like DCAA, we believe that PS&S should retain the distribution costs paid by USA Today. Based on the distribution costs submitted by the area distribution contractor for Korea for the month of February 1992, we computed that the cost of distributing USA Today averaged about 4 cents per copy received. We believe this would be a reasonable amount for PS&S to collect for distributing a competitor's newspaper, and would help to offset the administrative costs of processing USA Today's invoices.

Previous decisions not to modify the Korea area distribution contract to include verbal agreements made between the contractor and the PS&S Periodicals and Circulation manager were costly to PS&S. As provided by the contract, the contractor was paid 2.5 cents a copy to deliver complimentary television guides and other publications, produced in Korea, to U.S. military installations in Korea. Although not specifically addressed in the contract, the contractor also picked up and transported similar complimentary publications from the contractor's warehouse in Korea to Osan and Suwon Air Force bases to be airlifted to Okinawa, the Philippines, and Guam for distribution. Before July 1989, the contractor delivered the publications to the two Air Force bases at no cost to PS&S. In July 1989, for an undisclosed reason, the contractor began billing PS&S for labor and fuel costs for delivering the complimentary publications to Air Force bases. For the period July through October 1989, PS&S paid the contractor $663 for the airport deliveries.

In November 1989, the PS&S contracting officer determined that payment for delivery to the airports was not appropriate, since the publications were not to be delivered in Korea. Subsequently, the $663 was deducted from the contractor's November commissions. Rather than dispute the $663 reduction, the contractor submitted a bill dated April 19, 1991, for $71,875. The billing represented a request for payment for distribution of 2,875,000 complimentary publications, at 2.5 cents each, to the military airports. The contractor claimed payment for deliveries made from December 1987 through April 1991. Although PS&S management believed the claim was not valid, an Army Judge Advocate advised payment. After negotiation with the contractor, PS&S settled the claim for $65,000. If PS&S had had a specific contract for the deliveries, the $65,000 would probably not have been paid.

Control over Deposits of Sales Income. The terms of area distribution contracts require that all sales income be promptly deposited. There were no controls to ensure that this was done, and often it was not. As a result, substantial income was being diverted, at least temporarily.

Bank deposits and sales reports were not reconciled to ensure that reported daily bookstore sales and bank deposits agreed. Lack of reconciliation prevents management from promptly identifying cash receipts that had been diverted for personal use.

For example, DCAA Report No. 4201-92C48600074, June 30, 1992, reported that the Guam distribution contractor diverted cash receipts of $17,668 for personal use. The cash from daily sales was replaced by the contractor's personal checks. The personal checks were not deposited, sometimes for weeks, until the contractor received his monthly commission checks from PS&S. The DCAA auditors expressed concern that the diversion had not been identified by the PS&S accounting staff.

Area distribution contractors are required, by contract, to deposit daily cash sales receipts, intact, on the date of sale or by the next business day following the date of sale. The contractors send daily reports to PS&S showing the amount of cash sales and deposits. The amount reported as being deposited should be the same as the amount reported as cash sales, plus collections for subscriptions. Our review showed that not all cash receipts were deposited promptly and could not be reconciled to the day's sales. For example, the Korea distribution contractor reported that his cash sales for May 4, 1992, totaled $2,897. However, his deposits totaled $3,762. The bank deposit slips that accompanied the May 4, 1992, report showed that deposits represented sales that were made on April 23, 26, 27, 28, and 29, and May 3, 1992. Although these delayed deposits indicate possible cash diversion, PS&S accounting personnel had not identified the delays or determined why collections were not deposited intact and reported promptly.

Similarly, the Okinawa distribution contractor's reported daily deposits for June 1 through 12, 1992, consisted of deposit slips from as many as 3 days. The amounts shown as deposited were consistent with the dates of the reports, but did not agree with the amount reported as the total cash collected. Daily sales reports showed that as much as $27,000 in undeposited funds was on hand at the start of each business day. Since the area distribution contractors were responsible for providing their own change funds, we know of no reason why all funds were not deposited. PS&S management sent a message to the Okinawa area distribution contractor's accountant on June 10, 1992, expressing concern that money from sales made on May 22, 1992, was not deposited until May 28, 1992. The PS&S manager explained to the accountant that failure to make prompt cash deposits increased the risk of fraud or theft. On June 11, 1992, the contractor responded, stating that he had improved his deposit procedures. We did not identify any significant improvement as of July 7, 1992.

We visited the Okinawa bookstores and determined that the contractor routinely withheld cash deposits to pay the newpaper's home-delivery carriers instead of paying the delivery carriers by check. At month-end, the contractor deposited his personal check for the cash withheld. By failing to deposit all cash receipts promptly, we estimated that the contractor improperly used about $3,000 per month.

Unofficial Use of PS&S Checking Account. In 1985, the individual who was then the PS&S Comptroller inappropriately established a policy that allowed PS&S employees to have personal obligations paid with PS&S organizational checks. The employees exchanged payroll checks, personal checks, and U.S. or Japanese money with the PS&S cashier, who issued PS&S dollar or yen checks to pay employee obligations.

Army Regulation 600-50, "Standards of Conduct for Department of Army Personnel," January 28, 1988, prohibits the use of Government facilities, property, and personnel for personal use; Army Regulation 215-2, "The Management and Operation of Army Morale, Welfare, and Recreation Programs and Nonappropriated Fund Instrumentalities," September 10, 1990, prohibits the cashing of payroll checks for employees.

By paying Japanese companies for employees' obligations with yen purchased at the organizational rate of exchange, the employees not only avoided bank service charges, but also benefited from a higher currency exchange rate than other DoD U.S. employees serving in Japan. DoD Directive 7360.11, "Use of Foreign Currencies," requires DoD activities that provide currency exchange services to acquire foreign currencies from a military banking facility at its accommodation rate. This rate is normally 2 yen less per dollar than the organizational rate that Government entities receive when yen are purchased for

official business. Although the difference between the two exchange rates is not large, the rate received by the PS&S employees gives them about a 2-percent advantage in buying power over other U.S. Government employees serving in Japan.

Between October 1988 and October 1990, PS&S accounting personnel maintained a special log to keep track of the former PS&S Comptroller's personal transactions made through the PS&S account. In a November 1990 memorandum, an auditor assigned to the Pacific office of the Inspector General, DoD, recommended that the PS&S account not be used for employees' personal transactions. The only action taken by the former PS&S Comptroller, in response to the recommendation, was to stop having a record of his personal transactions maintained by PS&S accounting personnel. The ability to commingle personal and PS&S funds allowed the PS&S Comptroller to transfer, without detection, about $200,000 of his personal funds through the PS&S account to foreign banks. He not only avoided bank service charges, but also caused PS&S to engage in unauthorized bank-like activities. We referred this matter to the Air Force Office of Special Investigations for further action.

Lost Interest. PS&S was not maximizing interest income on funds in banks. PS&S did not effectively use the Army's Nonappropriated Fund centralized banking and investment program and OMB Circular No. A-125, "Prompt Payment," December 12, 1989, had not been implemented.

Centralized Banking and Investment Program. The Army Banking and Investment Fund (ABIF) provides centralized banking and investment opportunities for nonappropriated fund instrumentalities. The ABIF is the only means of investment authorized for nonappropriated fund instrumentalities that operate under Army responsibility. PS&S maintained a combined checking and investment account with the ABIF account in the Manufacturers Hanover Trust Company Bank. In June 1992, the ABIF paid 6.75 percent interest on the account's average monthly balance. PS&S also maintained non-ABIF checking accounts with 12 banks and 2 credit unions. These accounts were established so that area distribution contractors could deposit daily sales receipts. PS&S accounting personnel periodically transferred funds to the ABIF.

For the 3 months ending June 1992, there was an average month-end balance of $2.42 million in the non-ABIF accounts. Ten of the 12 bank accounts paid no interest, 1 paid 3.4 percent, and 1 paid 3.25 percent. The interest rate paid by the two credit unions was less than 4 percent. Because funds were allowed to accumulate in checking accounts that paid little or no interest, rather than being promptly transferred to the central investment account, we computed that PS&S failed to earn about $159,000 yearly in interest.

Failure to earn the maximum interest on available PS&S funds was also reported in the Gregor Professional Corporation's report, "Pacific Stars and Stripes, Report of Audit for the Twenty-Four Months Ended 30 September 1988," (undated). The auditors recommended that PS&S keep non-interest-bearing account balances to a minimum by transferring funds weekly. The PS&S commander agreed, but took no corrective action.

Premature Payment. PS&S also failed to earn interest income on its operational funds because, rather than waiting until the due date shown on vendors' invoices, PS&S accountants made payments as soon as the goods or services and vendors' invoices were received. OMB Circular No. A-125 requires that vendors be paid no sooner than 7 days before the due date. The payments we examined were made an average of 17 days before they should have been paid. We estimate that, because of early payments, at least $10,000 in interest income was lost annually.

Cashier Operations. Cashier operation procedures established in PS&S Standard Operating Procedure 3-1 were general and did not ensure minimum risk to the cash. PS&S cashier operations had weak internal controls and inadequate physical security. PS&S maintained a cashier operation so its U.S. employees and other U.S. Government personnel working nearby could cash personal checks to obtain U.S. dollars or Japanese yen. To provide this service, PS&S maintained a daily balance of about $10,000 and an equivalent balance in yen. Our review of cashier operations identified the following internal control weaknesses.

o The cashier was not required to take vacations, and there was no alternate cashier. Consequently, improprieties could be concealed.

o The chief accountant was responsible for maintaining the account books and performing the cashier's duties when the cashier was absent because of sickness. Consequently, established segregation of duties was negated.

o During duty hours, the door to the cashier's area remained open, the safe remained unlocked, and there was no alarm system to notify security personnel in case of robbery.

Tuition Assistance. PS&S managers paid the tuition expenses of ineligible employees for the school years 1988-89, 1989-90, and 1990-91. Management either disregarded or was unaware of the requirements of DoD Manual 1401.1-M, "Personnel Policy Manual for Nonappropriated Fund Instrumentalities," December 1988. The manual requires that for tuition to be paid for dependent children of nonappropriated fund employees stationed in foreign areas, the employees must meet the eligibility requirements established in "Department of State Standardized Regulations." These criteria require the

employees to have been hired in the continental United States and to have signed a transportation agreement to remain overseas at least 3 years.

Before FY 1990, PS&S paid tuition assistance to eligible employees from its nonappropriated funds. In FY 1990, Congress appropriated funds to the Department of Defense Dependents Schools to provide educational benefits to eligible nonappropriated fund employees' school-age dependents on a nonreimbursable basis. When determining the eligibility of PS&S employees to participate under the revised criteria, PS&S identified two employees who had been paid about $22,700, although they had not been eligible to receive tuition assistance. Management stopped the tuition payments, but did not recoup the employee debt that resulted from the improper payments. According to OMB Circular No. A-129, "Managing Federal Credit Programs," November 25, 1988, the forgiven debts should have been reported to the Internal Revenue Service as income for the two employees. However, this did not occur.

When PS&S stopped paying tuition assistance to the two employees, they received pay raises. One employee's raise was for $6,452, and the other raise was for $9,007. Although the pay raises appeared excessive, they were within established pay guidelines for nonappropriated fund employees. Management told us that the raises were given to compensate the employees for the lost tuition benefits.

Living Quarters and Post Allowances. Controls had not been established to periodically verify the family status of PS&S employees. PS&S managers must know their employees' family status in order to ensure that the employees receive correct amounts for living quarters and post allowances. PS&S funds are used to pay these allowances to qualified employees. To qualify, employees must meet the "Department of State Standardized Regulations" criteria, discussed under "Tuition Assistance" above. PS&S managers depended on the integrity of employees to notify PS&S of changes in family status.

The former PS&S Comptroller was inappropriately paid about $43,800 for tuition assistance, living quarters, and post allowances. When his marital status changed from "married with children" to "single without family" in June 1988, he did not inform the personnel section of the change. When the personnel section learned of his change of marital status, the former Comptroller claimed that he did not know he should make the change known to anyone. In March 1990, PS&S reduced the former Comptroller's living quarters and post allowance to the "single without family" rate and stopped tuition assistance payments. When the former Comptroller's employment with PS&S terminated on February 4, 1992, about $11,000 was withheld from his final pay and allowances. At the time of our audit, PS&S had not attempted to collect the remaining $32,800 overpayment. In accordance with the Debt Collection Act of 1982, interest should be charged on the outstanding debt. If the debt is

uncollectible, the uncollected amount should be reported to the Internal Revenue Service as income to the former Comptroller so that taxes can be collected.

Insurance. PS&S buildings, building improvements, and vehicles were not adequately insured, because management did not adhere to the insurance guidance in Army Regulation 215-1, "The Administration of Army Morale, Welfare, and Recreational Activities and Nonappropriated Fund Instrumentalities," September 10, 1990. The regulation requires nonappropriated fund buildings and vehicles to be insured for their actual cash value and building improvements to be insured at cost.

PS&S insured its buildings, improvements to buildings, and vehicles based on original cost less accumulated depreciation. While this method is appropriate for financial records, it underinsured assets and improvements. To illustrate, based on the method used by PS&S, a 7-year-old building with an estimated useful life of 45 years, built at a cost of $200,000 with an estimated replacement cost of $284,000, would be insured for $169,000. Under the actual cash value method, the same building should be insured for $239,000. Because assets were underinsured, PS&S was reimbursed $57,500 rather than $179,000 when a bookstore was destroyed by the 1991 volcanic eruption of Mount Pinatubo in the Philippines.

Audit Coverage. There was a lack of comprehensive audit coverage of PS&S, and a lack of followup to ensure that audit recommendations intended to improve operations and internal controls were implemented. Audits were made every 2 years between 1979 and 1992 by CPA firms. Although the CPA firms made recommendations for improvement, the primary purpose of their audits was to evaluate the accuracy of reported financial data.

Before 1990, the audits were contracted by PS&S and funded by the American Forces Information Service (AFIS). In 1990 and 1991, the commercial audits were funded and contracted for by AFIS personnel in accordance with DoDI 5120.4, "DoD Newspapers and Civilian Enterprise Publications," November 14, 1984. The audits were made in accordance with the contractual requirements set forth in Statements of Work prepared by AFIS. However, when the Statements of Work were developed, AFIS personnel were unaware of the audit requirements in DoDI 7600.6, "Audit of Nonappropriated Fund Instrumentalities and Related Activities," April 16, 1987. DoDI 7600.6 states that, for all nonappropriated fund instrumentalities, the preferred audit coverage shall be performance audits. The instruction also requires annual audits for activities such as PS&S that have annual revenues or expenses of $5 million or more. DoDI 5120.4 inappropriately required audits of the Stars and Stripes organization every 2 years. (At the time we issued our report, DoDI 5120.4 was being revised to require annual audits to be paid for by Stars & Stripes.) DoDI 7600.6 also requires audits of nonappropriated fund instrumentalities to

comply with Government auditing standards as established by the Comptroller General of the United States. The standards establish strict criteria to be followed for both financial and performance audits. This requirement was omitted from the Statement of Work for the commercial audits.

As shown in Appendix A, recommendations made by the commercial audit firms and by the Rosen Commission were frequently not implemented by PS&S, although PS&S agreed with the recommended actions. The procedures required by DoDI 7600.6 to ensure that followup and resolution of audit recommendations are accomplished were not established for the commercial audits. We have recommended that this requirement be included in the revision of DoDI 5120.4.

Use of Government Vehicles. PS&S management authorized the use of four vans and a station wagon to transport military and civilian employees residing on U.S. military installations in the Tokyo area to and from work. Although the vehicles were purchased using PS&S funds, they are U.S. Government vehicles and must be used in accordance with current regulations. With limited exceptions, Army Regulation 215-1, and Army Regulation 58-1, "Management, Acquisition, and Use of Administrative Vehicles," March 1, 1981, prohibit the use of Government vehicles for commuting. PS&S managers were unaware of this restriction, and they believed that this use of vehicles was needed because of the difficulty of using Japanese public transportation and driving in Tokyo's heavy commuter traffic. When we brought the situation to PS&S managers' attention, they immediately requested a waiver from the Secretary of the Army. The request was still being considered at the time of our report; therefore, we are not recommending any other corrective action.

Discounts. PS&S had established a limited discount policy for its bookstore operations. Service members and their dependents were charged the cover price for all magazines and most hardcover and paperback books. Hardcovers and paperbacks listed on publishers' best-seller lists were discounted 25 and 15 percent, respectively. These books represented a small percentage of the total merchandise offered for sale. Books that did not sell for extended periods were also discounted. PS&S management did not offer storewide discounts because they believed that maximum revenue was needed from bookstore operations to offset losses from the newspaper operations. Managers of Army and Air Force Exchanges and of a commercial bookstore in the Washington, D.C., area told us that when magazines and books are discounted, sales increase, which offsets the discounts. Although the Washington D.C., market and PS&S market are dissimilar, to the extent practicable, military personnel who serve overseas should receive discounts on all magazines and books similar to those found in military exchanges in the continental United States. At the military exchange at Andrews Air Force Base, Maryland, the cover prices of all periodicals and books were discounted 10 and 25 percent, respectively. In 1987, the Rosen

Commission recommended discounting hardcover books to increase sales. PS&S managers responded that they would evaluate the effect of discounts on sales in general. By charging cover prices for most books and all periodicals, sufficient revenue was generated to operate PS&S at a profit in FY 1991. Improved operational efficiencies should reduce the need for appropriated fund support, and enable additional discounting while continuing to operate profitably. As efficiencies are achieved, increases in customer discounts should serve as one measure of improved performance by management.

Recommendations for Corrective Action

1. We recommend that the Assistant Secretary of Defense (Public Affairs) revise DoD Instruction 5120.4 to require that military officers supervising business operations of the Stars and Stripes organization have experience in nonappropriated fund business procedures or in DoD comptroller functions.

2. We recommend that the Commander in Chief, U.S. Pacific Command, develop and implement guidance that clearly establishes responsibility for command oversight of the Pacific Stars and Stripes organization. Specifically, define responsibility for who on the Pacific Command staff should:

a. Make periodic inspections to determine whether the Pacific Stars and Stripes is complying with applicable laws and regulations;

b. Follow up on recommendations made by inspectors, auditors, and study teams; and

c. Direct that the Pacific Stars and Stripes implements the Federal Managers' Financial Integrity Act and reports internal control weaknesses as required.

3. We recommend that the Commander/Publisher, Pacific Stars and Stripes:

a. Implement the Federal Managers' Financial Integrity Act in accordance with DoD and Army guidance.

b. Establish return and loss rates for area distribution contractors for The Stars and Stripes newspaper, based on historic losses and estimates of monthly sales increases or decreases for each contract area; document the basis for the established return and loss rates; and modify existing contracts as warranted.

c. Monitor newspaper production of commercial printings of The Stars and Stripes newspaper to ensure that the printing of the newspaper is not delayed.

d. Notify contractors when quarterly and semiannual inventories are to be made; clarify that inventories are to be accomplished in accordance with contract requirements, including assistance by disinterested persons provided by local commanders; and take follow-up action when inventories are not taken as required.

e. Require that when bookstore inventories are taken by two inventory teams, each team must make an independent count of the merchandise. The two counts should be compared by an inventory supervisor to identify instances when the two counts do not agree. If the two counts do not agree, a third count must be taken to determine the correct on-hand balance.

f. Assign personnel from the Logistics Division, rather than accounting personnel, to take end-of-contract inventories initiated by the Pacific Stars and Stripes and provide the inventory results to accounting personnel.

g. Require that orders for periodicals to be sold in bookstores and third-party outlets be based on customer demand, and that no order be placed for a specific periodical in a distribution area when the demand is for less than 10 copies.

h. Require that all disbursements of funds be supported by original purchase orders, receiving reports, documents supporting returns, and vendors' invoices.

i. Revise area distribution contracts to remove the requirement to reimburse area distribution contractors for costs associated with distributing USA Today. Retain distribution costs paid to the Pacific Stars and Stripes by the publisher of USA Today.

j. Require managers to make, and follow, written agreements with all publishers and contractors doing business with the Pacific Stars and Stripes.

k. Require that area distribution contractors' daily sales reports be reconciled to bank deposit slips, and that accounting personnel do the following.

(1) Contact the area distribution contractor to document the reason for delay, and any corrective action taken, when the deposit slips indicate that deposits are not made as soon after daily sales as possible.

(2) Require area contractors to submit all cash register tapes and other sales records with their daily sales reports.

(3) Require that accounting personnel reconcile sales records, bank deposits, and sales reports to ensure that all sales are reported and all funds are deposited.

l. Prohibit the use of Pacific Stars and Stripes checking accounts for any purpose other than official business.

m. Prohibit selling Japanese yen to personnel at the organization rate of exchange.

n. Implement procedures to withdraw funds weekly from all bank accounts not associated with the Army Banking and Investment Fund (leaving on deposit the minimum balances required by the banks), and to deposit the funds withdrawn to the Army Banking and Investment Fund.

o. Implement Prompt Payment Act procedures and ensure that vendors are paid no sooner than 7 days before the invoice due date.

p. Develop and implement specific procedures for cashier operations. The following minimum requirements should be set.

(1) The door to the cashier area should be secure at all times.

(2) An alternate cashier should be designated.

(3) The separation of duties between accounting and cashier operations should be clarified.

(4) A mandatory vacation period should be set for the cashier, and an alternate cashier should be designated in writing and trained.

(5) Army or Air Force military security personnel should evaluate the physical security of the Pacific Stars and Stripes headquarters building, and Pacific Stars and Stripes management should implement all recommendations made and agreed to as a result of the evaluation.

q. Require employees to validate their marital and dependent status annually and ensure that employees' temporary living quarters and post allowances are computed correctly.

r. Collect debts owed to the Pacific Stars and Stripes by individuals and report all forgiven or uncollectible debts to the Internal Revenue Service.

s. Insure Pacific Stars and Stripes buildings and vehicles for their actual cash value, and insure building improvements at cost.

t. Require that audits of the Pacific Stars and Stripes organization be accomplished annually, and follow the Government auditing standards established by the Comptroller General of the United States.

4. We recommend that the Director, American Forces Information Service, routinely monitor the discounts offered in relation to revenues generated, cash reserve levels, and investment/contingency needs. As efficiency of operations improves and financial conditions permit, additional discounts on both books and periodicals should be offered to customers and used as one measure of improved performance by management.

Management Comments

The Special Assistant to the Secretary of Defense (Public Affairs) (formerly the Assistant Secretary of Defense [Public Affairs]) concurred with Recommendation 1. The Commander in Chief, U.S. Pacific Command, concurred with Recommendation 2. The Commander/Publisher, Pacific Stars and Stripes, concurred with Recommendation 3. The Director, American Forces Information Service (the Director), partially concurred with Recommendation 4 in the draft report, which recommended discounting all books and magazines 20 percent and 10 percent, respectively.

The Director agreed that, to the extent possible, Pacific Stars and Stripes bookstores should offer discounts to its customers. He stated that in FY 1992, customers received $700,000 in discounts on best-selling hardcovers and paperback books. The Director believed that the discounts generated traffic in the bookstores and led to additional sales. However, because of the inelasticity of the Pacific Stars and Stripes market, he did not believe that discounting all magazines and books would increase sales enough to offset the loss of income that would result from the recommended discounting. The Director stated that he was aware of only one chain that discounted all books and magazines. He also stated that bookstore profits must be maximized in order to offset losses from the newspaper operations. The Director also stated that the Pacific Stars and Stripes will continue to offer discounts, and identify and explore other discounting opportunities consistent with the financial health of the Pacific Stars and Stripes.

Audit Response to Management Comments

The comments were fully responsive to Recommendations 1., 2., and 3. We disagree, in part, with the management's comments on Recommendation 4. As we stated in our draft report, the Pacific Stars and Stripes and Washington, D.C., markets are not the same. However, we believe that our comparison to the Army & Air Force Exchange Service (AAFES) was valid. Both Stars and Stripes and the AAFES have been established to provide low-cost goods and services to military members and their dependents. The price charged for The Stars and Stripes newspaper as well as the discounts offered by the Pacific Stars and Stripes are valid performance measures of how well military customers are being served by management. Operational improvements in efficiency, such as those recommended and agreed to in this report, would offset potential decreases in revenue caused by discounting. Therefore, in the interest of providing improved service to military members and their dependents, management should strive to provide reading material at discounted prices. In the final report, we have revised the section entitled "Discounts" and Recommendation 4.

Status of Recommendations

Responses to the final report are required from the Director, American Forces Information Service, for Recommendation 4. The response must indicate whether they concur or nonconcur, propose corrective actions, and give completion dates for the proposed actions. See Part IV for the complete text of managment comments.

Part III - Additional Information

Appendix A. Followup on Prior Audit Reports and Prior Study

Audit Reports

Defense Audit Service Report No. 79-131, "The Audit of the Pacific Stars and Stripes," August 27, 1979.

Prior Audit Recommendations. The auditors recommended reducing production and distribution costs of the The Stars and Stripes newspaper by reducing the return and loss allowance from 22 percent to 14 percent; continually monitoring returns, losses, and cash sales to ensure that optimum return percentages are established in each sales area; and establishing separate allowances for unsold and lost newspapers.

Repeat Finding. As of September 1992, the Pacific Stars & Stripes allowable return and loss rate had increased to 25 percent. Optimum return and loss percentages were not determined based on the monitoring of returns, losses, and cash sales, and separate allowances for unsold and lost newspapers were not established.

Prior Audit Recommendation. The auditors recommended that physical inventories of PS&S property be made by disinterested persons.

Repeat Finding. When physical inventories were conducted, they were usually made by contractor personnel.

Gregor Professional Corporation, "Pacific Stars and Stripes Report of Audit for the Twenty-Four Months Ended 30 September 1988."

Prior Audit Recommendations. The auditors recommended that non-interest-bearing cash balances be kept to a minimum by maintaining no more than one week's receipts in non-interest-bearing accounts. All other amounts should be transferred into interest-bearing accounts weekly.

Repeat Finding. Funds were allowed to accumulate in low- or no-interest checking accounts. Because funds were not promptly transferred to the Army Banking and Investment Fund, interest income was not earned.

Study

Rosen Commission, "Stars and Stripes Advisory Task Force," October 1987.

Prior Study Recommendation. The Commission recommended that, to reduce the costs of handling, inventorying, and managing unsold periodicals, PS&S should reduce the number of periodical titles available for sale from 850 titles to the 200 best sellers.

Repeat Finding. As of August 1992, PS&S had about 1,100 different periodicals distributed to the sales outlets, and 40 to 50 percent of the periodicals ordered were not sold.

Prior Study Recommendation. The Commission recommended discounting hardcover books to increase sales.

Corrective Actions Taken. PS&S discounted best-selling hardcover and paperback books and hardcovers that had remained unsold for extended periods.

Repeat Finding. PS&S managers had not discounted all hardcover books.

Appendix B. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.	Economy and efficiency. Implementation should result in improved overall management.	Nonmonetary
2.	Economy and efficiency. Implementation should result in improved overall management.	Nonmonetary
3.a.	Compliance with law. Implementation should result in compliance with Federal Managers' Financial Integrity Act and improved internal controls.	Nonmonetary
3.b.	Economy and efficiency. Implementation should reduce the costs of newspaper publication and distribution.	Funds put to better use; $495,000 in FYs 1994-1998. *
3.c.	Internal controls. Improve controls over newspaper printing.	Nonmonetary
3.d.	Internal controls. Implementation should result in improved controls over inventories.	Nonmonetary
3.e.	Internal controls. Implementation should result in accurate inventories.	Nonmonetary

* For Recommendation 3.b., the Commander/Publisher, Pacific Stars and Stripes concurred with the potential monetary benefits, but stated that savings would not begin until FY 1994. All other monetary benefits are computed from mid FY 1993 through FY 1998.

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
3.f.	Internal controls. Implementation should result in improved controls over inventories.	Nonmonetary
3.g.	Economy and efficiency. The costs of handling, inventorying, and managing unsold periodicals should be reduced, and appropriated fund support for transporting periodicals from the continental United States should be reduced.	Undeterminable. We know of no basis on which to compute the monetary benefit.
3.h.	Internal controls. Implementation should result in improved control over disbursements.	Nonmonetary
3.i.	Economy and efficiency. Implementation should increase profits by retaining distribution costs paid by the publisher.	Funds put to better use; $186,000 in FYs 1993-1998.
3.j.	Internal controls. Implementation should result in documenting agreements with publishers.	Nonmonetary
3.k.	Internal controls. Implementation should result in improved control over sales income.	Nonmonetary
3.l.	Internal controls. Implementation should result in using operational checking accounts for official business only.	Nonmonetary

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
3.m.	Compliance with regulation. Implementation should result in compliance with DoD Directive 7360.11.	Nonmonetary
3.n.	Economy and efficiency. Implementation should increase interest income.	Funds put to better use; $874,500 in FYs 1993-1998.
3.o.	Compliance with law. Implementation should result in compliance with Prompt Payment Act and increased interest income.	Funds put to better use; $55,000 in FYs 1993-1998.
3.p.	Internal controls. Implementation should result in improved controls over cashier operations.	Nonmonetary
3.q.	Internal controls. Implementation should result in improved controls over employee entitlements.	Nonmonetary
3.r.	Compliance with regulation. Implementation will result in compliance with OMB Circular No. A-129, "Managing Federal Credit Programs."	Undeterminable. The amount that will be collected or reported to the Internal Revenue Service cannot be projected.

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
3.s.	Compliance with regulation. Implementation will result in compliance with insurance guidance in Army Regulation 215-1.	Undeterminable. Increases from insurance for future damages cannot be projected.
3.t.	Compliance with regulation. Implementation will result in compliance with Government auditing standards for performance audits and will improve the use of audit results as a management tool.	Nonmonetary
4.	Program results. Implementation should result in improved service to military customers and may increase sales.	Nonmonetary

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Special Assistant to the Secretary of Defense (Public Affairs), Washington, DC
Comptroller of the Department of Defense, Washington, DC

Department of the Army

Army Central Insurance Fund, U.S. Army Community and Family Support Center, Alexandria, VA

Department of the Air Force

Headquarters, Air Force Office of Special Investigations, Bolling Air Force Base, Washington, DC
Air Force Office of Special Investigations, Yokota Air Base, Japan

Unified and Specified Commands

Headquarters, U.S. Pacific Command, Camp H.M. Smith, HI
Headquarters, U.S. Forces Command, Japan, Yokota Air Base, Japan

Other Defense Organizations

American Forces Information Service, Alexandria, VA
Defense Contract Audit Agency, Tokyo, Japan
Defense Finance and Accounting Service, Washington, DC
Headquarters, Pacific Stars and Stripes, Tokyo, Japan
Japan Area Office, Pacific Stars and Stripes, Yokota Air Base, Japan

Non-DoD Federal Organizations

Okinawa Area Contractor, EC Corporation, Okinawa, Japan

Appendix D. Report Distribution

Office of the Secretary of Defense

Special Assistant to the Secretary of Defense (Public Affairs)
Comptroller of the Department of Defense

Department of the Army

Secretary of the Army
Inspector General, Department of the Army

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)

Unified Command

Commander in Chief, U.S. Pacific Command

Other Defense Organizations

Director, American Forces Information Service
Commander/Publisher, Pacific Stars and Stripes
Senior Official Responsible for Internal Controls, Pacific Stars and Stripes

Non-DoD Federal Organizations

Office of Management and Budget
U. S. General Accounting Office
NSIAD Technical Information Center

Chairman and Ranking Minority Member of each of the following Congressional Committees and Subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

Special Assistant to the Secretary of Defense (Public Affairs)

DEPARTMENT OF DEFENSE
AMERICAN FORCES INFORMATION SERVICE
601 NORTH FAIRFAX STREET
ALEXANDRIA, VIRGINIA 22314 2007

MAY 4 1993

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTENTION: ASSISTANT INSPECTOR GENERAL FOR AUDITING
THROUGH: SPECIAL ASSISTANT TO THE SECRETARY OF DEFENSE (PUBLIC AFFAIRS) MAY 17 1993

Operating elements
Armed Forces Radio and Television Service
American Forces Press and Publications Service
Defense Audiovisual Policy
Print Media Policy

SUBJECT: Draft Audit Report on the Pacific Stars and Stripes (Project No. 2FH-5004)

This memorandum responds to the DoD IG memorandum of February 26, 1993, which forwarded the subject draft report containing four recommendations for review and comments. The comments of the Commander in Chief, U.S. Pacific Command, and the Commander/Publisher, Pacific Stars and Stripes, are consolidated into this memorandum in order to present a coordinated response to the draft report.

Comments on recommendation 1, addressed to the Assistant Secretary of Defense for Public Affairs, and recommendation 4, addressed to the Director, American Forces Information Service, are contained in Attachment 1. Recommendation 2 is addressed by the Commander in Chief, U.S. Pacific Command, in Attachment 2. Recommendation 3 is addressed by the Commander/Publisher, Pacific Stars and Stripes, in Attachment 3. Attachment 4 is our clarification of comments by the Pacific Stars and Stripes' Commander/Publisher contained in paragraph II.h. of his memorandum of April 20, 1993, Attachment 3.

We wish to compliment your staff for the thorough and professional way in which this audit was conducted. By identifying and documenting important corrective actions, the report will greatly assist in improving the overall efficiency and effectiveness of Pacific Stars and Stripes business operations.

Jordan E. Rizer
Director

Attachments:
1. Comments on Recommendations 1. and 4.
2. Comments on Recommendation 2.
3. Comments on Recommendation 3.
4. Clarification of Recommendation 3.

Office of Assistant Secretary of Defense (Public Affairs)

COMMENTS ON RECOMMENDATIONS 1. AND 4. OF

DRAFT AUDIT REPORT ON PACIFIC STARS AND STRIPES

(PROJECT NO. 2FH-5004)

A. SUBJECT: PERSONNEL EXPERIENCE.

FINDING: Page 9. Concur.

RECOMMENDATION NO. 1. Page 23, Para. 1. Concur.

ACTION TAKEN/PLANNED: The proposed new DoD Directive governing Stars and Stripes states: "b. The S&S officers supervising business operations should have experience in DoD Comptroller functions and be familiar with laws and regulations applicable to DoD and NAF business operations. A masters degree in business is desirable, but not mandatory." The draft of the proposed DoD Directive has been coordinated within DoD and is to be published in the Federal Register for public comment in the near future. We hope to issue the new Directive by June 30, 1993. Although the current DoD Instruction 5120.4 does not specify DoD Comptroller or NAF business experience, successful efforts are being made to assign officers with such qualifications to Stars and Stripes for supervision of business/financial operations. The recently departed Pacific Stars and Stripes Deputy Commander for Finance, favorably mentioned in the draft report, is a prime example of such an officer.

B. SUBJECT: DISCOUNTS.

FINDING: page 21. Partially Concur. The finding is inaccurate in stating that Pacific Stars and Stripes only discounts those books which have not sold after an extended period. The finding should acknowledge that since January, 1991, Pacific Stars and Stripes has been discounting hardback best sellers by 25% and since January, 1992, has been discounting best selling paperback books by 15%. The repeat finding regarding discounts which appears on page 29 is likewise inaccurate and should be deleted.

RECOMMENDATION NO. 4. Page 25, Para. 4. Partially Concur. We agree that to the extent possible Stars and Stripes Bookstores should offer discounts to their customers. Pacific Stars and Stripes already discounts hardback best sellers 25% and paperback best sellers 15%. This discount program is very well received by customers and is believed to be effective in generating traffic in the bookstores which leads to additional sales. As a result of this program, Pacific Stars and Stripes Bookstore customers enjoyed total discounts amounting to $700,000 in fiscal year

Attachment 1

1992. This is the approach to bookstore discounting practiced by most of the major bookstore chains in the U.S. Crown Books is the only chain we know of that applies some discount to all of the books and magazines it sells. We concur with the judgement of Pacific Stars and Stripes management that discounting all books and magazines as recommended would result in much more loss in revenue than could be made up through increased sales or other cost-saving management initiatives. Stars and Stripes Bookstores differ from chains in the U.S. in that the Stars and Stripes market is fairly inelastic. For the recommended discounting initiative to result in no loss in bookstore profits, sales would have to be increased enough to compensate for the reduced profit margin on individual items. In the commercial market, this could occur if sufficient customers were lured from full price outlets to a discounter. However, since Stars and Stripes is virtually the only book seller serving the overseas military market, there is no competition to draw from. Therefore, discounting could only be effective in increasing sales if it resulted in convincing potential buyers who otherwise would not buy certain publications to buy them because they were discounted. We do not believe that a large enough number of potential customers would be persuaded to buy a certain $2.95 magazine just because it was discounted 10% to $2.66. Stars and Stripes Bookstores must generate sufficient profits to offset the substantial deficits associated with the Stars and Stripes newspaper. For Stars and Stripes, bookstore profits are a substitute for the large advertising revenues which make most commercial newspapers financially viable. Of necessity, Stars and Stripes advertising revenues are small in comparison, and, therefore, bookstore profits must be relied upon to cover the newspaper's losses. It is noted that Pacific Stars and Stripes' financial operating results for fiscal year 1992 showed an overall net loss of over $550,000 for its newspaper, bookstore and job printing operations.

ACTION TAKEN/PLANNED: Pacific Stars and Stripes will continue to offer discounts to its customers to the maximum extent possible. The present discounting program will be monitored in the future to identify and explore other discounting opportunities consistent with bookstore marketing plans and the financial health of Pacific Stars and Stripes.

COMMANDER IN CHIEF, U.S. PACIFIC COMMAND
(USCINCPAC)
CAMP H M SMITH, HAWAII 96861-5025

J03
5700
Ser: 016
23 April 1993

FIRST ENDORSEMENT on PS&S memo of 20 Apr 93

To: Inspector General, Department of Defense
Via: American Forces Information Service

Subj: DRAFT AUDIT REPORT ON THE PACIFIC STARS AND STRIPES (PROJECT NO. 2FH-5004)

Encl: (1) USCINCPAC Response to Draft DODIG Audit

1. Attached as Encl (1) is the USCINCPAC response to the draft DODIG Audit as requested.

HAROLD T. FIELDS, JR.
Lieutenant General, USA
Deputy USCINCPAC/Chief of Staff

Copy to: PS&S

Attachment 2

COMMENTS ON RECOMMENDATION 2 OF

DRAFT AUDIT REPORT ON PACIFIC STARS AND STRIPES

(PROJECT NO. 2FH-5004)

1. **Executive Summary.** First page. In the Objectives of the audit, it should be specified that the audit was conducted as part of an OSI investigation that was initiated by Pacific Stars and Stripes to investigate suspected wrongdoing and unauthorized business practices.

2. **Findings and Recommendations**

A. IG Comment: Executive Summary Page. Command oversight had not been clearly established, and managers were not following applicable laws and regulations.

Concur.

B. IG Recommendation 2: Page 23. That the Commander in Chief, U. S. Pacific Command, develop and implement guidance that clearly establishes responsibility for command oversight of the Pacific Stars and Stripes organization.

Concur. There was confusion about the assignment of management and oversight responsibilities regarding contracting activities. As a result of a September 1991 letter from the Commander, PS&S, requesting clarification of those responsibilities, and following extensive headquarters staff coordination, the Deputy Commander in Chief, U.S. Pacific Command directed, in a 20 April 92 memorandum, that the MACOM, U. S. Army, Pacific, provide that oversight, as prescribed by AR 215-4.

There was also confusion over who was to perform the audit requested as a result of the OSI investigation. Through USCINCPAC involvement, it was determined that the DoDIG would be the appropriate agency under the circumstances. USARPAC IG also performed a general assessment of PS&S in Jun 92.

(1) Recommendation 2a: Page 23. Define responsibility for who on the Pacific Command staff should make periodic inspections to determine whether PS&S is complying with applicable laws and regulations.

Concur. The USCINCPAC IG in coordination with the USCINCPAC PAO will provide oversight to ensure periodic inspections of

PS&S are conducted to ensure compliance with applicable laws and regulations.

(2) **Recommendation 2b:** Page 23. USCINCPAC define responsibility for who on the Pacific Command staff should follow up on recommendations made by inspectors, auditors, and study teams.

Concur. The USCINCPAC IG in coordination with the USCINCPAC PAO will provide oversight to ensure PS&S follows up on recommendations.

(3) **Recommendation 2c:** Page 23. USCINCPAC define responsibility for who on the Pacific Command staff should ensure that PS&S implements the Federal Managers' Financial Integrity Act (FMFIA) and reports internal control weaknesses as required.

Concur. The USCINCPAC Comptroller in coordination with the USCINCPAC PAO will provide oversight to ensure PS&S meets the requirements of the FMFIA.

The USCINCPAC Instruction 5720.15 is being rewritten to clarify responsibilities and addresses U.S. PACOM staff oversight of the specific issues mentioned in Para 2a,b &c of the recommendations on Page 23. Once staff coordination of the Instruction is complete, anticipated within 60 days, it will be published.

PACIFIC STARS AND STRIPES
Unit No 45002
APO AP 96337-0110

PSS-CDR/PUB 20 April 1993

MEMORANDUM THRU

COMMANDER IN CHIEF, U S PACIFIC COMMAND

AMERICAN FORCES INFORMATION SERVICE

FOR INSPECTOR GENERAL DEPARTMENT OF DEFENSE

SUBJECT Draft Audit Report on the Pacific Stars and Stripes (Project No 2FH-5004)

This is to provide the comments of the Commander/Publisher, Pacific Stars and Stripes (PS&S), on the draft audit report as requested in your memorandum of 26 Feb 93

I. Background

Before offering specific comments and recommendations on the draft audit report, the following observations may be helpful in putting the audit in a broader perspective:

Officers and civilians on the staff of PS&S had little or no training and insignificant experience in federal financial management regulations prior to Jan 91

Upon the arrival of a credentialed and experienced military comptroller to fill the deputy commander for finance position, the company began to re-examine management practices with a view toward correcting any which appeared to be contrary to regulations, and to ensure that PS&S operations were not only profitable, but also legal and ethical

This emphasis brought about allegations of contracting irregularities, and in May 91, PS&S initiated the Army Criminal Investigation Division/Air Force Office of Special Investigations inquiry which ultimately led to the DoD Audit of PS&S in the summer of 92 It was only with the assistance of USCINCPAC that our request for audit assets to assist AFOSI was finally approved and the Audit materialized All documents pertinent to the investigation were turned over to AFOSI and the Audit Team

In Feb 92 the civilian comptroller -- a PS&S employees since 1984 -- was found to have violated company policies and federal regulations and he was separated from government employment His ignorance of regulations and inattention to duty were underlying causes of many of the Audit Findings

Attachment 3

Progress in correcting practices uncovered by PS&S prior to the investigation was suspended, at the direction of AFOSI, pending completion of the Audit, in order to preclude any perception of command hinderance or impedance to the investigation Upon completion of the Audit, and with the approval of AFOSI, the company resumed action to correct deficiencies and initiated action to correct additional items reported during the Audit out-briefing on 4 Sep 92

When it became apparent that no higher headquarters had assumed responsibility for ensuring compliance with Army NAF Regulations, PS&S took the lead in gaining USCINCPAC assistance USARPAC was designated as the cognizant command on 20 Apr 92; and a USARPAC IG team provided an initial assessment on 26 Aug 92 As a result of that assessment, USARPAC proposed a rewrite of the USCINCPAC instructions governing PS&S operations Upon completion of staffing and approval, the revised directive will realign authorities and responsibilities for supervision of PS&S operations This, along with actions to correct audit findings, is a crucial step to ensure that PS&S operations remain consistent with federal regulations

COMMENT: Executive Summary, p i.

For your information PS&S is discontinuing service to the Philippines as of 30 Apr 93 because only a few active duty military personnel remain there and continued service is no longer cost effective

In the "Introduction" or "Objective," it may be worth noting for the record that "***The investigation was requested by PS&S and when it became evident that audit assistance was required, PS&S requested and gained the support of USCINCPAC in arranging the audit***"

COMMENT: Background, p.2.

The sentence in the first paragraph beginning with "Revenue for operations in FY91 "appears to be incorrect Recommend the sentence be rewritten as follows: "***Revenue from operations in FY 1991 consisted of $3.2 million from newspaper sales, $18.5 million from publications resale operations, $1.6 million from advertising, job shop printing, etc., and $2 million from other sources (interest, scrap sales, etc.).***"

In the third paragraph, first sentence, consideration should be given to deleting "the Philippines;" as noted above, there will be no further service to the Philippines after 30 Apr 93.

II. Findings and Recommendations (Recommendation No.3)

a. PERSONNEL EXPERIENCE

- FINDING: Page 9 Concur

- RECOMMENDATIONS: Page 23, para 1 Concur

- ACTION COMPLETED. The Joint Manning Document for Pacific Stars and Stripes was changed in Mar 93 to reflect the requirement for a military comptroller (DCR-FIN) with experience in NAF business operations to oversee business and finance operations [Additionally, the officer assigned must be approved by the Director of American Forces Information Service and the Deputy Commander in Chief of U S Pacific Command]

b. FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT OF 1982

- FINDING. Page 9 Concur

- RECOMMENDATION. Page 23, para 3 a Concur

- ACTION TAKEN/PLANNED. Completion of corrective actions associated with recommendations [3 c , 3 d , 3 e , 3 f , 3 h , 3 j , 3 k , 3 l , 3 p , and 3 q] on pages 23-25 of the Audit report as discussed below will fulfill the requirements of this recommendation Additionally, PS&S will implement a formal internal management control program as required by the FMFIA Estimated completion date: Corrective action continuing with overall completion date of Jun 95

c. NEWSPAPER RETURN AND LOSS ALLOWANCE

- FINDING. Page 9-10 Concur in reduction of return and loss allowance Currently neither PS&S nor the contractors have the capability to control sales scientifically, i e , with a circulation management hardware/software system which measures copy sales, time of sale, cash received in each coin box, and losses

- RECOMMENDATION. Page 23, para 3 b Concur

- ACTION PLANNED: We plan to reduce the returns and eliminate the loss allowance for all future contracts We also plan to negotiate reductions of allowances with current contractors by offering to provide the means to effect the reductions PS&S intends to purchase an automated circulation management system during FY94 for tracking of cash sales to optimize distribution in operating areas Estimated completion date Sep 94

- ESTIMATED MONETARY BENEFIT: Page 30 Concur for the five-year period FY94-99

d. DELAYED DISTRIBUTION

- FINDING. Page 10 Concur that newspaper distribution in the Philippines was delayed [The primary reason for delayed distribution of the newspaper from the commercial printing firm in Manila to the contractor at Subic Bay was the eruption of Mount Pinatubo and the tons of ash which not only impeded the movement of vehicles from Manila to Subic Bay, but also caused cancellation of flights from Tokyo on which newspaper page negatives were shipped

[Before the volcano, but after the contract printer was hired, PS&S was credited for having dramatically improved timeliness of delivery As previously mentioned, PS&S service to the Philippines will end on 30 Apr 93 In our planning for electronic transmission of the newspaper and remote printing in Korea, we believe delayed distribution from the printer to the distribution contractor is very unlikely, since both will be co-located in Seoul, South Korea]

- RECOMMENDATION: Page 23, para 3.c Concur

- ACTION COMPLETED: Remote printing contract terminated on 30 Sept 92

e. INVENTORIES

- FINDING: Page 10-12 Concur [As a final comment under this heading it might be worth noting that ***"The manager assigned to conduct timely and effective inventories was the former civilian comptroller. The individual who had filled that position since 1984 was found in violation of financial management regulations, relieved of his duties and separated Feb 92."]***

- RECOMMENDATIONS: Page 23, para 3 d, 3 e, and 3 f Concur

- ACTION COMPLETED: An inventory schedule has been published and distributed to contractors The PS&S Comptroller is coordinating follow up actions Additionally, sale price inventory procedure has been revised and controls of both counts will be enforced Inventory methods have also been changed Two inventory teams will make independent counts during sale price inventories Individuals from other than the office of the Comptroller-Area Accounting will be used to make inventory counts Action is ongoing and planning was completed Mar 93

f. PERIODICALS

- FINDING: Page 12-13 Concur

- RECOMMENDATION: Page 24, para 3 g Concur

- ACTION COMPLETED: Management is aware of the appropriated fund cost involved in transportation of periodicals This consideration is a primary factor in the decision process concerning continuing or deleting titles from inventory We have established a policy and the periodical product line manager is ensuring periodical titles that have demand of less than 10 copies in any one area are deleted from the periodicals listing for that area Action completed Mar 93

g. DISBURSING

- FINDING: Page 13 Concur

- RECOMMENDATION. Page 24, para 3 h Concur

- ACTION PLANNED: The PS&S Comptroller will require disbursements be supported by original purchase orders, receiving reports, vendor's invoices, and return documents Estimated completion date for all product lines: 30 Jun 93

h. DISTRIBUTION OF USA TODAY

- FINDING. Page 13-14 Concur

- RECOMMENDATION: Page 24, para 3 i and 3 j Concur

- ACTION TAKEN/ PLANNED. Completed written agreements on file: Mar 93 Current contracts in Korea and Okinawa provide for reimbursement to contractors for handling USA Today This provision cannot be deleted unless PS&S terminates existing contracts and solicits new offers It should be appreciated that contractors do incur costs to provide this service and such costs will be included as an additional amount in the offerors' basic commission proposals Estimated completion dates are Oct 94 (Okinawa Contract); Jun 95 (Korea Contract)

- ESTIMATED MONETARY BENEFIT. Page 31 Concur

i. CONTROL OF SALES INCOME DEPOSITS

- FINDING. Page 15-16 Concur

- RECOMMENDATION. Page 24, para 3 k Concur

- ACTION TAKEN/PLANNED: All of the recommended procedures to ensure compliance were completed in Mar 93 Additionally, a checklist will be attached to each sales report and signed off that the work has been done Estimated completion date: 1 May 93

j. UNOFFICIAL USE OF PS&S CHECKING ACCOUNT

- FINDING. Page 16-17 Concur

- RECOMMENDATIONS: Page 24, para 3 l and 3 m Concur

- ACTION TAKEN/PLANNED: PS&S check cashing policies and procedures have been changed to reflect the prohibition of use of PS&S accounts for other than official business Additionally, PS&S cashier has ceased selling yen at the organizational rate We now determine the daily rate by contacting the military banking facility in the afternoon of the preceding day Finally, currency exchange will be limited to personal checks or cash Estimated completion date for final action: 30 Apr 93

k. LOST INTEREST

- FINDING. Page 17-18 Concur

- RECOMMENDATIONS. Page 25, para 3 n and 3 o Concur

(1) CENTRALIZED BANKING AND INVESTMENT PROGRAM

- ACTION TAKEN/PLANNED: The PS&S Comptroller will publish, implement and enforce procedures to withdraw funds weekly from all banks not associated with the Army Banking Investment Fund, leaving only minimum balances, and deposit available funds with the Army Banking Investment Fund Banks not having electronic daily/weekly sweeps of funds are being directed to do so Estimation of completion date May 93

(2) PREMATURE PAYMENT

- ACTION COMPLETED: Payment procedures have been revised and personnel trained to ensure that vendors are paid no sooner than 7 days prior to invoice due date Action completed Mar 93

- ESTIMATED MONETARY BENEFIT: Page 32 Concur with respect to both 3 n and 3 o

l. CASHIER OPERATIONS

- FINDING. Page 18 Concur

- RECOMMENDATIONS. Page 25, para 3 p Concur

- ACTION TAKEN/PLANNED. Procedures for cashier operations have been developed and implemented The cashier door is secure at all times; an alternate cashier has been designated, accounting and cashier duties have been separated; a mandatory vacation period for principal cashier has been set; and, the Camp Zama Provost Marshall will conduct a physical security inspection of the cashier's facility Estimated date for completion: 26 Apr 93

m. TUITION ASSISTANCE

- FINDING. Page 18 Concur

- RECOMMENDATION: Page 25 para 3 q Concur

- ACTION COMPLETED: Validation of marital and dependent status of PS&S employees has been completed LQA payments have been reviewed to ensure allowance are computed correctly Action completed Mar 93

n. LIVING QUARTERS AND POST ALLOWANCES

- FINDING. Page 19 Concur

- RECOMMENDATION. Page 25, para 3 r Concur

- ACTION COMPLETED. IRS Forms 1099 have been issued to all individuals having departed who have uncollectible or forgiven debts to PS&S Copies of the 1099s were provided to the IRS Action completed: Mar 93

o. INSURANCE

- FINDING: Page 20 Concur

- RECOMMENDATION: Page 25, para 3 s Concur

- ACTION COMPLETED: Revaluation of physical property and depreciation schedules have been completed and Stripes property is now insured for replacement value Action completed Dec 92

p. AUDIT COVERAGE

- FINDING. Page 20 Concur

- RECOMMENDATION. Page 25, para 3 t Concur

- ACTION TAKEN/PLANNED. Internal review audit has not yet been scheduled awaiting revision and delegation of management oversight responsibility by USPACOM to USARPAC The Statement of Work for the FY93 audit will be reviewed by the applicable DoD Audit Service to ensure requirements conform with the Government Accounting Standards Board--"Yellow Book Standards" Estimated completion date for delegation of management oversight Jul 93

q. DISCOUNTS

- FINDING: Pages: 21-22 Nonconcur in the finding that "PS&S sales outlets charged military members and their dependents full price for magazines, paperback books and hardback books" It is a fact that PS&S charges full price for all periodicals and many books; however, hardback best sellers are discounted 25% and paperback best sellers are discounted 15% Recommend revised wording of this section (Additional comments on this topic are provided in our discussion of Appendix A)

- RECOMMENDATION: Page 25, para 4 Concur with "management initiatives to reduce expenses;" but ***non-concur in across the board discounting of all books 20 percent and all periodicals 10 percent.*** To implement this proposal would result in substantial annual

operating losses To break even, unit sales of books and periodicals would have to increase by 25% and 12% respectively; PS&S management does not believe these increases are attainable It may be worth noting that PS&S discounting policies have been reviewed and approved by the USCINCPAC Fund Council The intent of PS&S management is to sell the newspaper at a price comparable to a typical hometown newspaper, and offset that loss by income from the sale of books and periodicals; to continue to offer discounts on best-selling hardback and paperback books as a customer service, but to strive through cost effective operations to avoid any additional requirement for an appropriated or non-appropriated fund subsidy

III. ADDITIONAL INFORMATION

COMMENT: Appendix A. Study, p. 29

Concerning the Rosen Commission, current PS&S management believes that the recommendation to reduce the number of periodicals titles for sale from 850 to 200 was studied in 1988 from the standpoint of feasibility, acceptability and suitability, and the management decision was to continue carrying the same range of titles offered at equivalent bookstores in the U S Regulations governing PS&S operations require that "The assortment of commercial books, periodicals, magazines, and similar products shall approximate publications commercially available in United States bookstore chains of similar size " However, as noted in ACTION COMPLETED for the periodical finding, current policy is to delete periodical titles which record sales less than 10 copies per month per area

Concerning the "Prior Study Recommendation" of the Commission--discounting hardback books to increase sales, and "Corrective Action," it should be noted that since Jan 91, selected best selling hardback books have been discounted by 25 percent; and since Jan 92 best selling paperback books have been discounted by 15% These policies are independent of additional discounts that may be offered on hardback books that had not been sold for extended periods and special purchases from discount publishers

Concerning the last entry under "Repeat Finding," recommend wording change to read ***"Best selling books and paperbacks, but not periodicals, were discounted as a customer service."***

As a concluding comment on Appendix A, it may be a matter of interest that previous audit Findings and Recommendations were scarcely mentioned when current PS&S military officers received their initial orientation briefings The Rosen Commission was mentioned in passing as a matter of historical interest But the primary emphasis was on training and orientation to ensure effective newspaper operations and elimination of practices which led to allegations of censorship and news management

IV. Summary

Pacific Stars and Stripes appreciates the work of the IG Audit Team in helping AFOSI complete its investigation, and in providing a comprehensive set of recommendations to improve the company's cost effectiveness and compliance with federal regulations The IG audit and

implementation of the Team's recommendations are an integral part of a three year effort to upgrade the quality and effectiveness of Pacific Stars and Stripes' operations

Several recent PS&S developments -- intended to improve the company's management and cost effectiveness -- may be of interest to members of the Audit Team:

In Oct 92, the company hired a new professional circulation manager to reduce cost and improve the quality of circulation management; and, in Jan 93 the company hired a new professional civilian comptroller, a Certified Public Accountant with a Masters Degree in Business Administration He has been thoroughly briefed on the audit findings, applicable regulations, and continuing requirements to ensure compliance; and he is scheduled to attend the Comptroller's Professional Development Institute in Jun 93

In the interest of reducing costs, two other points are worth noting: (1) We are negotiating to sell to European Stars and Stripes a surplus printing press which will not only reduce costs, but also provide a one-time $492,000 cash infusion; (2) We now require all newly hired civilians to live in government quarters This policy has the potential to reduce non-appropriated fund costs by up to $800,000 per year by 1997

Our review of Audit findings and recommendations and corrective actions taken leads to the conclusion that the majority of required corrections have been accomplished We believe the remaining corrective actions can be completed by Jun 95

WALTER S de FOREST
Colonel, USMC
Commander/Publisher

9

CLARIFICATION TO COMMENT ON USA TODAY DISTRIBUTION

DRAFT AUDIT REPORT ON PACIFIC STARS AND STRIPES

(PROJECT NO. 2FH-5004)

In paragraph II.h. of his memorandum commenting on subject draft report, the Commander/Publisher of Pacific Stars and Stripes states that a contract provision authorizing reimbursement of contractors for distribution of USA Today could not be deleted from current contracts relating to Korea and Okinawa unless the contracts were terminated and new offers solicited. It is true that such contract provisions cannot be unilaterally deleted by the Government. However, Pacific Stars and Stripes management is consulting with the military contracting centers involved in Korea and Okinawa regarding the possibility of negotiating bilateral modifications to these contracts to effect the recommended deletions. In coordination with officials at the U.S. Pacific Command, we at American Forces Information Service will monitor this situation to ensure satisfactory resolution.

Attachment 4

DEPARTMENT OF DEFENSE
AMERICAN FORCES INFORMATION SERVICE
601 NORTH FAIRFAX STREET
ALEXANDRIA, VIRGINIA 22314 2007

MAY 18 1993

Operating elements
Armed Forces Radio and Television Service
American Forces Press and Publications Service
Defense Audiovisual Policy
Print Media Policy

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTN: ASSISTANT INSPECTOR GENERAL FOR AUDITING

SUBJECT: Draft Audit Report on the Pacific Stars and Stripes (Project No. 2FH-5004)

This memorandum is in further response to the DoD IG memorandum of February 26, 1993, which forwarded the subject draft report for review and comments. Attached is a clarification of three aspects of the Pacific Stars and Stripes Commander/Publisher's memorandum of April 20, 1993, commenting on the draft report.

Jordan E. Rizer
Director

Attachment
As stated

Office of Assistant Secretary of Defense (Public Affairs)

CLARIFICATION OF COMMENTS BY PACIFIC STARS AND STRIPES

REGARDING

DRAFT AUDIT REPORT ON PACIFIC STARS AND STRIPES

(PROJECT NO. 2FH-5004)

Certain of the comments contained in the Commander/Publisher of Pacific Stars and Stripes' memorandum commenting on subject draft report are clarified as follows:

1. On page 3, paragraph b, under ACTION TAKEN/PLANNED, the target date for implementation of a formal internal management control system is clarified to be June 1994. June 1995 is the target date for completion of all of the corrective actions discussed under this recommendation.

2. On page 3, paragraph c, under ESTIMATED MONETARY BENEFIT, the period FY 94-99 is clarified to be the six-year period which Pacific Stars and Stripes feels it needs to achieve the estimated monetary benefit. The six-year period FY 93-98 is not considered sufficient to achieve the estimated savings in view of the fact that FY 93 is more than half over.

3. On page 6, paragraph m, under ACTION COMPLETED, the validation of marital and dependent status of PS&S employees has been completed for FY 93. This is to clarify that Pacific Stars and Stripes intends to perform such a validation annually to make sure that their records are kept current.

Audit Team Members

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