

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

DOD MILK PLANTS IN THE PACIFIC-KOREA

Report No. 96-197

July 22, 1996

Department of Defense

Additional Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronym

EUSA

Eighth U.S. Army



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



July 22, 1996

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY
COMMANDER, ARMY AND AIR FORCE EXCHANGE
SERVICE

SUBJECT: Audit Report on DoD Milk Plants in the Pacific-Korea
(Report No. 96-197)

We are providing this audit report for review and comment. This report is the second in a series of reports that we will issue on DoD milk plants in the Pacific. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. Management comments were generally responsive to all recommendations. However, the Eighth U.S. Army did not fully respond to Recommendation 1.d., regarding employee bonuses. Therefore, we request additional comments from the Eighth U.S. Army by September 20, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Terry L. McKinney, Audit Program Director, at (703) 604-9288 (DSN 664-9288) or Mr. Ronald W. Hodges, Audit Project Manager, at (703) 604-9341 (DSN 664-9341). See Appendix F 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. 96-197
(Project No. 5CF-0060.01)

July 22, 1996

DoD Milk Plants in the Pacific-Korea

Executive Summary

Introduction. This report is the second in a series of reports on DoD milk plants in the Pacific. This report addresses the operation of the Eighth U.S. Army milk plant in Songnam, Korea. Since the immediate post-World War II era, the DoD has maintained a Government-owned, contractor-operated milk plant in Korea to provide milk and other dairy products to DoD personnel and their families. Operation of the milk plant was necessary because regular fresh milk and other dairy products were highly perishable and could not be economically shipped from the United States before spoiling. In addition, the Military Departments could not purchase milk and other dairy products from local dairy sources because Korean dairies did not meet U.S. health standards.

Seoul Dairy is operating the milk plant in Korea under a contract that expires September 30, 1996. The milk plant produces "filled milk" products that consist of nonfat dry milk powder mixed with water, vitamins, and coconut oil. The milk plant produced approximately 5 million quarts of milk and other dairy products in FY 1995.

Recent technological advances and sanitary improvements by U.S. dairy manufacturers have led to the development of a fresh milk with a shelf life of more than 60 days. The development of the extended-shelf-life milk gives the Military Departments a viable alternative to operating the milk plants.

Audit Objectives. The primary audit objective was to determine whether DoD milk plant operations in the Pacific theater are efficient, effective, and needed. Based on the results of our audit of the Okinawa milk plant, we decided to focus our review on determining whether operation of the milk plant in Korea is needed. Therefore, we did not review the management control program for the Eighth U.S. Army milk plant.

Audit Results. The Eighth U.S. Army milk plant in Korea is no longer needed. Technology has made extended-shelf-life milk available from U.S. dairy manufacturers. The Eighth U.S. Army has experienced losses totaling \$6.4 million for the last 3 years. By closing the milk plant and importing fresh milk, the Army could put at least \$2.4 million to better use over the next 6 years and would improve the quality of life for DoD personnel and their families in Korea. See the finding in Part I for details. Appendix D summarizes the potential benefits of the audit.

Summary of Recommendations. We recommend that the Commander, Eighth U.S. Army, close the milk plant and use the Defense Personnel Support Center to supply fresh milk and other dairy products to Army and Air Force dining facilities in Korea. We also recommend that the Eighth U.S. Army develop a contingency plan to have U.S. approved local dairies produce filled milk in case of shortages. In addition, we recommend that the Eighth U.S. Army determine whether the \$105,000 in employees bonuses paid under contract DAJB03-94-D-0001 was appropriate. We recommend that the Commander, Army and Air Force Exchange Service, direct the Army and Air Force Exchange Service in Korea to establish procedures to obtain fresh

milk and other dairy products from U.S. dairy manufacturers for retail outlets and DoD dependents schools in Korea, similar to procedures used to supply fresh milk and other dairy products to Okinawa.

Management Comments. We received comments from the Assistant Secretary of the Army (Installations, Logistics and Environment); the Commander, Eighth U.S. Army; and the Commander, Army and Air Force Exchange Service. The Assistant Secretary of the Army generally agreed with our draft report. The Eighth U.S. Army agreed to close the milk plant and to establish a contingency plan, but disagreed with certain statements in the finding discussion. The Army and Air Force Exchange Service agreed with the recommendation and has already made arrangements to purchase fresh milk and other dairy products from U.S. manufacturers. See Part I for a complete discussion of the management comments and Part III for the complete texts of those comments.

Audit Response. In response to the comments from the Eighth U.S. Army, we made minor changes to the report content as noted in Part I.

We consider the Eighth U.S. Army comments only partially responsive. We request that the Eighth U.S. Army explain why contract DAJB03-94-D-0001 was modified instead of contract DAJB03-93-D-0035 for the payment of \$105,000 for employee bonuses and why the U.S. Government reimbursed the contractor under a firm-fixed-price contract. We request the additional comments by September 20, 1996.

Table of Contents

Executive Summary	i
Part I - Audit Results	
Introduction	2
Audit Background	2
Audit Objectives	3
Eighth U.S. Army Milk Plant in Korea	4
Part II - Additional Information	
Appendix A. Audit Process	18
Appendix B. Prior Audits and Other Reviews	19
Appendix C. Comparison of Milk Plant and Extended-Shelf-Life Product Prices	20
Appendix D. Summary of Potential Benefits Resulting From Audit	21
Appendix E. Organizations Visited or Contacted	22
Appendix F. Report Distribution	24
Part III - Management Comments	
Assistant Secretary of the Army Comments	28
Eighth U.S. Army Comments	30
Army and Air Force Exchange Service Comments	37

Part I - Audit Results

Introduction

In the Pacific theater, the DoD has three Government-owned, contractor-operated milk plants that supply milk and other dairy products to U.S. military and civilian personnel and their dependents. This report is the second in a series of reports on DoD milk plants in the Pacific and discusses the Eighth U.S. Army (EUSA) milk plant in Songnam, Korea. Inspector General, DoD, Report No. 96-140, "DoD Milk Plants in the Pacific-Okinawa," June 3, 1996, discusses the milk plant on Okinawa, Japan.

Audit Background

Production of Milk by the Military Departments. In the past, fresh milk was highly perishable and subject to bacterial contamination, which required the milk to be consumed quickly to avoid spoilage. The Military Departments began producing milk and other dairy products shortly after World War II because technology did not exist to preserve fresh milk and other dairy products for the long period required to transport the products to consumers in the Pacific. In addition, the Military Departments could not purchase fresh milk and other dairy products from the local Korea dairies because, before 1993, the local dairies did not meet U.S. health standards. The three Government-owned, contractor-operated milk plants in the Pacific theater produce and distribute dairy products that consist of mixing nonfat dry milk powder with water, vitamins, and coconut oil. The milk produced is commonly referred to as "filled milk." Currently, DoD produces filled milk only in the Pacific theater.

U.S.-Manufactured Fresh Milk. Fresh milk produced in the United States is designated as Grade A or Grade B. Grade A fresh milk is produced under higher sanitary standards and is the only type of milk available for fluid consumption within the United States. Grade A milk can also be used for the production of other products such as ice cream, butter, and cottage cheese. In the United States, Grade B milk can only be used for the production of hard dairy products such as nonfat dry milk, cheese, and butter. U.S. dairy manufacturers now offer fresh (Grade A) milk with a shelf life of more than 60 days because of technological advances and sanitary improvements in U.S. production facilities. Commonly referred to as extended-shelf-life milk, the milk is pasteurized at a higher temperature and packaged in a highly sterile environment to extend the period before bacterial contamination occurs. Extended-shelf-life milk has resolved the problem of fresh milk spoiling during shipment over long distances and is currently available in commissaries throughout Korea.

Audit Objectives

The primary audit objective was to determine whether DoD milk plant operations in the Pacific theater are efficient, effective, and needed. Based on the results of our audit of the Okinawa milk plant, we focused our review on determining whether operation of the milk plant in Korea should be continued. Therefore, we did not review the management control program for the Eighth U.S. Army milk plant. See Appendix A for a discussion of the scope and methodology and Appendix B for a summary of prior audit coverage related to the audit objectives.

Eighth U.S. Army Milk Plant in Korea

The Eighth U.S. Army (EUSA) milk plant is no longer needed to produce milk and other products for consumption by military and civilian personnel and their dependents. The milk plant is no longer needed because:

- o the primary reason for the milk plant existence, nonavailability of fresh milk, is no longer an issue;
- o the milk plant is not cost-effective; and
- o the milk plant continues to have problems meeting health and sanitation standards.

As a result, EUSA experienced losses totaling about \$6.4 million for the last 3 years. By obtaining fresh milk and other dairy products from the United States, the Army could put at least \$2.4 million to better use over the next 6 years. The Army would also improve the quality of life for DoD personnel and their families in Korea by importing fresh milk and other dairy products.

Operation of the EUSA Milk Plant in Korea

EUSA Milk Plant Responsibility. The EUSA milk plant in Korea is a Government-owned, contractor-operated facility. Overall responsibility for the EUSA milk plant belongs to the 19th Theater Army Area Command. Within the 19th Theater Army Area Command, the 34th Support Group has responsibility for overseeing the day-to-day milk plant operations. Because the EUSA milk plant is a contractor-operated facility, the U.S. Army Contracting Command Korea is responsible for negotiating, awarding, and administering contracts to operate the plant. To assist in the administration of the contracts, the U.S. Army Contracting Command Korea designated a contracting officer representative in the 34th Support Group. The contracting officer representative and a staff of two Korean National employees are assigned full time to the milk plant to coordinate customer orders and to ensure that the contractor complies with the terms of the contract. The U.S. Army Veterinary Services, 106th Medical Detachment, 18th Medical Command, Korea, is responsible for testing the milk plant for compliance with military specifications for sanitation, while the Chief Food Analysis Laboratory, Tripler Army Medical Center, Hawaii, is responsible for testing the quality of milk plant products.

EUSA Milk Plant Contract. Before 1993, Dairy Maid Dairy, a U.S. invited contractor, operated the EUSA milk plant because local sources were not interested, qualified, or available. An invited contractor is generally a business that does not possess the licenses, registrations, and permits required to conduct business in the Republic of Korea and that receives logistics support from the U.S. armed forces for the purpose of executing contracts with DoD. During

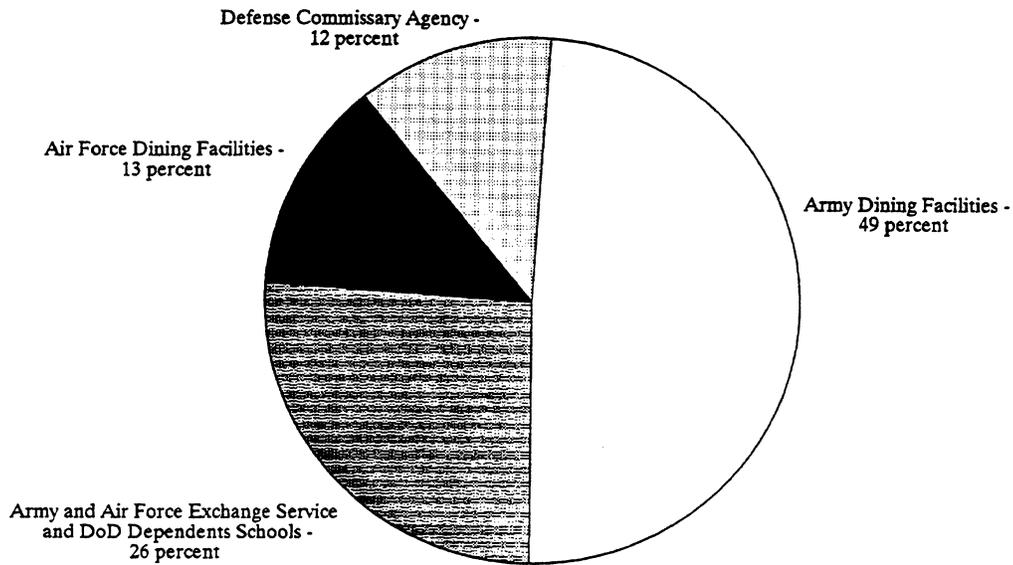
1993, the U.S. Army Contracting Command Korea determined that local sources were available, interested, and qualified to operate the milk plant. As a result, the U.S. Army Contracting Command Korea competitively awarded contract DAJB03-94-D-0001, valued at \$6.7 million, to Seoul Dairy in December 1993 for a base period and 1 option year ending September 30, 1995. The contract was extended two additional periods and expired on March 31, 1996. A new contract (DAJB03-96-D-0014) was awarded to the same contractor on April 1, 1996, and expires on September 30, 1996. The contractor employs 66 full-time personnel and is responsible for the operation and maintenance of the milk plant, including supplying personnel, equipment, and services, except for those items provided by the U.S. Government. The contractor is also responsible for keeping a 60-day supply of all ingredients and for delivering the dairy products in vehicles that are supplied by the U.S. Government. Although the Army awarded contract DAJB03-94-D-0001 competitively, Seoul Dairy is the only source available for a follow-on contract because Dairy Maid Dairy no longer has invited contractor status and because no other parties were interested.

EUSA Milk Plant Production. Construction of the EUSA milk plant at K-16 Airbase in Songnam, Korea, was completed in 1984. The milk plant produces 52 line items of milk and other products.

EUSA Milk Plant Customers. The milk plant customers include troop dining facilities, commissaries, and exchanges (retail outlets) in Korea. The Commander, Army and Air Force Exchange Service, is responsible for operating the exchanges. The Army and Air Force Exchange Service is also responsible for supplying the exchanges and DoD dependents schools in Korea with milk and other dairy products. The Army and Air Force Exchange Service and the Army and Air Force dining facilities in Korea obtain 100 percent of their milk and other dairy products from the EUSA milk plant. The Defense Commissary Agency is responsible for the operation of the commissaries in Korea. Of the total milk and other dairy products obtained for resale by the Korea commissaries, the commissaries receive 20 percent of their products from the EUSA milk plant and 80 percent from United States dairy sources.

Eighth U.S. Army Milk Plant in Korea

The figure below shows the percent of sales of products to the milk plant customers.



FY 1995 EUSA Milk Plant Percent of Sales to Customers

Need for the EUSA Milk Plant in Korea

The EUSA milk plant is no longer needed. The EUSA justification to operate the milk plant was based on the need to supply milk and other dairy products to U.S. Forces in Korea when local and U.S. dairy manufacturers could not satisfy the need. Local Korean dairy sources did not meet U.S. dairy standards for quality before 1993, while U.S.-manufactured fresh milk and other dairy products could not be economically shipped by sea without spoiling. However, fresh milk and other dairy products are now pasteurized at higher temperatures and under higher sanitary conditions, extending the shelf life of fresh milk and other dairy products to at least 60 days. The longer shelf life allows the fresh milk and other dairy products to be shipped by sea without spoiling, which makes purchasing fresh milk and other dairy products a viable alternative to operating the EUSA milk plant.

Cost-Effectiveness of EUSA Milk Plant in Korea

EUSA Cost Study. The EUSA milk plant in Korea is not cost-effective. EUSA continues to base the need for a milk plant operation on cost studies that were inaccurate and incomplete. In November 1993, EUSA conducted its most recent cost study on the previous milk plant contract with Dairy Maid Dairy to determine whether to keep the EUSA milk plant open. The EUSA Assistant Chief of Staff, Resource Management, conducted the cost-benefit analysis, concluded that purchasing fresh milk and other dairy products from U.S. dairy manufacturers was more economical than operating the milk plant, and recommended closing the milk plant. The EUSA Command Group and the 19th Theater Army Area Command (formerly the 19th Support Command) did not support the cost study conclusions. The commands claimed that shipping delays would occur and that EUSA did not have enough cold storage space. In addition, they claimed that the study did not adequately account for all transportation costs associated with transporting the fresh milk and other dairy products from the United States to locations throughout Korea. EUSA considered the commands' concerns by adjusting the original savings to account for sealift costs and stated that shipments of milk should arrive as frequently as milk plant deliveries, so additional storage space should not be necessary. Although the study supported closing the EUSA milk plant and responded to the commands' concern, EUSA decided to keep the milk plant open.

Cost of Operations. By deciding to continue the operation of the milk plant, operating costs exceeded customer purchases (sales) for the last 3 years, causing both EUSA and the Seoul Dairy to experience losses totaling \$7.6 million, as shown in the following table.

FYs 1993 Through 1995 EUSA Milk Plant Operating Data (in millions)					
	<u>Sales</u>	<u>EUSA</u>		<u>Contractor</u>	<u>Total</u>
	(A)	<u>Operating</u> <u>Costs</u>	<u>Operating</u> <u>Loss</u>	<u>Loss</u>	<u>Loss</u>
		(B)	(C=B-A)	(D)	(E=C+D)
FY 1993	\$2.7 ¹	\$5.9 ²	\$3.2		\$3.2
FY 1994	3.6	5.2	1.6	\$0.6	2.2
FY 1995	3.6	5.2	<u>1.6</u>	<u>0.6</u>	<u>2.2</u>
Total			\$6.4	\$1.2	\$7.6

¹Estimated sales based on Eighth U.S. Army cost study of FY 1993 costs.
²Includes \$952,000 penalty payment.

Eighth U.S. Army Milk Plant in Korea

Our comparison of milk plant sales to total EUSA operating costs for the milk plant between FYs 1993 through 1995 showed that EUSA lost about \$6.4 million. Included in the \$6.4 million is a penalty payment of \$952,000 that EUSA was required to pay in 1993 because the contract with Dairy Maid Dairy contained a minimum order quantity clause. However, EUSA adjusted minimum order quantities and virtually eliminated the need to pay a penalty payment under the Seoul Dairy contract. Nevertheless, Seoul Dairy officials stated that while performing under contract DAJB03-94-D-0001 during FYs 1994 and 1995, Seoul Dairy lost \$1.2 million. Sales, operating costs, and losses appear to have been fairly consistent for FYs 1993 through 1995, when the loss claimed by Seoul Dairy is applied to the FYs 1994 and 1995 operating costs.

The primary reason that EUSA and Seoul Dairy experienced a loss on the operation of the EUSA milk plant is that fixed costs (primarily labor) were too high and customer demands were stagnant. As a result, EUSA will experience further losses if it continues to operate the milk plant.

EUSA Milk Plant Labor Costs. The Republic of Korea labor law specified that the labor force of 66 employees would continue to operate the milk plant under the Seoul Dairy contract. The labor law provides employees the right of continued employment unless justifiable reasons exist to reduce the labor force. Therefore, Seoul Dairy was required to reemploy all 66 milk plant employees and hire employees at the same grade levels when employees retired. Also, milk plant employees threatened to strike when Seoul Dairy refused to pay the employees bonuses earned from October through December 1993, before the award of the Seoul Dairy contract. To prevent the strike, EUSA modified contract DAJB03-94-D-0001 to pay \$105,000 in employee bonuses promised by the prior contractor. Based on our limited review of this payment, we question whether a firm-fixed-price contract should have been modified to pay bonuses promised by the contractor. We also question whether modifying the contract to pay for services received on the prior contract is proper. EUSA should make a complete review of the reasons for paying the bonuses and take appropriate action.

EUSA Dairy Product Purchases and Prices. EUSA cannot increase customer purchases or the prices for EUSA milk plant products. Fresh milk and other dairy products produced in the United States comprise more than 80 percent of the milk and other dairy products sold in the Korea commissaries, even though the prices are 30 percent higher than milk plant products. For instance, the Korea commissaries charge customers \$0.69 per quart of milk manufactured at the milk plant compared to \$0.90 per quart of fresh milk manufactured in the United States. The prices make milk plant dairy products the most economical. However, if EUSA increases milk plant dairy product prices to offset losses from operating the milk plant, milk plant products would cost more than fresh milk and other dairy products. As a result, milk plant sales to all customers will decrease further, causing the milk plant to experience even greater losses.

In addition, EUSA is negotiating with Seoul Dairy, the only source for the anticipated follow-on milk plant contract. Seoul Dairy has requested at least a

35-percent price increase on the follow-on contract to prevent further losses. If milk plant dairy product prices increase by 35 percent, fresh milk and other dairy products will cost customers less than milk plant dairy products. For example, with a 35-percent price increase, the same quart of milk will cost \$0.93 compared to a quart of fresh milk that costs \$0.90. Overall, our cost analysis determined that continued operation of the milk plant with the proposed price increase would result in EUSA losing at least \$2.4 million over the next 6 years.

Inspector General Cost Review. To verify the cost study of the EUSA Assistant Chief of Staff, Resource Management, we performed a cost-benefit analysis to determine whether procuring fresh milk and other dairy products from U.S. dairy manufacturers would be cost-effective. Using data that the U.S. Army Audit Agency and the Defense Personnel Support Center provided, we concluded that procuring fresh milk and other dairy products from U.S. dairy manufacturers instead of keeping the milk plant open will save EUSA at least \$400,000 a year. Appendix C shows the costs of milk plant products compared with fresh milk and other dairy products, including sea transportation and in-country transportation costs.

Quality of Milk

The milk plant operation continues to have problems meeting health and sanitation standards. At a minimum, life on U.S. bases overseas should at least meet the basic U.S. standards in regard to the availability of products and services. The basic U.S. standard for milk is Grade A fresh milk, not filled milk. Furthermore, United States Code, title 21, section 62, declares filled milk illegal in the United States. A decision to supply fresh milk and other dairy products will provide a better quality product as well as improve the quality of life for our fighting forces and their dependents in Korea.

Product Quality. The consumer perception of filled milk potentially causes people to stop drinking milk because of the poor taste. The taste difference occurs because the fat in filled milk is coconut oil instead of butter fat. In addition, the use of milk powder results in a taste difference because of the milk powder processing. According to the Department of Agriculture Marketing Service, powdered milk is available in two U.S. grades. The higher U.S. grade, U.S. extra grade milk powder, has a slight chalky, cooked, and flat taste. Therefore, even if the EUSA milk plant uses extra grade milk powder in its products, the products will not have a "fresh" taste. As a result, individuals who stop drinking milk because of the taste may not get the recommended daily allowance of vitamins and minerals.

Military Personnel and Their Dependents. Although no taste tests have been recorded in Korea, troop issue support organization personnel stated that many soldiers will not drink the filled milk products in the dining halls. As a result, troop dining facilities provided carbonated beverages as an alternative to filled milk. In addition, the commissary customers, who have a choice between fresh

Eighth U.S. Army Milk Plant in Korea

or filled milk and other dairy products, purchase fresh milk and other dairy products over milk plant dairy products by a margin of 4 to 1, even though fresh milk costs about 30 percent more per quart. Continuing to supply U.S. troops in Korea with filled milk when fresh milk products are available in the commissaries could adversely affect troop morale. The well-being of troops overseas may be jeopardized because troops do not think that they are receiving the best quality dairy products available. In addition, milk plant products are the only milk products provided to the school children.

Quality of the EUSA Milk Plant and Products. During FY 1995, the milk plant received unsatisfactory sanitary inspection ratings for 8 of the 12 months. Unsatisfactory sanitary conditions can lead to product contamination, resulting in high bacteria and mineral counts and causing possible health risks for consumers. Of the 8 unsatisfactory ratings, 16 critical problems were reported. Furthermore, 12 of the 16 problems were recurrent in at least 2 consecutive months, including products being pasteurized at inadequate temperatures and ingredients left out on the countertop where they were subject to contamination. In addition, product samples sent for product quality testing to the Chief Food Analysis Lab, Tripler Army Medical Center, consistently reported results that did not meet military standards. For instance, cottage cheese and two flavors of yogurt tested in August 1995 did not meet military standards for quality. As a result, the U.S. Army Veterinary Services suspended production of several products, including six flavors of yogurt, from July through September 1995.

One cause of the quality problems is the need for repair or replacement of several major equipment items. According to the contracting officer's representative, the milk plant needs additional repairs, maintenance, and upgrades of at least \$2.7 million if the milk plant continues to operate. Even though the Army is aware of the quality problems and maintenance requirements, it has not decided whether to correct the problems or to close the milk plant and procure fresh milk and other dairy products from U.S. dairy manufacturers.

Availability of Fresh Milk and Other Dairy Products

The Defense Commissary Agency has procured fresh milk and other dairy products from U.S. dairy manufacturers and sold the products in the Korea commissaries since at least 1991. Based on a 60-day shelf life at the time of production, fresh milk and other dairy products have an average remaining shelf life of 30 days when the products are available for sale in the commissaries. The commissary manager in Korea stated that he never experienced shortages of fresh milk and other dairy products. With a remaining 30-day shelf life for the fresh milk and other dairy products and with regular shipping schedules, the cold storage facilities will be able to keep reserves of fresh milk and other dairy products for emergencies. In addition, a contract for in-country transportation is available for the delivery of perishable items. The in-country transportation contract could be amended to include transportation of fresh milk and other

dairy products. Although cold storage facilities and in-country transportation are available, EUSA should develop a contingency plan in case shortages of fresh milk and other dairy products occur because of shipping delays.

Contingency Plan for Fresh Milk and Other Dairy Products. Although the commissaries in Korea have not experienced shortages of fresh milk and other dairy products, senior EUSA personnel are concerned that shortages could occur because of shipping disruptions. The EUSA should develop a contingency plan to address possible shortages that could adversely affect the supply of fresh milk and other dairy products in Korea. One viable option that EUSA should consider is to use U.S. approved local dairy facilities in Korea as a source to supply filled milk if shortages occur. In addition, any contingency plan that is established should cover the troop dining facilities, commissaries, and exchanges. Although those organizations may have separate contracts for fresh milk and other dairy products, establishing separate contingency plans may not be feasible or cost-effective considering that limited alternative dairy sources exist.

Supply Source for Fresh Milk and Other Dairy Products. The Defense Personnel Support Center (the Center) was established to provide support to the Military Departments and is capable of lowering product costs by using multiple suppliers. The Military Departments on Okinawa decided to close the Okinawa milk plant and awarded a contract to the Center on January 31, 1996, to supply fresh milk and other dairy products to the military organizations on Okinawa. The Army and Air Force dining facilities will have the option of submitting orders directly to the Center or consolidating orders before submission to the Center. As a result, using the Center as a source of supply for fresh milk and other dairy products in Korea is a viable alternative to operating the EUSA milk plant. In addition, the Army and Air Force Exchange Service needs to establish a source of supply for fresh milk and other dairy products for its retail outlets and for schools for DoD dependents in Korea. The Army and Air Force Exchange Service could award a contract for the supply of fresh milk and other dairy products in Korea similar to the contract with U.S. dairy manufacturers to supply fresh milk and other dairy products to Okinawa.

Conclusion

The only type of fresh milk available for consumption within the United States is Grade A fresh milk, which is produced under the highest sanitary standards. The production of filled milk is outdated and results in unfavorable treatment of our military personnel and their families. However, senior EUSA officials stated that our fighting forces will experience a monetary loss if fresh dairy products are obtained because fresh dairy products will cost more. Those officials also believe that supplying fresh milk and other dairy products to our fighting forces and their families in Korea will lower the quality of life because U.S. dairy manufacturers cannot supply all milk plant products. To the contrary, fresh milk should cost less than filled milk products if all costs to operate the milk plant at a breakeven point are charged. In addition, U.S. dairy

Eighth U.S. Army Milk Plant in Korea

manufacturers have assured DoD that the only product they will not be able to provide under a contract to supply fresh milk and other dairy products is buttermilk, which represents only 1 percent of dairy products consumed in Korea. A greater monetary loss, at least \$2.4 million over the next 6 years, would result if a follow-on milk plant contract is awarded because the contractor plans to increase prices, resulting in milk plant dairy products costing more than fresh milk and other dairy products. With the availability of fresh milk and other dairy products and to improve the quality of life of DoD personnel, EUSA should not operate the milk plant. With adequate cold storage facilities to store dairy products, in-country transportation to deliver the dairy products throughout Korea, and a contingency plan to resolve potential shortages of fresh dairy products, EUSA no longer needs to operate the milk plant.

Recommendations for Corrective Action

1. We recommend that the Commander, Eighth U.S. Army:
 - a. Use the Defense Personnel Support Center to supply extended-shelf-life fresh milk and other dairy products to the Army and Air Force dining facilities in Korea.
 - b. Develop a contingency plan to provide filled milk and other dairy products from United States approved local dairy sources to troop dining facilities, commissaries, and exchanges in case of shortages caused by potential shipping disruptions.
 - c. Close the Eighth U.S. Army milk plant once a contract for fresh milk and other dairy products and a contingency plan are established.
 - d. Determine whether modifications to the Seoul Dairy contract totaling \$105,000 for milk plant employee bonuses were appropriate. If inappropriate, determine why payments were made and take appropriate action against those involved.
2. We recommend that the Commander, Army and Air Force Exchange Service, direct the Army and Air Force Exchange Service in Korea to establish procedures to obtain extended-shelf-life fresh milk and other dairy products for retail stores and for schools for DoD dependents in Korea, similar to procedures used to supply fresh milk and other dairy products to Okinawa.

Management Comments and Audit Response

Department of the Army Comments. The Army generally agreed with the draft report recommendations, but recommended that the Army Cost and Economic Analysis Center revalidate the potential cost benefits.

Audit Response. We believe the cost benefits are sound. Furthermore, EUSA agreed that closing the milk plant would result in benefits of \$400,000 per year.

Eighth U.S. Army Comments. The EUSA generally agreed with the report, except for certain statements. In response to the recommendations, EUSA stated the following.

- o **Recommendation 1.a.** A contract for the delivery of fresh milk and other dairy products to Korea is planned to be awarded by the Center on August 1, 1996, with the first shipment of products scheduled for early September 1996.

- o **Recommendation 1.b.** EUSA is developing a contingency plan that is scheduled to be completed by July 31, 1996.

- o **Recommendation 1.c.** The milk plant is scheduled to close when the contract expires on September 30, 1996. In addition, EUSA concurred with \$2.4 million in potential monetary benefits from closing the milk plant and purchasing products from U.S. dairy manufacturers.

- o **Recommendation 1.d.** EUSA reviewed the contract files regarding the bonus payments totaling \$104,424 and determined that the payments were appropriate. EUSA modified contract DAJB03-94-D-0001 in accordance with a contract provision that references a U.S. Forces Korea regulation, which states that bonuses will be paid to eligible employees.

Regarding report content, EUSA recommended that we delete certain statements concerning the quality of filled milk and its effects on the readiness, retention, and well-being of troops overseas.

Also, EUSA stated that Army Audit Agency Report No. AA96-10, "Milk Plant Operations, U.S. Forces Korea," February 22, 1996, concluded that it was cost-beneficial to operate the EUSA milk plant during FY 1995. The Army Audit Agency report also stated that the contractor was operating the plant in an acceptable manner and that EUSA managers reduced unnecessary expenditures to the U.S. Government under the contract.

EUSA also disagreed with the draft report statement regarding EUSA and Seoul Dairy experiencing losses on the operation of the milk plant because they could not reduce labor costs or increase customer purchases and prices of products. EUSA stated that Republic of Korea law provides employees the "right of continued employment." Also, termination of employment at the retirement age, separation of an employee with unsatisfactory performance or misconduct, and reduction of employees based on business decisions are recognized "justifiable reasons" for employees to lose their employment. Therefore, EUSA or the contractor could have reduced labor costs by reducing the number of employees working at the milk plant.

In addition, EUSA presented information from EUSA milk plant contract files that included dates for contract awards and extensions that differed from the time frames stated in the draft report.

Eighth U.S. Army Milk Plant in Korea

Audit Response. Although EUSA concurred with Recommendation 1.d., EUSA did not state why contract DAJB03-94-D-0001 was modified to pay bonuses when the work was performed under contract DAJB03-93-D-0035. This problem is one that the Defense Finance and Accounting Office has been working to correct for the last 3 years. Specifically, payments for work need to be charged against the proper contract if contracting and financial records are to agree. Additionally, EUSA stated that the contractor is required to pay employee bonuses in accordance with U.S. Forces Korea Regulation 690-1, but EUSA did not explain why the U.S. Government reimbursed the contractor for payment of the bonuses under a firm-fixed-price contract. We do not challenge the bonuses, but we question whether the U.S. Government is responsible for the payment. We request that EUSA respond to these additional concerns.

We disagree with the comments that statements in the draft report concerning the quality of filled milk and its effects on the well-being of troops overseas are unsubstantiated. As stated in the report, we obtained test results from the Chief Food Analysis Laboratory, Tripler Army Medical Center, which consistently reported results that EUSA milk plant products did not meet military standards. Other statements in the draft report were based on statements in the U.S. Forces Korea cost study of FY 1993 milk plant operations. The cost study states:

After talking to food service personnel, the decline in milk products to the TISAs [Troop Issue Support Activities] could be attributed to the fact that the troops do not like the taste of filled milk and that other beverages such as soft drinks have been introduced in the dining facilities. Air Force dining facilities avoid this problem by providing ESL [extended-shelf-life] milk. In fact, the commissary now has ESL milk and that now accounts for more than 80% of the sales. There is a declining demand for filled milk in the commissary even though it has a lower price.

In addition to the U.S. Forces Korea FY 1993 cost study showing that extended-shelf-life milk is preferred over filled milk at a ratio of 4 to 1, our audit work in Japan showed that extended-shelf-life milk is preferred over filled milk at ratios as high as 21 to 1. Although we could not show that fighting capability (readiness) and that soldiers are leaving the Services (retention) have been directly affected by the presence of filled milk versus fresh milk, morale has been affected. Service personnel pointed out that some troops within the same theater are receiving fresh milk while other troops are receiving only filled milk. We changed the final report to delete references to readiness and retention.

In response to comments on the February 22, 1996, Army Audit Agency report, we disagree with the report's conclusions regarding the data used in the Army's cost comparison, because data from the Center provided a more accurate calculation of fresh milk transportation costs. (See Appendix C for the Inspector General, DoD, cost comparison using information from the Army

Audit Agency report and the Center.) Furthermore, the cost cuts claimed by EUSA managers were passed on to the contractor, Seoul Dairy, which lost \$1.2 million during FYs 1994 and 1995.

In response to the ability of EUSA and the contractor to reduce labor costs, we changed the final report to clarify our point that fixed costs under the contract are too high and that customer demand for milk plant products is stagnant.

Lastly, the final report reflects the contract award and extension dates as stated in the management comments.

Army and Air Force Exchange Service Comments. The Army and Air Force Exchange Service agreed with Recommendation 2. The Army and Air Force Exchange Service has established procedures to obtain extended-shelf-life fresh milk and other dairy products from U.S. manufacturers. Deliveries are scheduled to begin in August or September 1996.

Part II - Additional Information

Appendix A. Audit Process

Audit Scope and Methodology. We reviewed contract DAJB03-94-D-0001 documents for the EUSA milk plant at Songnam, Korea, and obtained related cost and consumption data for FYs 1994 through 1995 during the audit of contract administration in the Pacific theater. We announced the DoD milk plant audit in June 1995, and we requested audit assistance from the Army Audit Agency in Korea. We interviewed the contracting officer representative for the milk plant and toured the plant to observe production of milk and other dairy products. We also interviewed DoD personnel involved with milk procurement, including the Defense Commissary Agency officials. The Army Audit Agency results were included in a report on the EUSA milk plant issued to the Commander, EUSA (see Appendix B).

Audit Period, Standards, and Locations. We performed this economy and efficiency audit from June 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. We did not rely on computer-processed data or statistical sampling procedures to perform the audit. Appendix E lists the organizations visited or contacted.

Appendix B. Prior Audits and Other Reviews

Inspector General, DoD

Inspector General, DoD, Report No. 96-140, "DoD Milk Plants in the Pacific-Okinawa," June 3, 1996, states that the Air Force recommendation to close the Okinawa milk plant and use extended-shelf-life fresh milk was proper. The audit determined whether the Okinawa milk plant was necessary and responded to allegations stated in a complaint to the Defense Hotline. The report also states that the Air Force and Marine Corps need to resolve key issues regarding the supply of fresh milk to troops on Okinawa. The report recommends that the Commander, U.S. Forces Japan, designate either the Air Force or the Marine Corps as the lead organization responsible for providing dairy support for the troops on Okinawa.

In response to unsolicited comments received from the Marine Corps and the Defense Commissary Agency, the recommendation concerning funding for the milk plant contractor deficit was deleted from the final report. The Commander, U.S. Forces Japan, agreed with the final report and stated that the Air Force would be the lead organization responsible for providing dairy support for the troops on Okinawa. The Commander also stated that the Air Force and the Defense Commissary Agency have agreed to share cold storage space and that the Air Force has developed a contingency plan for supplying fresh milk to the dining facilities.

Inspector General, DoD, Audit Report No. 94-098, "Audit of the Eighth U.S. Army Milk Plant Contract," May 13, 1994, states that the U.S. Army Contracting Command Korea generally followed acquisition procedures for the renewal of the EUSA milk plant in the Republic of Korea. The audit responded to congressional concerns that stemmed from constituents' allegations that U.S. firms were excluded from competing and that Korean firms were given preferential treatment for the pending milk plant contract renewal. The report contains no recommendations.

Department of the Army

U.S. Army Audit Agency, Audit Report No. AA 96-103, "Milk Plant Operations, Eighth U.S. Army, Seoul, Korea," February 22, 1996, was issued in response to an Inspector General, DoD, request for audit assistance. The report provides operating costs and sales data on the EUSA milk plant. The report states that because of scope limitations, the Army Audit Agency did not determine whether the milk plant is operating at maximum efficiency or whether it would be more economical to obtain dairy and juice products from other sources. The report contains no recommendations.

Appendix C. Comparison of Milk Plant and Extended-Shelf-Life Product Prices

FY 1995 Milk Plant Operating Costs

Contract cost	\$3,561,000
Milk powder (60 day supply)	64,000
Army civilian salaries	76,000
Korean national salaries	67,000
Travel costs	4,000
Supplies	59,000
Water and sewage	29,000
Electricity	73,000
Heating	31,000
Maintenance and repair	12,000
Trash removal	4,000
Pest control	2,000
Shipping cost of ingredients from United States	248,000
Annual depreciation of building and facilities	193,000
Annual depreciation of equipment and vehicles	691,000
Dry ice	40,000
Inspection and contract administration costs	<u>42,000</u>

Total milk plant operating costs **\$5,196,000**

35-Percent increase in contract price¹
 $\$3,561,000 \times 0.35$ + \$1,246,000

Operating costs with 35-percent increase **\$6,442,000**

Costs to Purchase Products from U.S. Dairy Manufacturers

Product cost	\$4,465,000 ²
Sea-lift costs from United States	1,418,300 ³
In-Country transportation costs	<u>132,028³</u>

Total Cost **\$6,015,328**

Monetary Benefits From Closing the Milk Plant and Purchasing Products From U.S. Dairy Manufacturers

Annual difference with a 35-percent increase **\$ 426,672**

¹The U.S. Army Contracting Command Korea estimated that the FY 1995 contracting price may increase by 35 percent.

²Based on FY 1995 milk plant production and prices from two vendors who supply dairy products to commissaries in Korea.

³Based on calculations from the Defense Personnel Support Center.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Type of Benefit
1.a., 1.c.	Economy and Efficiency. Reduces DoD infrastructure and improves the quality of life for U.S. fighting forces in Korea.	More than \$2.4 million of Operation and Maintenance appropriation 21X2020 funds to be put to better use during FYs 1997 through 2002.
1.b.	Program Results. Ensures that DoD personnel and dependents will not be without dairy products.	Nonmonetary.
1.d.	Economy and Efficiency. Verifies whether the Army made appropriate payments to the contractor for employee bonuses.	At least \$105,000 of Operation and Maintenance appropriation 21X2020 funds put to better use.
2.	Program Results. Improves quality of life for retail store customers and DoD school children.	Nonmonetary.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
Deputy Under Secretary of Defense (Logistics), Washington, DC
Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management), Washington, DC
Assistant Secretary of Defense (Force Management Policy), Washington, DC
Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education), Washington, DC

Department of the Army

Auditor General, Department of the Army, Washington, DC
U.S. Army Audit Agency, Alexandria, VA
Korea Field Office, U.S. Army Audit Agency, Seoul, Korea
Army Directorate of Services, Washington, DC
Food Management Division, Washington, DC
U.S. Army Soldier Systems Command, Natick, MA
U.S. Army Natick Research, Development, and Education Center, Natick, MA
Eighth U.S. Army, Yongsan Army Base, Seoul, Korea
U.S. Army Contracting Command Korea, Seoul, Korea
19th Theater Army Area Command, Seoul, Korea
34th Support Group, Seoul, Korea
Eighth U.S. Army Milk Plant, K-16 Airbase, Songnam, Korea
U.S. Army Veterinary Services, 106th Medical Detachment, 18th Medical Command, Seoul, Korea
DoD Veterinary Laboratory, Fort Sam Houston, TX
Tripler Army Medical Center, Schofield Barracks, HI

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller), Washington, DC
Military Sealift Command, Washington, DC
Office of the Inspector General, Washington, DC
Dry Cargo Division, Washington, DC
Line Agreement Division, Washington, DC
Naval Supply Command, Washington, DC
Navy Food Services Office, Washington, DC

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller),
Washington, DC
Air Force Directorate of Services, Washington, DC
Food Management Division, Washington, DC
Headquarters, Pacific Air Forces, Hickam Air Force Base, HI

Unified Commands

Commander in Chief, U.S. Pacific Command, Honolulu, HI
U.S. Forces Korea, Yongsan Army Base, Seoul, Korea

Other Defense Organizations

Headquarters, Defense Commissary Agency, Fort Lee, VA
Northwest/Pacific Region, Fort Lewis, WA
Korea Zone, Seoul, Korea
Headquarters, Defense Logistics Agency, Fort Belvoir, VA
Defense Personnel Support Center, Philadelphia, PA
Military Traffic Management Command, Alexandria, VA
Ocean Cargo Clearance Authority, Yokohama, Japan
Army and Air Force Exchange Service, Washington, DC

Non-Government Organizations

International Dairy Foods Association, Washington, DC
United States Dairy Association, Washington, DC
California Sunshine, Ultrafresh Dairy Products, Fullerton, CA
Dairy Maid Dairy, Inc., Virginia Beach, VA
Hood Dairy, Alder Foods, ME
California Pacific Association, Oakland, CA

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Deputy Under Secretary of Defense (Acquisition Reform)
Deputy Under Secretary of Defense (Logistics)
Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Force Management Policy)
Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, Eighth U.S. 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

Unified Commands

Commander in Chief, U.S. Pacific Command
Commander, U.S. Forces Korea, Yongsan Army Base

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
 Director, Defense Personnel Support Center
Director, National Security Agency
 Inspector General, National Security Agency
Director, Defense Commissary Agency
Commander, Army and Air Force Exchange Service
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

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

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 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 on National Security

Honorable Owen B. Pickett, U.S. House of Representatives

Part III - Management Comments

Assistant Secretary of the Army Comments

FOR OFFICIAL USE ONLY



DEPARTMENT OF THE ARMY
OFFICE OF THE DEPUTY CHIEF OF STAFF FOR LOGISTICS
500 ARMY PENTAGON
WASHINGTON, DC 20310-0500



DALO-TST

1.4 JUN 1996

MEMORANDUM THRU

~~DIRECTOR OF THE ARMY STAFF~~ *Willie 14 June 96* *Eric A. Orsini*
Deputy Assistant Secretary of the Army
(Logistics)
OASA (I&L)
ASSISTANT SECRETARY OF THE ARMY (INSTALLATIONS, LOGISTICS AND ENVIRONMENT)

FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (AUDITING)

SUBJECT: Audit Report on DoD Milk Plants in the Pacific-Korea
(Project No. 5CF-0060.01)--INFORMATION MEMORANDUM

1. This is in response to USAAA memorandum of 19 Apr 96 (Tab A), which asked ODCSLOG to respond to your memorandum of 15 Apr 96 (Encl to Tab A). Your memorandum requested an Army position concerning subject audit.
2. The Army agrees with the findings regarding the Eighth U.S. Army milk plant, and concurs with the Command's position to close the Government-Owned, Contractor-Operated milk plant. We concur that providing Extended Shelf Life (ESL) for troop consumption equalizes product consistency across all sources in the Pacific theater, i.e., dining facilities, commissaries, exchange shoppettes and dependent schools. Air Force dining facilities are already procuring ESL milk through the Defense Commissary Agency.
3. We recommend that the Army and Air Force Exchange Service consider using the Defense Personnel Support Center's ESL milk contract as their source of supply to further leverage buying power and reduce per unit cost. It is also recommended the Army Cost and Economic Analysis Center (CEAC) revalidate the total cost savings. The contract savings from closing the milk plant should be transferred to Subsistence-in-Kind and Second

FOR OFFICIAL USE ONLY

This marking is canceled when separated from
the material bearing a protective marking

Printed on Recycled Paper

DASA(L) #... *0195* ...

Eighth U.S. Army Comments



DEPARTMENT OF THE ARMY
HEADQUARTERS, EIGHTH UNITED STATES ARMY
UNIT #18238
APO AP 96205-0009

REPLY TO
ATTENTION OF:

EAIR

12 JUN 1996

MEMORANDUM FOR OFFICE OF THE DEPUTY CHIEF OF STAFF FOR LOGISTICS,
ATTN: DALO-TS2-A, 500 ARMY PENTAGON, WASHINGTON,
DC 20310-0500

SUBJECT: Response to the DoDIG Draft Audit Report on DoD Milk
Plants in the Pacific-Korea (Project No. SCF-0060.1)

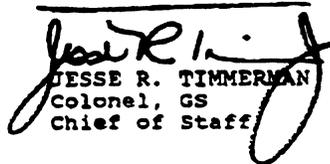
1. The Eighth United States Army (EUSA) response to the Department of Defense Inspector General (DoDIG) draft audit report on DoD Milk Plants in the Pacific-Korea (Project No. SCF-0060.1, dated 15 April 1996) is enclosed.

2. We have decided to close the EUSA Milk Plant on 30 September 1996 and use the Defense Personnel Support Center to supply fresh milk and other dairy products to dining facilities in Korea. This decision was based on the 40-percent escalation in the contract prices from the FY95 contract, and also based on the projected costs of equipment replacement and building repair at the EUSA Milk Plant. In this regard, our decision coincides with the DoDIG recommendation to close the EUSA Milk Plant.

3. We object to the negative tenor of the DoDIG draft audit report and the unsubstantiated statements in the report concerning the quality of the filled milk and its effects on the readiness, retention, and well-being of troops overseas. The EUSA Milk Plant has been effectively accomplishing its mission of providing dairy products to U.S. Forces in Korea. A recent audit report by another audit agency concluded that it was cost-beneficial to operate the EUSA Milk Plant during FY95. Also, DoDIG has no support for their statements concerning the quality of the filled milk and its effects on the troops stationed in Korea. These unsupported statements should be deleted from the final audit report.

4. Point of contact for this action is Mr. William J. Kanik, 723-5187.

FOR THE COMMANDER:


JESSE R. TIMMERMAN JR.
Colonel, GS
Chief of Staff

Printed on  Recycled Paper

EUSA COMMAND RESPONSE

DODIG DRAFT AUDIT REPORT ON DOD MILK PLANTS IN PACIFIC-KOREA
(Project No. SCF-0060.1)

OVERALL COMMENTS

Our decision to close the EUSA Milk Plant on 30 September 1996 coincides with the DoDIG recommendation to close the plant. However, we object to the negative tenor of the DoDIG draft audit report.

a. The EUSA Milk Plant has been effectively accomplishing its mission of providing dairy products to U.S. Forces in Korea. A recent U.S. Army Audit Agency audit report (Report Number AA96-103, dated 22 February 1996) concluded that (i) the plant's current contractor operated the plant in an acceptable manner, as evidenced by performance reports and laboratory testing of the plant's products, (ii) EUSA managers initiated cost-cutting actions to prevent unnecessary expenditures of government funds, and (iii) a comparison of the plant's FY95 operating costs with the costs of purchasing dairy and juice products from alternative commercial sources in CONUS indicated that it was cost-beneficial to operate the plant during that year.

b. Statements should be deleted from the final audit report alleging that soldiers will not drink filled milk and that providing filled milk to dining facilities jeopardizes the readiness, retention, and well-being of troops overseas (See pages 10 and 12 of the draft audit report). EUSA food management teams and food service advisors visit all EUSA dining facilities on a regular basis and the quality of dairy products has never been raised as an issue.

ADDITIONAL COMMENTS

The following additional comments are provided to ensure the accuracy of the DoDIG final report:

a. Page 5. The DoDIG draft audit report stated that contract DAJB03-94-D-0001 was awarded in December 1993 for a 2-year period ending September 30, 1995. However, contract files show that contract DAJB03-94-D-0001 was awarded for a base period from 15 December 1993 to 30 September 1994, with an option period from 1 October 1994 to 30 September 1995. The option period was extended by modification P00005, dated 1 August 1994.

Revised

Final Report
Reference

Revised

b. Page 5. The DoDIG draft audit report stated that contract DAJB03-94-D-0001 was extended for two 6-month periods extending the contract until 30 September 1996. However, contract files indicate that modification P00016, dated 10 August 1995, extended contract services from 30 September 1995 to 14 November 1995. Modification P00017, dated 13 September 1995, extended contract services from 14 November 1995 to 31 March 1996. A separate contract DAJB03-96-D-0014 was awarded on 1 April 1996 to Seoul Dairy Cooperative for a 6-month period from 1 April 1996 to 30 September 1996.

c. Page 8. The following statement in the DoDIG draft audit report is inaccurate and should be deleted from the final audit report:

Revised

"The primary reason that EUSA and Seoul Dairy experienced a loss on the operation of the EUSA milk plant is that neither EUSA nor the contractor can reduce labor costs or increase customer purchases and prices of products."

The Republic of Korea (ROK) law provides the employees "right of continued employment" during contracting out or business transfer. "Right of continued employment" stems from a legal interpretation, by the Ministry of Justice of Article 27 of ROK Labor Standards Law (Restrictions of Dismissal). The interpretation provides that the employment contract (appointment) and the conditions of employment with the previous employer continue with the new employer. This is accepted legal interpretation and enforced during contracting out or change in business ownership. While the "right of continued employment" is highly protective of employees, it does not preclude an employer from dismissing, separating or taking punitive actions subsequent to business take over, when there is a "justifiable reason". Termination of employment at the retirement age, separation of an employee with unsatisfactory performance or misconduct, and reduction of employees based on business decisions are recognized "justifiable reasons". Labor cost reduction by means of employee "wage cut" is not possible. However, there are opportunities for labor cost reduction by means of improved management. Therefore, the statement that "neither EUSA nor the contractor can reduce labor cost" is not entirely correct.

Page 10. The following statements in the DoDIG draft audit report concerning the quality of milk produced by the EUSA Milk Plant are erroneous and unsubstantiated, and should be deleted from the final audit report:

"The consumer perception of filled milk potentially causes people to stop drinking milk because of the poor taste."

"Although no taste tests have been recorded in Korea, troop issue support organization personnel stated that many soldiers will not drink the filled milk products in the dining halls."

"The readiness, retention, and well-being of troops overseas may be jeopardized because troops do not think that they are receiving the best quality dairy products available."

Revised

EUSA strongly disagrees with these unsubstantiated statements. The EUSA G4 Food Management Assistance Team (FMAT) conducts assistance visits to all EUSA dining facilities on a regular basis. As part of these visits, FMAT personnel question U.S. and KATUSA personnel who eat at the dining facilities on the quality of food and service being provided. To date, FMAT personnel have never received unfavorable comments about the taste or quality of the milk served in the dining facilities. Additionally, the 19th Theater Army Area Command Food Service Advisor has made numerous visits to the dining facilities, and the quality of dairy products has never been raised as an issue.

Page 11 and 12. The DoDIG draft audit report states that adequate cold storage facilities are available throughout Korea to store dairy products. However, based on supply requirements, three of the five Army TISAs will require additional chill or cold storage space. The 19th Theater Army Area Command is currently reviewing possible options for acquiring the additional cold storage space for the three TISAs.

RESPONSE TO RECOMMENDATIONS

The following comments are in response for each recommendation that DoDIG made to the Commander, EUSA:

a. Recommendation 1.a.: Use the Defense Personnel Support Center to supply extended-shelf-life fresh milk and other dairy products to the Army and Air Force dining facilities in Korea.

EUSA Response: Concur. The Defense Personnel Support Center (DPSC) will be used to supply extended-shelf-life (ESL) fresh milk and other dairy products to dining facilities in Korea. The milestone plan for this action is as follows:

<u>Task</u>	<u>Suspense Date</u>	<u>Status</u>
Solicitation Put Out For Contract	3May96	Completed
Award Contract	1Aug96	Planned
1st Shipment Departs for Korea	1Sep96 and Weekly Thereafter	Planned
Arrival at Pusan	20Sep96	Planned
Products Shipped to TISAs	23/24Sep96	Planned
TISAs/Dining Halls Receive Products	24Sep96 and Weekly Thereafter	Planned
Milk Plant Closes	30Sep96	Planned

The current plan calls for DPSC to ship four containers of ESL milk to Korea each week. DPSC will contract for inland distribution via a commercial freight carrier to the five Army and two Air Force Troop Issue Subsistence Activities (TISAs) in Korea. Dining facilities will pick-up their milk supplies directly from their supporting TISA, except at Camp Kyle (Uijongbu), where a contractor will deliver the products directly to the dining facilities in the Camps Casey and Hovey area.

b. Recommendation 1.b.: Develop a contingency plan to provide filled milk and other dairy products from United States approved local dairy sources to troop dining facilities, commissaries, and exchanges in case of shortages caused by potential shipping disruptions.

EUSA Response: Concur. A contingency plan to provide milk and other dairy products from other approved sources in case of shortages caused by potential shipping disruptions will be developed. The target completion date for this action is 31 July 1996. There are a number of possible options currently under review. One option is to store two weeks of Ultra High Temperature (UHT) milk for all of Korea at the Pusan Storage Facility (PSF). UHT milk has a shelf life of approximately six months and there is no chill or cold storage requirements for this product. If shortages occur, the PSF will distribute UHT products to customers. Other possible options include: (i) resupply of dairy products from the Air Force contingency stocks at Okinawa, (ii) resupply of dairy products from the milk plant in mainland Japan, (iii) receipt of dairy products via air resupply from CONUS, and (iv) the acquisition of milk products via a Korean milk producer through the U.S. Army Contracting Command, Korea. The best option to provide milk products from other sources will be selected based on an in-depth analysis of the alternatives.

c. Recommendation 1.c.: Close the Eighth U.S. Army milk plant once a contract for fresh milk and other dairy products and a contingency plan are established.

EUSA Response: Concur. The EUSA milk plant is scheduled to close for business on 30 September 1996.

d. Recommendation 1.d.: Determine whether modifications to the Seoul Dairy contract totaling \$105,000 for milk plant employee bonuses were appropriate. If inappropriate, determine why payments were made and take appropriate action against those involved.

EUSA Response: Concur. A review of both contract files was completed to determine whether modifications for milk plant employee bonuses were appropriate. The results of the review disclosed that the payments made of \$104,424.46 for the employee bonuses were appropriate. Contract DAJB03-93-D-0035 was originally for a base period from 1 July 1993 through 30 September 1993. The contract was extended three times as follows:

<u>Modification</u>	<u>Date</u>	<u>Period</u>
P00003	30Sep93	1-31Oct93
P00005	1Nov93	1-30Nov93
P00009	30Nov93	1-15Dec93

After 15 December 1993, a new contract DAJB03-94-D-0001 was awarded to another contractor. The modifications to DAJB03-94-D-0001 questioned by DoDIG in this recommendation are as follows:

<u>Modification</u>	<u>Amount</u>	<u>Date</u>	<u>Period</u>	<u>Description</u>
P00001	\$69,961	4Feb94	1Oct - 15Dec93	1994 Lunar Bonus
P00002	\$34,463	1Apr94	1Nov - 15Dec93	1994 Spring Bonus

Documentation in both files indicate that the unit costs (contract line items) for milk products associated with the extension periods (Modifications P00003, P00005, and P00009) did not include bonuses for employees. The milk plant operation is a Government Owned Contractor Operated (GOCO) facility. The Contracting Officer (CO) at the time, issued the modifications in accordance with a contract provision in Section H, paragraph H-3 (the same provision included in both contracts) which references that Invited Contractors doing business in Korea shall comply with Korean Labor laws, rules, and regulations established in USFK Regulation 690-1. This regulation states that bonuses will be paid to eligible employees. In accordance with a memorandum for

record, dated 1 April 1994, the CO determined that it was in the best interest of the Government to pay the bonuses separately. The issue of why contract DAJB03-94-D-0001 was modified vice contract DAJB03-93-D-0035, was not addressed. However, the same employees were paid their bonuses and only the operator of the GOCO facility changed. Each contract file will be notated with the results of this review of the payments made for the employee bonuses.

COMMENTS ON APPENDIX D
SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

1. The DoDIG draft audit report claimed a potential benefit of \$2.4 million of funds put to better use during FYs 1997 through 2002, as follows:

<u>Recommendation Reference</u>	<u>Description of Benefit</u>	<u>Type of Benefit</u>
1.a., 1.c.	Economy and Efficiency. Reduces DoD infrastructure and improves the quality of life for U.S. fighting forces in Korea.	More than \$2.4 million of appropriation 21X2020 funds to be put to better use during FYs 1997 through 2002.

EUSA RESPONSE: Concur. The USAAA audit report, Milk Plant Operations, U.S. Forces Korea (Report No. AA96-10, dated 22 February 1996) showed that it was cost-beneficial to operate the milk plant during FY 95. Based on the 40-percent increase for contract DAJB03-96-D-094 for the 6-month period 1 April to 30 September 1996, the potential monetary benefit of \$400,000 a year appears reasonable.

2. The DoDIG draft report claimed a potential benefit of \$105,000 of funds put to better used based on a verification to determine whether appropriate payments were made to the contractor for employee bonuses, as follows:

1.d.	Economy and Efficiency. Verifies whether the Army made appropriate payments to the contractor for employee bonuses.	At least \$105,000 put to better use.
------	--	---------------------------------------

EUSA RESPONSE: Nonconcur. As previously stated, in response to Recommendation 1.d., our review of contract files disclosed that payments made of \$104,424.46 for the employee bonuses were appropriate.

Army and Air Force Exchange Service Comments

AAFES DEPARTMENTS OF THE ARMY & AIR FORCE
Headquarters Army & Air Force Exchange Service
Dallas, Texas 75286-0202



13 JUN 1996

SUBJECT: DoD Milk Products in the Pacific-Korea
(IG Memo, April 15, 1996)

THRU: Lieutenant General George T. Babbitt
Chairman, Board of Directors
Army and Air Force Exchange Service
1290 Air Force Pentagon
Washington DC 20330-1290

George T. Babbitt 14 JUN 1996
Lt Gen Babbitt
DCS/Logistics

TO: Inspector General, Department of Defense
ATTN: Paul Allison, AIG-AIM
400 Army Navy Drive, Room 415
Arlington, VA 22202-2884

1. Reference subject audit draft dated April 15, 1996.
2. We concur with recommendation #2, page 13 of the IG Audit Report regarding DoD milk plants in the Pacific. Due to escalating prices of DoD milk plant products in Korea, AAFES has already established procedures to obtain fresh milk and dairy products from US sources. Initial deliveries are planned for the Aug/Sep time frame.

A. D. Bunger
A. D. BUNGER
Major General, U.S. Air Force
Commander

Audit Team Members

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

Terry L. McKinney
Ronald W. Hodges
Robert W. Smith
Brian C. Filer
Shawn L. James
Lorin T. Pfeil
Ana M. Myrie