

**Audit**



**Report**

OFFICE OF THE INSPECTOR GENERAL

APPROPRIATED FUNDS USED TO MOVE ARMY  
AND AIR FORCE EXCHANGE SERVICE'S  
MERCHANDISE OVERSEAS

Report No. 95-251

June 26, 1995

**Department of Defense**

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### **Acronyms**

AAFES  
MWR

Army and Air Force Exchange Service  
Morale, Welfare, and Recreation



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



June 26, 1995

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR PERSONNEL  
AND READINESS  
UNDER SECRETARY OF DEFENSE (COMPTROLLER)  
COMPTROLLER OF THE ARMY  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY  
COMMANDER, ARMY AND AIR FORCE EXCHANGE  
SERVICE**

**SUBJECT: Audit Report on Appropriated Funds Used to Move Army and Air Force  
Exchange Service's Merchandise Overseas (Report No. 95-251)**

We are providing this report for your review and comments. Management comments on the draft of this report were considered in preparing this report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request the Under Secretary of Defense for Personnel and Readiness provide comments on revised Recommendation 1 by August 28, 1995.

The courtesies extended to the audit staff are appreciated. If you have questions on this audit, please contact Mr. Dennis Payne, Program Director, at (703) 604-8907 (DSN 664-8907) or Mr. Darrell E. Eminhizer, Project Manager, at (703) 604-8929 (DSN 664-8929). The distribution of this report is in Appendix C.

**Robert J. Lieberman  
Assistant Inspector General  
for Auditing**

Office of the Inspector General, DoD

Report No. 95-251  
(Project No. 1PR-0070)

June 26, 1995

**APPROPRIATED FUNDS USED TO MOVE ARMY AND  
AIR FORCE EXCHANGE SERVICE'S MERCHANDISE OVERSEAS**

**EXECUTIVE SUMMARY**

**Introduction.** The Army and Air Force Exchange Service (AAFES) is a DoD nonappropriated fund instrumentality. Nonappropriated fund instrumentalities operate on a self-sustaining basis. Part of the AAFES mission is to provide merchandise for resale to authorized customers in the United States and foreign countries. AAFES does not directly receive appropriated funds for its purchasing operations. However, AAFES receives appropriated funds from the Army to pay the transportation costs for merchandise shipped between the United States and overseas locations. Congress is aware of this practice, and a congressional committee has suggested that a separate budget line item be used in DoD's future requests for appropriated funds.

**Objective.** The original objective of the audit was to determine whether DoD appropriated funds were used in accordance with DoD policy to transport AAFES merchandise overseas. During the field work phase of the audit, we found conflicting legislative references discussing the use of appropriated funds to pay for transportation of AAFES merchandise. The objective was changed to determine the extent to which appropriated funds had been used to transport AAFES merchandise between the United States and overseas locations.

**Audit Results.** Title 10, United States Code, Sections 4779(b) and 9779(b) (10 U.S.C. 4779(b) and 9779(b)), state that appropriated funds are not to be used to support Army and Air Force exchanges' operations. However, Congress has been providing funds for AAFES overseas transportation costs through Defense authorization and appropriations acts. The AAFES transportation costs are not a separate line item in either the Army or DoD transportation budgets; and, as a result, visibility over funds requested is lost in the DoD budget approval process. From FYs 1991 through 1993, the DoD funded \$421.5 million in overseas transportation costs for AAFES merchandise with appropriated monies. Also, Army's budget request for AAFES overseas transportation was understated by almost \$100 million in FY 1994. Funding intended to transport military items in FY 1994 was needed to transport AAFES merchandise.

Clarifying the statutes in future Defense authorization and appropriation acts by establishing a separate line item to provide appropriated fund support for the transportation of AAFES merchandise overseas should eliminate concerns about the legality of using Army appropriations for this purpose. Also, more accurate budget requests for AAFES overseas transportation should decrease the need for reprogramming from other transportation accounts to cover AAFES funding shortfalls.

The audit did not identify any materiel management control weaknesses. Details on potential benefits resulting from the audit are contained in Appendix A.

**Summary of Recommendations.** We recommend that the Under Secretary of Defense for Personnel and Readiness clarify the use of appropriated funds for AAFES second destination overseas transportation costs by either (1) initiating action to amend 10 U.S.C. 4779(b) and 9779(b), or (2) establishing a separate budget line item for these costs in future annual Defense authorization and appropriation acts. We also recommend that the Army adjust future budget requests for appropriated funds to include full funding for the AAFES overseas transportation costs.

**Management Comments.** The Under Secretary of Defense for Personnel and Readiness did not response to the draft report. The Office of Under Secretary of Defense (Comptroller) nonconcurrent with the draft recommendation to revise the statutes concerning the use of appropriated funds to pay AAFES overseas transportation costs. The position was that these statutes do not prohibit using appropriated funds for transportation of AAFES merchandise overseas because of a provision that permits the use of public transportation that is not needed for other purposes. The Army also provided unsolicited comments nonconcurring with the recommendation for legislative change.

The Army concurred with the recommendation to fully fund AAFES overseas transportation costs. The Army had fully funded AAFES overseas transportation costs of \$144 million in FY 1994 even though only \$56.8 million was included for these costs in the FY 1994 budget. The Army FY 1995 budget request included the entire \$110 million requested by AAFES for FY 1995. The Army requested the Office of the Secretary of Defense to consider AAFES unfunded transportation requirements for FYs 1996 through 2001. Program Budget Decision 724, "Army Executive Agency Programs," December 19, 1994, fully funded AAFES overseas transportation costs for FYs 1996 through 2001. Management comments are provided in Part IV of this report.

**Audit Response.** The legality of using appropriated funds for AAFES second destination overseas transportation needs to be clarified. Recommendation 1 has been modified to give more flexibility in achieving this objective.

We request that the Under Secretary of Defense for Personnel and Readiness provide comments by August 28, 1995.

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This report was prepared by the Audit Planning and Technical Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

# **Part I - Introduction**

## Introduction

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## Background

The DoD Morale, Welfare, and Recreation (MWR) Program provides a variety of goods, services, and activities designed to enhance the well-being of members of the Services (the Army, the Navy, the Air Force, and the Marine Corps) and their dependents. MWR activities are grouped into three categories, based upon their ability to generate revenue and their importance to the MWR mission. MWR's Category C Activities (Revenue Generating Programs) are comparable to self-sustaining businesses and are able to fund most if not all their own expenses. That category includes the Army and Air Force Exchange Service (AAFES). AAFES is the largest Service exchange operation, employing approximately 68,000 military and civilian personnel and generating annual sales of more than \$7 billion. The AAFES mission is to provide merchandise and services to authorized patrons at uniformly low prices. AAFES sales generate sufficient profits to supplement other Army and Air Force MWR activities. Although AAFES operates at a profit, it receives appropriated fund support through the Army budget. AAFES uses the appropriated funds primarily to transport merchandise between the continental United States and overseas locations.

## Objective

The initial objective was to determine whether the use of DoD appropriated funds to move AAFES merchandise between the continental United States and overseas locations was in accordance with DoD policy. During the field work phase of the audit, however, we found conflicting legislation concerning the use of appropriated funds to pay AAFES operations. The objective was modified to examine the extent to which appropriated funds were used to transport AAFES merchandise to and from overseas locations. We also reviewed applicable management controls.

## Scope and Methodology

We reviewed AAFES use of appropriated funds for FYs 1983 through 1992. For the period from October 1982 through May 1992, we verified the Military Sealift Command's overseas transportation costs of AAFES shipments between the continental United States and overseas locations. We examined pertinent documentation to include DoD directives and instructions, transportation account codes, Public Laws, Comptroller General decisions, Defense appropriations and authorization acts, congressional hearings, and U.S. Customs

Service regulations. We also obtained AAFES funding requirements and reviewed the Army's Program Objectives Memorandum requirements for AAFES transportation costs for shipments to and from overseas locations.

This economy and efficiency audit was made from September 1991 through January 1995. We did not rely on computer-processed data or statistical sampling procedures to conduct the audit. The audit was performed in accordance with the auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly included such tests of management controls as were considered necessary. Organizations visited or contacted are listed in Appendix B.

## Management Controls

We assessed management controls related to AAFES overseas transportation operations and examined AAFES implementation of DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. AAFES has a management control program in place, and the audit did not identify material management control weaknesses concerning the transportation of AAFES merchandise to and from overseas locations.

## Prior Audits and Other Reviews

The General Accounting Office; the Inspector General, DoD; and the Army Audit Agency; had recently conducted audits on related issues that may have an impact on the DoD Morale, Welfare and Recreation funding.

General Accounting Office Report No. NSIAD-94-120 (OSD-Case No. 9621) "Morale, Welfare, and Recreation (MWR) - Declining Funds Require DoD to Take Action," February 28, 1994, reports that the financial outlook of the DoD MWR program appears to be worsening. Military Exchange stores, the largest producer of MWR revenue and a source of dividends for other MWR activities, have experienced declining income since 1989. Appropriated funds are expected to decline as overall budgets decline.

Inspector General, DoD, Report No. 94-047, "Armed Forces Recreation Center Europe," February 28, 1994, states that the Armed Forces Recreation Center Europe was not able to be self-sustaining without appropriated fund support even though the Center operated at near capacity. For FYs 1991 and 1992, the Center had operating losses of \$36.5 million before appropriated fund contributions.

Army Audit Agency Report SR 94-C17, "Review of Nonappropriated Fund Cash Levels," June 14, 1994, reports that the Army's nonappropriated fund

## Introduction

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cash balances were within reasonable limits for FYs 1993 and 1994. However, forecasted nonappropriated fund cash balances decreased below a sound financial position from FYs 1995 through 1998.

## Other Matters of Interest

During the audit, we reviewed the payment of customs duties, known as "drawback," to AAFES. Drawback is a procedure involving refund of customs duties paid on foreign goods that are imported into the United States and subsequently exported to a foreign country, which causes the refund. The U.S. Customs Service (Customs) administers the drawback program. We curtailed our review of this area because of AAFES minimal participation in the Customs' drawback program (less than .5 percent of a \$500 million program), and an on-going review at that time by the General Accounting Office (GAO). Based on the review, the GAO issued report GAO/AIMD/94-38, "Control Weaknesses Limited Customs' Ability to Ensure That Duties Were Properly Assessed," in March 1994, that included an assessment of Customs' drawback program.

## **Part II - Finding and Recommendations**

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## **Army and Air Force Exchange Service's Overseas Transportation Costs**

The Army was requesting and receiving appropriated funds to support AAFES overseas transportation costs even though Title 10, United States Code, sections 4779(b) and 9779(b) state that appropriated funds are not to be used to support AAFES operations. Use of appropriated funds was occurring because Congress has consistently provided appropriated money through Defense authorization and appropriation acts to fund transportation costs to move AAFES merchandise overseas despite the Title 10 restrictions. Also, DoD Directive 1015.6, "Funding of Morale, Welfare, and Recreation Programs," authorizes the military exchanges to use appropriated funds to transport both domestic and foreign-made merchandise between the United States and overseas locations. As a result, the Army spends about \$421.5 million on AAFES overseas transportation costs from FYs 1991 through 1993. Also, the Army budget request for AAFES overseas transportation was understated by about \$100 million in FY 1994, necessitating major reprogramming.

### **Background**

AAFES is a nonappropriated fund instrumentality of the United States. Its primary purpose is to provide merchandise for resale to military personnel and their dependents. AAFES is not intended to receive appropriated funds for its operations; through its sales, AAFES generates sufficient revenues to meet operating costs, with the major exception of overseas transportation costs. For many years, the Army has used appropriated funds to subsidize the cost of overseas transportation for AAFES goods to keep prices in overseas exchanges comparable to exchanges' prices in the United States. The Army is the responsible executive agent for overseas transportation of AAFES cargo. The Army funds the cost of transportation provided by commercial shippers through contracts with the Military Traffic Management Command, Military Sealift Command, and the Air Mobility Command, in addition to shipments on government transport.

## **Use of Appropriated Funds**

Historically, Department of Defense authorization and appropriations acts have included funds to pay AAFES overseas transportation costs, but DoD budget requests for the Army have not included a separate budget line item for these costs. Therefore, visibility over funds requested to pay AAFES overseas transportation costs is lost in the DoD budget approval process. Two statutes, Title 10 U.S.C. 4779(b) and 9779(b), state that no funds appropriated for the support of the Army or the Air Force may be spent for Army or Air Force exchanges, but allow the use of "public transportation . . . not needed for other purposes." As executive paying agent for AAFES overseas transportation costs, the Army must meet legislative requirements to fund AAFES overseas transportation costs. No statutes prohibit using appropriated funds to transport merchandise overseas to Navy and Marine Corps exchanges.

## **Congressional Concerns About Appropriated Funds Provisions**

**Congressional Opinion.** The use of appropriated funds to support AAFES overseas transportation costs has been questioned periodically. For example, the DoD budget estimate for FY 1979 contained \$79 million for transportation of military exchange merchandise overseas. In evaluating the FY 1979 DoD Appropriations bill, the Senate Committee on Appropriations viewed the use of appropriated funds to pay for the transportation of military exchange merchandise overseas as conflicting with 10 U.S.C. 4779(b) and 9779(b). The Committee recommended deletion of the funds from the DoD budget and the inclusion of a provision to prohibit the further use of appropriated funds to pay the transportation costs to move military exchanges merchandise. The funds were not deleted and the Committee's recommended provision was not incorporated. No legislation was subsequently proposed by the DoD to change 10 U.S.C. 4779(b) and 9779(b) and Congress took no further action. The statutes have remained unchanged since August 10, 1956.

Although supporting the DoD funding to transport AAFES merchandise overseas, Congress again recently emphasized the need to revise current funding practices. The Committee on Armed Services, House of Representatives, Report No. 103-200, "National Defense Authorization Act for Fiscal Year 1994," July 30, 1993, stated that the Department of Defense should seek authorization for transportation of merchandise for military exchanges as a separate line item in each Service's budget. The Committee noted that funds requested for overseas transportation costs for exchanges was inadequate. This inadequacy was partially attributed to transportation rates the Military Traffic

## **Army and Air Force Exchange Service's Overseas Transportation Costs**

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Management Command and the Military Sealift Command charged that caused the military exchanges to pay 30 percent more than commercial rates to move their merchandise.

**Comptroller General Decisions.** The Comptroller General of the United States ruled that it is a violation of law if appropriations are spent for expenditures prohibited by law. According to Comptroller General decision B-62700, 26 Comp. Gen. 545 (1947), inclusion of a budget estimate for expenditures prohibited by law does not authorize the expenditures or make the appropriations available for use. Unless Congress makes specific references allowing the expenditures in the DoD authorization and appropriation acts or changes the statutes, the expenditures are not authorized.

The Army has continued to budget, request and provide appropriated funds to move AAFES merchandise overseas. Unless legislation is enacted to amend 10 U.S.C. 4779(b) and 9779(b) or other appropriate actions are taken to provide specific authorization and appropriation for these costs, concerns about the funding of AAFES overseas transportation costs will continue. A separate line item in the annual Defense authorization and appropriation acts to fund the AAFES second destination overseas transportation costs would resolve congressional concerns.

### **DoD Authorization to Use Appropriated Funds**

The Office of the Assistant Secretary of Defense (Force Management and Personnel) (currently, the Under Secretary of Defense for Personnel and Readiness), issued DoD Directive 1015.6, "Funding of Morale, Welfare, and Recreation Programs," August 3, 1984. The directive authorizes the military exchanges to use appropriated funds to transport both domestic and foreign-made merchandise between the United States and overseas locations. Management officials in the office of the Under Secretary of Defense for Personnel and Readiness said they believed that DoD Directive 1015.6 implemented the intent of Congress. Their belief was based on the fact that Congress had consistently approved and funded annual Army budget submissions that included funding for AAFES overseas transportation costs.

### **AAFES Overseas Transportation Costs**

Army budget projections for AAFES overseas transportation costs have been consistently and significantly understated. Based on the current budget projections, if the Army continued using appropriated funds for AAFES overseas transportation costs, the Army would require \$288.3 million in appropriated funds from FYs 1994 to 1999. In FY 1994, the Army

## **Army and Air Force Exchange Service's Overseas Transportation Costs**

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budgeted \$56.8 million for AAFES overseas transportation costs, but these costs reached \$99 million by May 1994 and were estimated by AAFES to reach \$157 million by the end of FY 1994. The Army budget request for second destination transportation was understated by about \$100 million in FY 1994 for AAFES overseas transportation. Also, the Army's estimate for FY 1996 (as of June 1994) was \$28.9 million, which was about 81 percent less than the FY 1994 estimate. However, AAFES projected that merchandise transported would decline by only 2 percent (about 28,700 measurement tons) from FYs 1994 to 1996.

Reasons for the Army's understatement of AAFES overseas transportation costs included the rapid escalation in the transportation rates the Air Mobility Command, Military Traffic Management Command, and Military Sealift Command charged to move AAFES merchandise overseas. The Army should adjust future budget estimates to more accurately reflect anticipated costs so that funds will not have to be reprogrammed from other transportation accounts for military operations to compensate for AAFES transportation funding shortfalls. Large-scale reprogramming of this type could have a significant impact on readiness.

### **Recommendations, Management Comments, and Audit Response**

**Management Comments on the Finding.** As a result of management comments, we revised the draft report finding to focus on the need to respond to recurring congressional concerns about the use of appropriated funds to pay AAFES overseas transportation costs. See Part IV for management comments.

**Revised Recommendation.** As a result of management comments, we revised draft Recommendation 1 to establish a separate line item for the use of appropriated funds for AAFES overseas transportation costs to eliminate the conflict between statutes. The draft Recommendation 1 was to revise future Defense authorization and appropriation acts to specifically allow the use of appropriated funds for AAFES overseas transportation costs.

**1. We recommend the Under Secretary of Defense for Personnel and Readiness initiate action to either (1) amend 10 U.S.C. 4779(b) and 9779(b) to allow use of appropriated funds for AAFES second destination overseas transportation costs, or (2) establish a separate budget line item and appropriate language for future annual Defense authorization and appropriation acts to fund the AAFES second destination overseas transportation costs.**

**Management Comments.** The Under Secretary of Defense for Personnel and Readiness did not respond to the draft report. The Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller), nonconcurrent with the recommendation to revise the statutes concerning the use of appropriated funds to pay AAFES overseas transportation costs, stating that the

## Army and Air Force Exchange Service's Overseas Transportation Costs

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position of the Office of the Deputy General Counsel (Fiscal) is that the cited statutes, 10 U.S.C. 4779(b) and 9779(b), do not prohibit the use of appropriated funds to pay AAFES to transport merchandise overseas since the use of "public transportation . . . not needed for other purposes" is allowed; and that the Anti-Deficiency Act has not been violated as a result of this funding. To support this position, the Associate Deputy General Counsel references GAO Report B-169972, "Should Appropriated Funds Be Used For Transportation Procured Specifically for Armed Forces Exchange Goods?," August 6, 1973, in which GAO takes the position that the regulations or payments for transportation of exchange goods were valid and legal.

Although comments were not solicited, the Army Deputy Chief of Staff for Logistics also nonconcurred with the recommendation. The Deputy Chief of Staff's position was that although 10 U.S.C. 4779(b) and 9779(b) generally prohibit the use of appropriated funds for AAFES, the provisions permit the use of public transportation to move AAFES merchandise overseas. The Deputy Chief of Staff also stated that the National Defense Authorization Act of Fiscal Year 1995 authorizes the use of appropriated funds for second destination transportation of military exchange merchandise to overseas locations.

**Audit Response.** We agree that the Anti-Deficiency Act has not been violated. The purpose of this recommendation is to resolve recurring congressional concerns about using appropriated funds to transport AAFES merchandise overseas. We believe that the direct use of commercial carriers by AAFES, rather than available public transportation through DoD, may become the predominate source of transporting AAFES goods overseas. The Committee on Armed Services, House of Representatives, Report No. 104-131, "House Committee on National Security on the National Defense Authorization Act for Fiscal Year 1996," June 1, 1995, encourages the use of the most cost effective carriers (to include commercial carriers) for transporting exchange goods overseas. Also, the GAO report referenced in the Deputy Chief Financial Officer's comments stated that after reviewing the matter and evaluating the various interpretations of the pertinent statutes, GAO's opinion was that considerable doubt exists as to the intent of the Congress with respect to using appropriated funds to finance the exchanges' transportation costs. The GAO report recommended that the Congress consider whether the Government should fund the cost of transporting exchange goods by using transportation not owned by the Government or for which the Government is not otherwise obligated to pay. Although Congress has continued to provide appropriated funds and various congressional committees have discussed the use of appropriated funds to pay AAFES overseas transportation costs, the Congress and DoD have taken no action to resolve the lack of clarity in the laws.

The Army Deputy Chief of Staff for Logistics said the National Defense Authorization Act of Fiscal Year 1995 specifically authorized the use of appropriated funds to transport military exchanges' merchandise overseas. Our review showed the Act contained no such provision. However, we found committee language supporting the use of appropriated funds for second destination overseas transportation of exchange merchandise in report 103-282, "Senate Committee on Armed Services on the National Defense Authorization Act for Fiscal Year 1995," June 14, 1994.

## Army and Air Force Exchange Service's Overseas Transportation Costs

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We modified our draft report recommendation to include an alternative action; specifically, to establish a separate budget line item for appropriated funds for AAFES overseas transportation costs in future Defense authorization and appropriations acts. We request the Under Secretary of Defense for Personnel and Readiness provide comments on revised Recommendation 1 by August 28, 1995.

**2. We recommend the Deputy Chief of Staff for Logistics, Department of the Army, adjust future budget requests for appropriated funds to represent full funding for the Army and Air Force Exchange Service's overseas transportation costs.**

**Management Comments.** The Army Deputy Chief of Staff for Logistics concurred with the importance of the Army fully budgeting and funding AAFES overseas transportation costs. He stated that the Army had fully funded AAFES transportation costs of \$144 million in FY 1994 and has budgeted the \$110 million AAFES requested for FY 1995. He also noted that the Army had requested the Office of the Secretary of Defense to consider AAFES unfunded transportation requirements for FYs 1996 through 2001. Program Budget Decision 724, "Army Executive Agency Programs," December 19, 1994, would fully fund AAFES for FYs 1996 through 2001 as the Army requested.

Although comments were not solicited, the Deputy Chief Financial Officer, Office of the Under Secretary of Defense (Comptroller), also concurred with the recommendation.

**Audit Response.** The actions taken by the Army Deputy Chief of Staff for Logistics are responsive, and no further comments are required.

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## **Part III - Additional Information**

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## Appendix A. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Amount and/or Description of Benefit	Type of Benefit
1.	Compliance. Clarifies the legality of using appropriated funds to pay for AAFES overseas transportation costs.	Nonmonetary.
2.	Program Results. Decreases need to reprogram other second destination transportation funds which could adversely impact readiness.	Nonmonetary.

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## **Appendix B. Organizations Visited or Contacted**

### **Office of the Secretary of Defense**

Assistant Secretary of Defense (Force Management and Personnel), Washington, DC  
Assistant Secretary of Defense (Production and Logistics), Washington DC  
Under Secretary of Defense (Comptroller), Washington, DC  
Defense Logistics Standard Systems Division, Falls Church, VA

### **Department of the Army**

Army Materiel Command, Alexandria, VA  
Military Traffic Management Command, Falls Church, VA  
Eastern Area Command, Military Traffic Management Command, Bayonne, NJ  
Military Ocean Terminal, Bayonne, NJ  
Deputy Chief of Staff for Logistics, Washington, DC  
Comptroller of the Army, Arlington, VA

### **Department of the Navy**

Military Sealift Command, Washington, DC  
Naval Supply System Command, Arlington, VA  
Navy Exchange Service Command, Staten Island, NY  
Naval Supply Center, Norfolk, VA  
Navy Materiel Transportation Office, Norfolk, VA  
Navy Exchange Center, Norfolk, VA  
Navy Comptroller, Washington, DC

### **Other DoD Organizations**

Army and Air Force Exchange Service Dallas, TX  
Dan Daniel Distribution Center, Army and Air Force Exchange Service,  
Newport News, VA  
Army and Air Force Exchange Service Distribution Center, Atlanta, GA  
Army and Air Force Exchange Service Distribution Center, Waco, TX

### **Non-DoD Federal Organizations**

U.S. Customs Service, Inspection and Control Division, Washington, DC  
U.S. Customs Service, New York Region, New York, NY  
U.S. Customs Office, District 4601, Newark, NJ  
District Director of Customs, Dulles Airport, Chantilly, VA

## Appendix B. Organizations Visited or Contacted

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### Contractors

Azar Industries Inc., Elizabeth, NJ  
Dynasty Classics Corp., Saddlebrook, NJ  
F.E. Wallace and Co., Inc., Sparta, NJ  
Goody Products Inc., Kearny, NJ  
Harbor Footware, Port Washington, NY  
Harris & Mallow Inc., Lakewood, NJ  
Remco Toys Co., New York, NY

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## **Appendix C. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller)  
Under Secretary of Defense for Personnel and Readiness  
Assistant Secretary of Defense (Production and Logistics)  
Director, Administration and Management

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Auditor General, Department of the Navy

### **Department of the Air Force**

Auditor General, Department of the Air Force

### **Defense Organizations**

Commander in Chief, U.S. Transportation Command  
Director, Defense Logistics Agency  
Director, Defense Logistics Studies Information Exchange  
Commander, Army and Air Force Exchange Service  
Commander, Navy Retail and Exchange Service  
Commander, Military Sealift Command  
Commander, Military Traffic Management Command

### **Non-DoD Federal Organizations**

Office of Management and Budget  
National Security Division, Special Projects Branch  
General Accounting Office, Technical Information Center, National Security and  
International Affairs Division  
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

## Appendix C. Report Distribution

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Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on National Security, Committee on Appropriations  
House Committee on Government Reform and Oversight  
House Subcommittee on National Security, International Affairs, and Criminal  
Justice, Committee on Government Reform and Oversight  
House Committee and National Security  
House Committee on National Security, Morale, Welfare and Recreation

## **Part IV - Management Comments**

# Office of the Under Secretary of Defense (Comptroller) Comments



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
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APR 11 1995

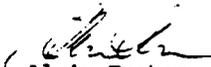
MEMORANDUM FOR DIRECTOR, AUDIT PLANNING AND TECHNICAL SUPPORT,  
OFFICE OF THE INSPECTOR GENERAL, DOD

SUBJECT: Draft Audit Report on Appropriated Funds Used to Move  
Army and Air Force Exchange Service Merchandise  
Overseas (Project No. 1PR-0070)

This responds to your memorandum of October 17, 1994, which  
requested comments on the subject draft audit report.

This office does not agree with the DoDIG recommendation  
that the Under Secretary of Defense for Personnel and Readiness  
should initiate actions to change Title 10, United States Code,  
sections 4779(b) and 9779(b), to allow use of appropriated funds  
to pay for the Army and Air Force Exchange Service overseas  
transportation. Attached are more detailed comments to the  
recommendations contained in the subject report.

The opportunity to comment on this draft audit is appreci-  
ated. Mr. John Glover is my staff contact on this matter.  
He may be reached on (703) 697-0537.

  
Alvin Tucker  
Deputy Chief Financial Officer

Attachments

INSPECTOR GENERAL, DEPARTMENT OF DEFENSE,  
DRAFT REPORT  
"APPROPRIATED FUNDS USED TO MOVE ARMY AND AIR FORCE  
EXCHANGE SERVICE MERCHANDISE OVERSEAS"  
(PROJECT NO. 1PR-0070)

DEPARTMENT OF DEFENSE COMMENTS

\* \* \* \* \*

RECOMMENDATIONS

- Recommendation 1. The DoDIG recommended that the Under Secretary of Defense for Personnel and Readiness initiate actions to change Title 10, United States Code, sections 4779(b) and 9779(b), or to request that FY 1996 and future annual Defense Authorization and Appropriation Acts, using language "notwithstanding any other provisions of law," specifically allow use of appropriated funds to pay for the Army and Air Force Exchange Service's overseas transportation costs.

DoD Response: Nonconcur. This office does not agree that the Under Secretary of Defense for Personnel and Readiness should initiate actions to change Title 10, United States Code, sections 4779(b) and 9779(b), to allow use of appropriated funds to pay for the Army and Air Force Exchange Service (AAFES) overseas transportation. The Office of the Deputy General Counsel (Fiscal) (ODGC(F)) opined that "the audit report is incorrect in its conclusion that the provisions of 10 U.S.C., sections 4779(b) and 9779(b) apply to transportation of exchange service merchandise overseas." The ODGC(F) also stated that "there is no illegality to the transportation of Exchange goods overseas and no actual or potential violation of the Antideficiency Act as the result of that transportation." (copy attached)

- Recommendation 2. The DoDIG recommended that the Deputy Chief of Staff for Logistics, Department of the Army, adjust future budget requests for appropriated funds to represent full funding for the Army and Air Force Exchange Service's overseas transportation costs if appropriated funds are provided.

DoD Response: Concur.

Attachment

# Department of the Army Comments



DEPARTMENT OF THE ARMY  
OFFICE OF THE DEPUTY CHIEF OF STAFF FOR LOGISTICS  
WASHINGTON, DC 20310-0508



DALO-RML

24 JAN 1995

MEMORANDUM THRU

~~DIRECTOR OF THE ARMY STAFF~~ <sup>27 Jan 95</sup> MICHAEL B. WALSON, LTC, GS, ADECO

~~ASSISTANT SECRETARY OF THE ARMY (INSTALLATIONS, LOGISTICS AND ENVIRONMENT)~~ <sup>2/7/95</sup> Alma Moore  
POASA (ILE)

FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (AUDITING)

SUBJECT: Draft Audit Report, "Appropriated Funds Used to Move Army and Air Force Exchange Service Merchandise Overseas," Project No. 1PR-0070--INFORMATION MEMORANDUM

1. This is in response to HQ, USAAA memorandum of 26 October 1994 (Tab A), which requested ODCSLOG respond to subject draft audit (Encl to Tab A).
2. The draft audit report has been reviewed as requested. The Army supports the Army and Air Force Exchange Service (AAFES) and the improved quality of life, morale builder, and well-being that it provides to our soldiers overseas. We fully recognize the importance of this program. We have completed a coordinated review of subject report, and the following comments are provided:
  - a. Pages i, ii, 6, 7, 8, and 10. Nonconcur to references to Sections 4779(b) and 9779(b) of Title 10, United States Code (10 U.S.C. 4779(b) and 9779(b)).
    - (1) Although referenced sections 4779(b) and 9779(b) of Title 10, United States Code, at enclosure, generally prohibit the use of appropriated funds, these provisions also permit the transportation of AAFES supplies and goods by "public transportation," which would include the Air Mobility Command and Military Sealift Command, to overseas installations.
    - (2) Congress authorized the use of Appropriated Funds for Second Destination Transportation of military exchange products to overseas locations. This authorization, found on page 191 of the National Defense Authorization Act of Fiscal Year 1995, demonstrates Congress' recognition that appropriated funds may be used for transportation of exchange products and states the following:

DASA(L) # 0229 -

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"Second destination transportation. The committee has long recognized its responsibility to ensure that service members and their families overseas receive the necessary support. As a part of this effort, Congress annually appropriates funds for second destination transportation for the transportation of military exchange products to overseas locations. These funds are intended to provide our military personnel and their dependents stationed overseas American products at prices comparable to prices charged in the United States."

b. Page 6, "Army and Air Force Exchange Service's Overseas Transportation Costs," first paragraph. The first two sentences are objectionable because they state that United States Code (10 U.S.C. 4779(b) and 9779(b)) prohibit the use of appropriated funds for the transportation of exchange products. These statutory provisions do not prohibit such use.

c. Page 7, "Use of Appropriated Funds." Again, this provision incorrectly states that United States Code (10 U.S.C. 4779(b) and 9779(b)) prohibit the use of appropriated funds.

d. Army nonconcur with the section in the draft report on pages 8-9, "AAFES Funding." "AAFES Capability to Fund Overseas Transportation Costs." The report's suggestion that Army SDT is unnecessary, since AAFES could pay from net earnings, has dangerous implications for the future of the Defense Transportation System (DTS). Requiring AAFES to pay for over-ocean shipment of U.S.-made goods would also increase pressure on AAFES to sell foreign-made rather than U.S.-made goods at its overseas exchanges to save shipping costs, where comparable goods (e.g., soft drinks) are manufactured both in the U.S. and overseas.

e. Pages 11 and 10, Recommendations for Corrective Action. We concur with importance of Department of the Army fully budgeting/funding of the Army and Air Force Exchange Service Second Destination Transportation, but Department of the Army needs to make prioritization decisions among its programs at the senior leadership level and reserves its right to do so.

FACT: The Deputy Chief of Staff for Logistics, Department of the Army and the Army Budget Office recognize the importance of funding AAFES overseas transportation costs. This was evidenced in FY 94, as AAFES requirements were reduced to

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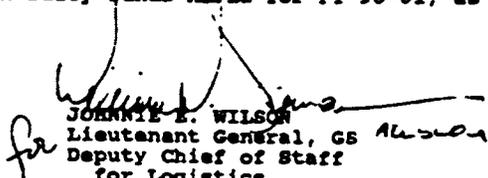
SUBJECT: Draft Audit Report, "Appropriated Funds Used to Move Army and Air Force Exchange Service Merchandise Overseas," Project No. 1PR-0070--INFORMATION MEMORANDUM

\$144 million. The Army fully supported this requirement. In FY 95, AAFES adjusted their SDT requirements to \$110 million, and AAFES is funded in FY 95 at \$110 million. Recommend that these facts be included in your document.

2. Page 7, "Congressional Concerns about Appropriated Funds Provisions." Recommend deleting the first paragraph as it addresses funds to support AAFES overseas transportation costs in FY 79 (15 years ago). It should be noted that Congressional concerns did not result in Congressional legislation. This paragraph also addresses United States Code (10 U.S.C. 4779(b) and 9779(b)). See our comment in para 2a above.

3. ODCSLOG fully supports and funds AAFES within available resources. AAFES SDT requirements for FY 96-01 are \$110 million, and AAFES unfunded requirements for FY 96-01 were submitted to OSD for consideration. Program Budget Decision 724, subject: "Army Executive Agency Programs," was signed by OSD on 19 Dec 94. This Program Budget Decision fully funds AAFES for FY 96-01, as requested by Army.

Encl

  
JOHNNIE E. WILSON  
Lieutenant General, GS *Alison*  
Deputy Chief of Staff  
for Logistics

Army Budget Office (SAFM-BUO) - Concur, Mr. Jefferis/50282  
ODCSPER (DAPE-MBB) - Concur, Ms. McArdle/55604  
Judge Advocate General - No Legal Objection, MAJ Stockel/44316

Helen Solomon/73095