

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**FUNDING FOR OPERATIONAL SUPPORT
OF THE DEFENSE COMMISSARY AGENCY
CONSTRUCTION PROGRAM**

Report No. 96-193

July 3, 1996

Department of Defense

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Acronyms

DBOF	Defense Business Operations Fund
DeCA	Defense Commissary Agency
DCD	Design and Construction Division



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



July 3, 1996

MEMORANDUM FOR DIRECTOR, DEFENSE COMMISSARY AGENCY

SUBJECT: Audit Report on Funding for Operational Support of the Defense Commissary Agency Construction Program (Report No. 96-193)

We are providing this audit report for review and comment. It reports on our audit project entitled, "Defense Commissary Agency Design and Construction Process." We considered management comments on a draft of this report in preparing the final report.

The DeCA nonconcurred with the recommendation to use Commissary Surchage Collections funds to pay operational support costs related to its commissary construction program. We believe that our recommendation is still valid and should be implemented. DoD Directive 7650.3 requires that all unresolved issues be resolved promptly. Therefore, we request that the Director, DeCA, provide comments on the unresolved recommendation by September 3, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Michael A. Joseph, Audit Program Director, or Mr. Timothy J. Tonkovic, Audit Project Manager, at (804) 766-2703. See Appendix D for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-193
(Project No. 5LF-0013)

July 3, 1996

Funding for Operational Support of the Defense Commissary Agency Construction Program

Executive Summary

Introduction. This is our report on the funding of the operational costs of the Defense Commissary Agency (DeCA) design and construction program. Operational costs include costs for contractual support, construction supervision, inspection, overhead, and project management. The DeCA constructed or renovated 55 commissaries between October 1992 and January 1996 at a cost of about \$368.5 million. As of February 1996, DeCA had 20 projects, valued at \$148.9 million, under construction. It plans to construct or upgrade 49 commissaries between FY 1996 and FY 1998 at a cost of about \$331.3 million. Commissary construction and upgrade costs are paid from the Commissary Surcharge Collections Fund that is continually replenished by charging commissary patrons a 5-percent surcharge on their purchases.

In September 1994, DeCA published its goals and objectives in a five year strategic plan. Two of the goals of the FY 1994 to FY 1998 plan include maximizing customer satisfaction and enhancing the effectiveness and efficiency of commissary operations at all levels. To achieve the goals, DeCA plans to improve customer service at the commissary level and reduce appropriated support funding.

Audit Objectives. The originally announced audit objectives were to determine the efficiency and effectiveness of the DeCA design and build process for commissary construction and to evaluate the management control program applicable to the primary audit objective.

In October 1995, DeCA requested assistance from the Office of the Inspector General, DoD, to develop a better methodology to project commissary sales and to size new commissaries. We are working with DeCA personnel to develop a commissary sizing model, a sales forecasting model, and a patron survey model and questionnaire. The models, if properly and consistently applied, along with revised facility planning policies and procedures, should enable DeCA to accurately develop, program, and validate project requirements. We plan to complete the joint effort in September 1996. Because of our participation in that effort, we did not pursue issues related to the DeCA design and build process for commissaries. As a result, we focused our review on the funding of operational support for the DeCA commissary construction program.

Audit Results. The DeCA used appropriated funds from the Defense Business Operations Fund (Commissary Operations) instead of funds from the Commissary Surcharge Collections Fund to pay salaries and other support costs related to the commissary construction program. By using the Commissary Surcharge Collections Fund to pay for salaries and other support costs, DeCA could work toward its goal of reducing its appropriated fund requirements. For details of the audit results, see Part I.

We have addressed material management control weaknesses in the DeCA commissary construction program in prior reports, and we are working jointly with DeCA to resolve the deficiencies. Additionally, the issue identified in this report is a policy

issue, not a management control issue. Accordingly, we make no recommendation addressing management controls in this report. See Appendix A for a discussion of our review of the management control program.

Summary of Recommendation. We recommend that DeCA establish a policy to use the Commissary Surcharge Collections Fund to pay operational support costs related to its commissary construction program.

Management Comments. The DeCA nonconcurred with the recommendation and stated that the use of the Commissary Surcharge Collection Fund to pay operational support costs related to the commissary construction program was inappropriate. The DeCA stated that the deciding factor on whether or not operational support costs were paid out of appropriated funds or from the Commissary Surcharge Collections Fund was based on whether the labor was from "in-house" or outside resources. The DeCA also stated that using the Commissary Surcharge Collections Fund to pay operational support costs would further reduce funds available for commissary construction. See Part I for a discussion of management comments and Part III for the complete text of management comments.

Audit Response. The DeCA comments are not responsive to the recommendation. We believe that there is sufficient precedence in the past actions of DeCA and the Services (Army, Navy, Air Force, and the Marine Corps) to support our position that DeCA should use the Commissary Surcharge Collections Fund to pay operational support costs for its construction program.

Additionally, in March 1996, DeCA was nominated by the Secretary of Defense to become a Performance Based Organization. As a Performance Based Organization, DeCA would merge funds from the Defense Business Operations Fund (Commissary Operations) and the Commissary Surcharge Collections Fund into a single operating fund. Such a merger of funds would in effect resolve the issue of paying operating support costs with appropriated funds. We request that DeCA reconsider its position on the recommendation and provide comments to the final report by September 3, 1996.

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Part I - Audit Results

Audit Background

Mission. The mission of the Defense Commissary Agency (DeCA) is to provide an efficient and effective worldwide system of commissaries for the not-for-profit sale of groceries and household supplies at the lowest practical price to members of the Services (Army, Navy, Air Force, and the Marine Corps) and their dependents and to other authorized patrons. The commissary system provides one of the most visible and valued benefits for active duty and retired military members and their dependents. To provide the benefit, DeCA received about \$1 billion in appropriated fund support during FY 1995.

Strategic Goals. Two of the goals in the DeCA FY 1994 to FY 1998 strategic plan are to maximize customer satisfaction and enhance the effectiveness and efficiency of commissary operations at all levels. To achieve the goals, DeCA plans to improve customer service at the commissary level and reduce appropriated fund support. The DeCA plans to reduce appropriated fund support through establishment of marketing business units, organizational realignments, staffing reductions, and validation of inter-service support agreements and transportation costs.

Construction Program. The DeCA commissary construction program includes procurement of new equipment for commissary upgrade and replacement projects, upgrades of existing commissaries, and replacement of old commissaries. Between October 1992 and January 1996, DeCA completed about 55 upgrade and replacement commissary projects. The DeCA had 20 projects under construction and planned to construct or upgrade another 49 commissaries between FY 1996 and FY 1998. Details are shown in Table 1.

Table 1. FY 1993 Through FY 1998 Completed, In-Process, and Planned Commissary Construction Program (as of February 1996)

<u>Fiscal Year Completed</u>	<u>Number of Projects</u>	<u>Project Amount (millions)</u>
1993	17	\$118.7
1994	17	115.6
1995	17	105.8
1996	<u>4</u>	<u>28.4</u>
Subtotal	55	368.5
<u>In-Process</u>		
1996	<u>20</u>	<u>148.9</u>
Subtotal	20	148.9
<u>Planned</u>		
1996	9	54.7
1997	20	151.9
1998	<u>20</u>	<u>124.7</u>
Subtotal	49	331.3
Total	124	\$ 848.7

Construction Funding. The DeCA commissary construction program, excluding most operational support costs, is paid from the Commissary Surcharge Collections Fund (the Surcharge fund). The Surcharge fund is a revolving fund that DeCA maintains by charging commissary patrons a 5-percent surcharge on their purchases. Additionally, Surcharge fund revenues are received from other sources such as the sale of cardboard and paper products and unusable excess equipment. Surcharge fund revenues in FY 1995 were \$276 million, and the fund balance at September 30, 1995, was \$81 million.

Operational Support. The DeCA uses appropriated Defense Business Operations Fund (DBOF) (Commissary Operations) funds to pay for civilian labor, transportation, and travel that are related to commissary operations. The DeCA also uses DBOF (Commissary Operations) funds for civilian labor, equipment, supplies, and travel that are in support of the DeCA commissary construction program. Included in those costs are contractual support, construction supervision, inspection, overhead, and project management.

Audit Results

Audit Objectives

The originally announced audit objectives were to determine the efficiency and effectiveness of the DeCA design and build process for commissary construction and to evaluate the management control program applicable to the primary audit objective.

In October 1995, DeCA requested assistance from the Inspector General, DoD, to develop a better methodology to project commissary sales and size new commissaries. We are working with DeCA personnel to develop a commissary sizing model, a sales forecasting model, and a patron survey model and questionnaire. We plan to complete the joint effort in September 1996. Because of our participation in that effort, we did not pursue issues related to the DeCA design and build process for commissaries. We focused our review on the funding of operational support for the DeCA commissary construction program. See Appendix A for details on our joint effort to project commissary sales and size new commissaries.

The details of the audit scope and methodology and the review of the management control program are also discussed in Appendix A. See Appendix B for a summary of prior audit coverage related to the audit objectives.

Funding for Operational Support of the Commissary Construction Program

The DeCA used appropriated DBOF (Commissary Operations) rather than Surcharge funds to pay operational support costs related to the commissary construction program. The condition occurred because DeCA continued the Air Force practice of using appropriated funds to pay operational support costs, including costs for construction supervision, inspection, overhead, and contract administration services. By using Surcharge funds to pay for salaries and other support, DeCA could reduce its annual reliance on DBOF (Commissary Operations) by about \$3.7 million and work toward its strategic goal of reduced appropriated support.

Consolidation of the Commissary System

In May 1990, the Deputy Secretary of Defense announced that DeCA would be established to consolidate the commissary systems of the Services. Before that date, the Army Troop Support Agency, the Navy Resale Services Support Office, the Marine Corps Services Branch, and the Air Force Commissary Service independently operated the commissaries.

Criteria

United States Code, title 10, section 2685, enacted December 1974, (amended in August 1977 and October 1982) includes provisions on the establishment and use of Surcharge funds as follows.

(a) Notwithstanding any other provisions of law, the Secretary of a military department, under regulations established by him and approved by the Secretary of Defense, may, for the purposes of this section, provide for an adjustment of, or surcharge on, sales prices of goods and services sold in commissary store facilities.

(b) The Secretary of a military department, under regulations established by him and approved by the Secretary of Defense, may use the proceeds from the adjustments or surcharges authorized by subsection (a) to acquire, construct, convert, expand, install, or otherwise improve commissary store facilities at defense installations and for related environmental evaluation and construction costs, including surveys, administration, overhead, planning, and design.

The DeCA Directive 20-1, "Planning and Programming Major and Minor Commissary Construction Projects," October 1994, states that Surcharge funds can be used for associated design; contract procurement; and supervision,

Funding for Operational Support of the Commissary Construction Program

inspection, and overhead costs for Surcharge-funded projects. It also states that supervision, inspection, and overhead costs are costs that are attributed to project administration.

The DeCA Directive 70-18, "Budget Policies and Procedures," April 1995, provides that facilities equipment, such as air conditioning, automatic doors, dock levelers, heating, lighting, refrigeration, and ventilation should be funded from Surcharge funds. The Directive further states that equipment purchased with Surcharge funds should be calibrated, maintained, and repaired with Surcharge funds.

Appropriated Fund Support

Although DeCA used Surcharge funds to pay for most construction and renovation costs, in FY 1995, it used \$3.7 million (\$3.1 million in salaries and \$0.6 million in other support costs) of DBOF (Commissary Operations) funds to pay operational support costs related to the commissary construction program.

Operational Support Salary Costs. The DeCA funded the salaries (\$3.1 million) of 52 civilian employees that provided operational support to the DeCA commissary construction program with DBOF (Commissary Operations) funds. The civilian labor was provided by personnel from the DeCA Headquarters Facilities Directorate, Fort Lee, Virginia; the DeCA Design and Construction Division (DCD), Lackland Air Force Base, San Antonio, Texas; and the U.S. Air Force Air Education and Training Command Contracting Squadron, Randolph Air Force Base, Texas.

DeCA Headquarters Facilities Directorate. The DeCA paid about \$1.2 million annually in DBOF (Commissary Operations) for 18 personnel assigned to its Headquarters Facilities Directorate. That amount included overhead costs, such as health insurance; life insurance; retirement; social security, if applicable; and thrift savings contributions.

The 18 civilian personnel assigned to the DeCA Headquarters Facilities Directorate included 2 administrative personnel and 16 engineers who planned and programmed the agency's requirements for its commissary construction program. Those personnel were responsible for developing cost estimates for the commissary construction program; developing, maintaining, and updating the commissary store sizing model and commissary standard store layouts; managing real property; master planning of commissary facilities; and refrigeration equipment repair and maintenance. Although the 18 personnel support the commissary construction program, they are not always assigned to specific projects.

Funding for Operational Support of the Commissary Construction Program

Design and Construction Division. The DeCA paid about \$1.2 million annually in DBOF (Commissary Operations) for 18 personnel assigned to the DCD. That amount included overhead costs, such as health insurance; life insurance; retirement; social security, if applicable; and thrift savings contributions.

The DCD executed and managed the commissary construction and renovation program using construction and design contracts awarded by the U.S. Air Force Air Education and Training Command Contracting Squadron (the Contracting Squadron). The DCD staff of 18 civilian personnel included 2 administrative personnel and 16 engineers assigned to specific construction or renovation projects. The engineers monitored the performance of project management including the review of contractor submissions to ensure conformance with contract specifications and design requirements. Additionally, they reported on facility and mechanical system deficiencies, initiated contract change orders and/or deficiency lists, and performed in-process reviews and final inspections of commissary facilities.

Contracting Squadron. The DeCA paid about \$719,000 (excluding personnel benefits) annually in DBOF (Commissary Operations) for 16 personnel assigned to the Contracting Squadron. The DeCA used the Contracting Squadron to award and administer construction and renovation contracts.

Table 2. summarizes the FY 1995 salary costs that DeCA paid from the DBOF (Commissary Operations) for its commissary construction and renovation program.

Table 2. FY 1995 Salary Expenses Paid from the DeCA DBOF (Commissary Operations)		
<u>Location</u>	<u>Number of Personnel</u>	<u>Annual Costs (millions)</u>
DeCA Headquarters Facilities Directorate	18	\$ 1.2
DeCA DCD	18	1.2
U.S. Air Force Air Education and Training Command Contracting Squadron	<u>16</u>	<u>.7</u>
Total	52	\$ 3.1

Other Support Costs. The DeCA paid operational support costs of \$0.6 million for equipment and supplies, purchased services, and paid travel expenses with DBOF (Commissary Operations) funds instead of Surcharge funds. Equipment and supply expenses were incurred to support the administrative function of the DeCA commissary construction program. Purchased services were for custodial services, maintenance of photocopying equipment, paying training instructors, paying tuition for training classes, and purchasing other commercial services. Travel expenses were incurred in

Funding for Operational Support of the Commissary Construction Program

conjunction with project administration, design and planning conferences, inspection of commissary construction projects, project management, progress reviews, and training. The costs are summarized in Table 3.

<u>Organizations</u>	<u>Annual Cost</u>
Equipment and Supplies	
DeCA Headquarters Facility Directorate	\$ 51,000
DeCA DCD	58,000
Purchased Services	
DeCA Headquarters Facility Directorate	37,700
DeCA DCD	25,100
Travel	
DeCA Headquarters Facility Directorate	198,800
DeCA DCD	106,800
U.S. Air Force Air Education and Training Command Contracting Squadron	<u>100,000</u>
Total	\$ 577,400

Precedent for Funding of Commissary Operational Support

The DeCA personnel stated that operational support costs for the commissary construction program were paid with DBOF (Commissary Operations) funds because of the precedent established by the Services before the consolidation of the Services' commissary organizations. However, only one of the DeCA predecessors paid all commissary construction operational support costs with Operations and Maintenance funds (currently DBOF [Commissary Operations]).

Army and Navy Precedent. Most construction costs for Army and Navy commissaries, including supervision, inspection, overhead, and contract administration were paid with Surcharge funds. Army and Navy commissary construction was administered and managed on a reimbursable basis by the U.S. Army Corps of Engineers (Corps of Engineers) or the Naval Facilities Engineering Command. However, the Army and Navy headquarters' commissary planning and programming functions were funded with Operation and Maintenance funds. For a limited number of projects, DeCA continues to use the Corps of Engineers or the Naval Facilities Engineering Command to administer and manage construction funds contracts. The DeCA pays for such operational support with Surcharge funds.

Funding for Operational Support of the Commissary Construction Program

Air Force Precedent. Air Force commissary construction was funded by Surcharge funds; however, supervision, inspection, overhead, and contract administration expenses were paid from appropriated funds. Air Force commissary construction was executed and managed by the DCD of the Air Force Commissary Service.

Use of Surcharge Funds

United States Code, title 10, section 2685, permits DeCA to use Surcharge funds to pay for all commissary construction costs, including operational support costs. However, section 2685 does not mandate the use of Surcharge funds.

The DeCA chose to pay most of its operational support costs for commissary construction with DBOF (Commissary Operations). However, for projects managed and administered by the Corps of Engineers or the Naval Facilities Engineering Command, DeCA uses Surcharge funds to pay all of the project costs. Additionally, DeCA uses Surcharge funds to pay the costs associated with a program management assistance contractor. The contractor provides on-site construction management to include administrative, contract, and engineering support. It also assigns a full-time inspector to each project.

Conclusion

Because of the varying precedent, the statutory authority to use Surcharge funds, and the DeCA inconsistent application of that authority, we believe DeCA should establish policy to pay for all operational support costs for commissary construction with Surcharge funds. The large unobligated balance of \$81 million in Surcharge funds presents DeCA with the opportunity to reduce its reliance on appropriated fund support and work toward its strategic goal of reduced appropriated support.

Recommendation, Management Comments and Audit Response

We recommend that the Director, Defense Commissary Agency establish a policy to use Commissary Surcharge Collections funds to pay operational support costs for the Defense Commissary Agency Headquarters Facility Directorate, the Defense Commissary Agency Design and Construction Division, and the U.S. Air Force Air Education and Training Command Contracting Squadron.

Funding for Operational Support of the Commissary Construction Program

DeCA Comments. The DeCA nonconcurred with the recommendation and stated that prior to its establishment in 1991, the Services had similar policies regarding construction supervision, inspection, overhead, and contract administration expenses. The Services consistently used appropriated funds to pay "in-house" planning, design, supervision, inspection, and overhead charges, and used Surcharge funds for external support for design supervision, inspection, and overhead expenses. Surcharge funds were used to pay expenses for services provided by the Corps of Engineers, the Naval Facilities Engineering Command, and overhires required for a specific project. The DeCA stated that the key deciding factor on whether or not labor costs were paid from appropriated funds was based on whether or not the labor was from "in-house" or outside resources. The "in-house" versus external labor distinction has continued since the establishment of DeCA. The DeCA stated that there is no legal or regulatory requirement to use Surcharge funds for operational support costs and that to do so would not be consistent with past congressional acceptance. The DeCA also stated that the use of Surcharge funds to pay operational support costs would further reduce funds available for commissary construction.

The DeCA stated that paragraph 4-401 of DoD Directive 1330.17, "Armed Services Commissary Regulations," April 1987, provides, in part, that military personnel, civil service employees, and contract personnel paid from appropriated funds shall be used to staff and operate commissaries and to perform related administrative and support functions.

The DeCA stated that it received \$940 million in appropriated fund support during FY 1995 instead of the \$1.2 billion shown in the draft audit report. The DeCA stated that the correct unobligated Surcharge fund balance as of September 30, 1995, was \$81 million and that the unobligated balance exists because of delays in executing the construction program. The DeCA further stated that the estimated backlog in unfunded facility improvements is at least \$300 million.

Audit Response. We consider the DeCA comments to be nonresponsive. After a review of the comments, an analysis of information obtained from Service facility planners, and a review of DoD Directive 1330.17, we concluded that the recommendation is valid. Therefore, we request that DeCA reconsider its position and provide comments to the final report.

The DeCA should continue the practice established by the Services and pay design supervision, inspection, and overhead support costs with Surcharge funds. Prior to the establishment of DeCA, the Army Troop Support Agency, the Navy Resale Services Support Office, and the Marine Corps Services Branch used the Corps of Engineers and the Naval Facilities Engineering Command to provide design supervision, inspection, and overhead support for construction. The services provided by those "external" support organizations were paid with Surcharge funds.

For most commissary construction, DeCA no longer uses the services of the Corps of Engineers or the Naval Facilities Engineering Command. Those functions are currently performed by DeCA personnel or contractor personnel.

Funding for Operational Support of the Commissary Construction Program

The majority of the DeCA headquarters staff are responsible for developing cost estimates; developing, maintaining, and updating the commissary models and layouts; and developing master plans of commissary facilities. Those services, provided by DeCA employees, are paid with DBOF (Commissary Operations) funds. In our opinion, those operational support costs should be paid from Surcharge funds. We believe the shift in funding for the same operational support services refutes the DeCA consistency argument. We recognized, in the audit finding, that the Army and Navy headquarters commissary planning and programming functions (in-house costs) were funded with appropriated Operation and Maintenance funds. We recognize that the use of DBOF (Commissary Operations) funds to pay the operational support costs for a limited number of personnel assigned to the DeCA Headquarters Facilities Directorate (at Fort Lee) may be appropriate.

We agree that DeCA received \$940 million in appropriated fund support during FY 1995. However, information from the Under Secretary of Defense (Comptroller), showed that the House of Representatives conference report accompanying the DoD Appropriations Act for FY 1995 (House Report 103-747) directed that an additional \$252 million be transferred from the DBOF cash balances to the DeCA. The issue of DBOF transfers was addressed in Inspector General, DoD, Report No. 96-160, "Defense Business Operations Fund Equity Transfer-- Defense Commissary Agency," June 13, 1996. See Appendix B for a discussion of the \$252 million transfer to DeCA. Because the amount does not affect our conclusion, we revised the report to show approximately \$1 billion in appropriated fund support.

We agree that the unobligated Surcharge fund balance as of September 30, 1995, was \$81 million and revised the report to reflect the updated information. However, the \$81 million balance should not be compared to the \$300 million backlog in unfunded facility improvements. The \$81 million is a yearend balance, and the \$300 million represents unfunded requirements for long-range facility improvement projects. In addition, the commissary construction criteria used to justify the \$300 million backlog estimate is currently being reviewed.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed Surcharge fund expenditures and obtained financial information on other support costs and salaries from February 1993 to October 1996 relating to the DeCA commissary construction and renovation program. Within the DeCA Headquarters Facility Directorate, we reviewed position descriptions, organizational responsibilities, and responsibilities of the firm used to provide on-site construction management. We also obtained and reviewed operational support policies for commissary construction that were in effect prior to the establishment of DeCA. Additionally, we compared DeCA policies applicable to the use of Surcharge funds to United States Code, title 10.

Audit Locations Visited. To evaluate salary and support costs related to the commissary construction process, we visited DeCA Headquarters, Fort Lee, Virginia; the DCD, Lackland Air Force Base, San Antonio, Texas; selected commissaries; the U.S. Air Force Air Education and Training Command Contracting Squadron, Randolph Air Force Base, Texas; and a commercial architectural engineering firm. At those locations, we obtained administrative and contracting cost information, mission statements, and position descriptions. We also obtained equipment, salary, and other support cost information. A complete list of organizations visited or contacted is in Appendix C.

Use of Computer-Processed Data. The audit did not rely on computer-processed data or statistical sampling procedures.

Audit Period and Standards. This economy and efficiency audit was made from July 1995 through January 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls that we considered necessary.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of DeCA management controls over the commissary construction program. Specifically, we reviewed DeCA management controls over commissary construction planning and programming. We also reviewed management's self-evaluation of those controls.

Adequacy of Management Controls. The Office of the Inspector General, DoD, previously reported a material management control weakness in the commissary construction planning and programming process. In October 1995, DeCA requested assistance from the Office of the Inspector General, DoD, to develop a better methodology to project commissary sales and to size new commissaries. We are in the process of developing a commissary sizing model, a sales forecasting model, and a patron survey model and questionnaire with personnel from the DeCA. The models and questionnaire, properly and consistently applied, along with revised facility planning policies and procedures, should enable DeCA to accurately validate project requirements. As a result of the joint effort, and because the issue identified in this report is not a management control issue, we are not making a recommendation concerning the material weakness.

Adequacy of the Management's Self-Evaluation. DeCA officials have identified and reported the material management control weakness related to the DeCA commissary construction program.

Appendix B. Summary of Prior Audits and Other Reviews

Inspector General, DoD, Report No. 96-160, "Defense Business Operations Fund Equity Transfer -- Defense Commissary Agency," June 13, 1996, reported that the DeCA erroneously reported a \$251.6 million transfer of equity from the Defense Logistics Agency segment of DBOF as revenue in its FY 1995 financial statements. The transfer was made as a result of guidance provided by the Office of the Under Secretary of Defense (Comptroller). We recommended that the Under Secretary of Defense (Comptroller) direct that accounting records and the FY 1995 consolidated financial statements of the DBOF be corrected by reducing revenues by \$251.6 million and increasing equity by the same amount. The Deputy Chief Financial Officer nonconcurred with the recommendation stating that the equity transfer conformed to congressional direction. Additional comments on the report are pending.

Inspector General, DoD, Report No. 95-218, "Statement of Financial Position for the Commissary Surcharge Collections Fund, as of September 30, 1994," June 5, 1994, reported that the Inspector General, DoD, could not render an opinion on the Statement of Financial Position for the Surcharge fund because an effective internal control structure over accounts payable, cash, capital equipment, and construction in-progress was not in place to provide reasonable assurance that material misstatements would be prevented or detected in a timely manner. We recommended, in part, that the DeCA conform with DoD procedures for capitalizing all construction in-progress costs. DeCA stated that it was prohibited by statute from capitalizing in-house labor in the Surcharge fund.

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Personnel and Readiness, Washington, DC

Department of the Army

U.S. Army Corps of Engineers, Washington, DC

Department of the Navy

Headquarters, Naval Facilities Engineering Command, Alexandria, VA
Naval Facilities Engineering Command, Atlantic Division, Norfolk, VA

Air Force

U.S. Air Force Air Education and Training Command Contracting Squadron, Randolph
Air Force Base, TX

Other Defense Organizations

Defense Commissary Agency, Headquarters, Fort Lee, Petersburg, VA
Design and Construction Division, Lackland Air Force Base, TX
Fort Eustis, Commissary Resale Store, Newport News, VA
Fort Monroe, Commissary Resale Store, Hampton, VA
Fort Sam Houston, Commissary Resale Store, San Antonio, TX
Lackland Air Force Base, Commissary Resale Store, San Antonio, TX
Little Creek Amphibious Base, Commissary Resale Store, Virginia Beach, VA
Norfolk Naval Shipyard, Commissary Resale Store, Portsmouth, VA
Oceana Naval Air Station, Commissary Resale Store, Virginia Beach, VA

Non-Government Organizations

American Logistics Association, Washington, DC
The Jenkins Group, Itasca, IL
Farm Fresh Supermarkets, Norfolk, VA
Willard Bishop Consulting, Ltd., Barrington, IL
Academy of Food Marketing, St. Josephs University, Philadelphia, PA
Food Marketing Institute, Washington, DC
Ukrops Supermarkets, Richmond, VA

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Comptroller Financial Officer
Deputy Comptroller (Program and Budget)
Assistant Secretary of Defense (Force Management Policy)
Director of Morale, Welfare, Recreation, and Resale Activities
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Commissary Agency
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

General Accounting Office

National Security and International Affairs Division,

Technical Information Center

Health, Education, and Human Services

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 Subcommittee on Military Construction, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on National Security, Committee on Appropriations

House Subcommittee on Military Construction, 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 on National Security

Part III - Management Comments

Defense Commissary Agency Comments



REPLY TO
ATTENTION OF

IR

MAY 29 1996

DEFENSE COMMISSARY AGENCY
HEADQUARTERS
1300 E AVENUE
FORT LEE, VIRGINIA 22001-1800

MEMORANDUM FOR INSPECTOR GENERAL, LOGISTICS SUPPORT DIRECTORATE,
400 ARMY NAVY DRIVE, ARLINGTON, VA 22202-2884

SUBJECT: Audit Report on the Funding for Operational Support of
the Defense Commissary Agency Construction Program
(Project No. 5LF-0013)

Reference: DoDIG Memorandum, dtd August 8, 1996, SAB.

Attached is the DeCA reply to the recommendation provided in
subject report. We agree that no monetary benefit benefits should
be claimed for the report. If you have any questions, please
contact Mr. Ben Mikell at (804) 734-8103.

A handwritten signature in black ink, appearing to read "R. McCoy", written over a horizontal line.

RONALD P. MCCOY
Colonel, USAF
Chief of Staff

Attachments:
As Stated

DEFENSE COMMISSARY AGENCY REPLY

SUBJECT: Audit Report on the Funding for Operational Support of
the Defense Commissary Agency Construction Program
(Project No. 5LF-0013)

Additional Comments:

Page 2 of the draft report states that "DeCA received about \$1.2 billion in appropriated fund support during FY 1995". This is incorrect; the actual amount was \$940 million.

Page 3 of the draft report states that "the fund balance at September 30, 1995, was \$58 million". Assuming the draft report is referring to the unobligated balance, the actual amount is \$81 million.

Page 4 of the draft report states that the joint effort between DoDIG and DeCA for the development of a better methodology to project commissary sales and size new commissaries is planned to be completed in May 1996. Based on the latest meeting between DoDIG and DeCA, a more realistic completion date is September 1996.

Page 5 of the draft report states that "The condition occurred because DeCA continued the Air Force practice of using appropriated funds to pay operational support costs including construction supervision, inspection overhead, and contract administration services". This is not correct. All service components had very similar policies in effect regarding funding of operational support costs. The key deciding factor on whether or not labor costs were paid out of appropriated or surcharge funds was based on whether or not the labor was from "in-house" or outside resources. All service components were consistent in the use of appropriated funds to pay for "in-house" resources for planning, design, supervision, inspection and overhead charges but applied surcharge funds for external support for design supervision, inspection and overhead charges, including those provided by the Army Corps of Engineers (COE), Naval Facilities Engineering Command (NAVFAC) and overhires required for a specific project. The only distinction between the Army and Navy service programs and the Air Force program was that the Air Force program paid for A-E and construction management services directly to A-E contractors where the Army and Navy utilized the COE and NAVFAC as design and construction agents to oversee design and construction efforts. In all three services, in-house labor organic to the commissary agency was paid out of appropriated funds. This "in-house" versus external labor distinction continued under DeCA.

Page 5 of the draft report is correct in that using Surcharge funds to pay for salaries and other support could reduce the annual

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Defense Commissary Agency Comments

Final Report
Reference

reliance on DBOF by about \$3.7 million; however, the report should also recognize that the funding for commissary construction would be reduced by a like amount.

The first table on page 8 of the draft report shows that \$3.1 million of the FY 1995 cost were for salaries. Paragraph 4-401 of DoD Directive 1330.17 states in part that military personnel, civil service employees, and contract personnel paid from appropriated funds shall be used to staff and operate commissaries and related administrative and support functions. To be in compliance with this directive, all three Services were required to use appropriated funds for all salaries related to the administration and support functions associated with all facets of the commissary program to include construction. DeCA has continued to follow this requirement and precedent.

The statement on page 10 of the draft report that "Because of the varying precedent, the statutory authority to use Surcharge funds, and the DeCA inconsistent application of that authority..." is not correct. Since DeCA's inception, DBOF funds have been consistently used for all headquarters level operational support costs related to the construction program and Surcharge funds for all other construction program costs.

Page 10 of the draft report states that the unobligated balance is \$58 million in Surcharge funds. At the end of FY 1995, the unobligated balance was \$81 million. The unobligated balance only exists because of delays in executing the construction program. These funds are required for critically needed facility improvements. In fact, the estimated backlog in unfunded facility improvements is at least \$300 million.

Recommendation. We recommend that the Director, DeCA establish a policy to use Commissary Surcharge Collections funds to pay operational support costs for the DeCA Headquarters Facility Directorate, the DeCA Design and Construction Division, and the U.S. Air Force Air Education and Training Command Contracting Squadron.

Action Taken. Nonconcur. We considered the use of Commissary Surcharge Collections funds to pay operational support costs for the DeCA Headquarters Facility Directorate, the DeCA Design and Construction Division, and the U.S. Air Force Air Education and Training Command Contracting Squadron but found it not to be appropriate. There is no legal or regulatory requirement to use the Surcharge Collections funds for this purpose and not consistent with past congressional acceptance. It would also further reduce funds available for commissary construction which are already in short supply.

Revised
Page 8

Audit Team Members

This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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