Audit Report

USE OF UNPAID CONSULTANTS BY THE
DOD EXCHANGE SERVICES

Report No. D-2001-005 October 16, 2000

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Acronyms

AAFES	Army and Air Force Exchange Service
FACA	Federal Advisory Committee Act

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

October 16, 2000

MEMORANDUM FOR COMMANDER, ARMY AND AIR FORCE EXCHANGE SERVICE

SUBJECT: Audit Report on the Use of Unpaid Consultants by the DoD Exchange Services (Report No. D-2001-005)

We are providing this audit report for information and use. The audit was performed in response to a request by the Special Oversight Panel on Morale, Welfare and Recreation, Committee on Armed Services, U.S. House of Representatives, to determine the propriety of the military exchanges' use of unpaid consultants. We considered management comments on a draft of this report when preparing the final report.

Management comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Joseph P. Doyle at (703) 604-9349 (DSN 664-9349) (jdoyle @dodig.osd.mil) or Mr. Michael J. Tully at (703) 604-9347 (DSN 664-9347) (mtully@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

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Deputy Assistant Inspector General
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Office of the Inspector General, DoD

Report No. D-2001-005 **October 16, 2000**
Project No. (D2000CK-0082)

Use of Unpaid Consultants by the DoD Exchange Services

Executive Summary

Introduction. The Special Oversight Panel on Morale, Welfare and Recreation, Committee on Armed Services, U.S. House of Representatives requested this audit. The request was made in response to allegations that the Army and Air Force Exchange Service inappropriately engaged consultants who were financially affiliated with companies that did business with the exchange and as a result of the relationship, the exchange made improper procurement actions.

Objectives. The audit objectives were to review the propriety of the military exchanges' use of consultants, determine whether the use of the consultants complies with prevailing ethics laws and regulations, and whether any related procurement actions were improper.

Results. The Army and Air Force Exchange Service's use of unpaid consultants did not fully comply with existing laws and regulations. Army and Air Force Exchange Service did not require unpaid consultants to file financial disclosure reports, which could have assisted in identifying potential conflicts of interest. Further, by allowing the unpaid consultants to serve on its board of directors, the Army and Air Force Exchange Service may have created an advisory committee within the meaning of the Federal Advisory Committee Act, yet did not comply with that Act's requirements. As a result, the potential for, and the appearance of, conflicts of interest existed. We did not, however, identify any improper procurement actions resulting from the use of the unpaid consultants. For details of the audit results, see the Finding section of the report, and see Appendix B for a discussion of the allegations.

Summary of Recommendations. We recommend that the Commander, Army and Air Force Exchange Service require the consultants to file financial disclosure reports and attend annual ethics training, alter the relationship between its board of directors and the consultants, and establish policy on the use of unpaid consultants.

Management Comments. The Army and Air Force Exchange Service agreed to require the unpaid consultants to file financial disclosure reports and attend annual ethics training. They also agreed to restructure the working relationship between the consultants and its board of directors and to establish policy on the use of unpaid consultants. Refer to the Finding section of the report for a discussion of management comments and to the Management Comments section of the report for the complete text of the comments.

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Background

In November 1999, the Special Oversight Panel on Morale, Welfare and Recreation, Committee on Armed Services, U.S. House of Representatives requested a review of the use of unpaid consultants by the Army and Air Force Exchange Service (AAFES). Specifically, the Panel requested that we determine, in light of prevailing ethics laws and regulations, the proprietary of engaging as advisors, civilian business leaders who are still active in retail business and, in some cases, paid board members of companies that do business with the exchanges.

Military Exchange Services. The military exchange services are non-appropriated fund activities that are established and operated for the benefit of DoD Components. The military exchanges have two primary missions. The first is to provide authorized patrons quality merchandise and services at uniformly low prices. The second is to provide reasonable earnings for the support of DoD morale, welfare and recreation programs. The DoD has three exchange services: the Army and Air Force Exchange Service, the Navy Exchange Service Command, and the Marine Corps Exchange.

Use of Unpaid Consultants by AAFES. AAFES had three unpaid consultants who provided consulting services to the AAFES Commander. The terms and conditions of the consulting services were outlined in no-fee service contracts with a 3-year performance period. The unpaid consultants' role was to provide advice and recommendations to the Commander. Further, the unpaid consultants participated as non-voting members in AAFES board of directors' meetings. In February 2000, the Commander directed that AAFES terminate its contracts with the unpaid consultants.

Use of Unpaid Consultants by the Navy Exchange. The Navy Exchange does not currently utilize the services of unpaid consultants. However, the Navy Exchange used unpaid consultants in the past as part of its Navy Exchange Advisory Committee. The committee used the unpaid consultants to provide business and financial advice to the exchange. The Navy Exchange discontinued its use of consultants when DoD disestablished the Navy Exchange Advisory Committee in December 1993.

Use of Unpaid Consultants by the Marine Corp Exchange. The Marine Corp Exchange used two unpaid consultants to provide financial advice to separate investment and retirement committees. The Marine Corp Exchange established no-fee service agreements with each of the unpaid consultants. The unpaid consultants advise the retirement and investment committees on market issues and asset allocation, and provide financial trend analysis. One consultant provides his services in conjunction with his Marine Corps Reserve commitment and attends all committee meetings. The committee on which he serves does not make decisions or vote on matters or issues. The other consultant does not

attend all committee meetings and does not participate in all aspects of those meetings. Further, he is not present when voting matters are discussed and decisions are made.

Objectives

The audit objectives were to review the propriety of the military exchanges' use of unpaid consultants, determine whether the use of the consultants complies with prevailing ethics laws and regulations, and whether any related procurement actions were improper. See Appendix A for a discussion of the audit scope, methodology, and prior audit coverage.

Use of Consultants by DoD Military Exchange Services

Use of unpaid consultants by AAFES did not fully comply with existing laws and regulations governing standards of ethical conduct. This occurred because AAFES did not treat the unpaid consultants as special Government employees who are subject to ethical standards of conduct and reporting requirements of the Joint Ethics Regulation. Also, by permitting the unpaid consultants to regularly attend and participate in board of directors' meetings, AAFES may have created an advisory committee without complying with the requirements of the Federal Advisory Committee Act. Finally, AAFES did not have internal policies covering the duties, limitations, and requirements for the use of unpaid consultants. As a result, the potential for, and the appearance of, conflicts of interest existed.

Use of Unpaid Consultants

Advisors to the Commander. AAFES terminated its contracts with the unpaid consultants in February 2000, but continued to use the unpaid consultants as in the past. The unpaid consultants provided advice and recommendations to the AAFES management on retail industry trends, technology advances, and best business practices. The unpaid consultants assisted AAFES in evaluating the effectiveness and adequacy of its operations and strategic direction. Further, the unpaid consultants' role was to provide a degree of retail experience not otherwise available within DoD. AAFES use of unpaid consultants did not fully comply with existing laws and regulations governing the standards of ethical conduct. Specifically, AAFES did not treat the consultants as special Government employees and did not require them to file financial disclosure reports. In addition, the unpaid consultants' attendance and participation in AAFES board of directors' meetings may have created a Federal advisory committee, yet AAFES did not comply with the requirements of the Federal Advisory Committee Act (FACA).

Requirements Governing the Use of Consultants

Special Government Employees. AAFES did not treat the unpaid consultants as “special Government employees” and did not require them to file financial disclosure reports or attend annual ethics training in accordance with ethics laws and regulations. Special Government employees include consultants, experts, and members of advisory committees who perform temporary duties either on a full time or part time basis, with or without compensation. The Office of Government Ethics has issued standards of ethical conduct and requirements for financial disclosure and annual ethics training. DoD implemented those standards in DoD 5500.7-R, "Joint Ethics Regulation," August 30, 1993, which sets forth the basic obligations of public service. Sufficient evidence existed to support classifying the AAFES unpaid consultants as special Government employees. AAFES

frequently solicited advice from the unpaid consultants and, because of their attendance and participation in board of directors' meetings, the consultants appeared to be performing a Federal function. If AAFES continues to use these consultants as it has in the past, the consultants should be classified as special Government employees.

Financial Disclosure and Ethics Training. The AAFES use of unpaid consultants did not comply with the Joint Ethics Regulation disclosure and training requirements. AAFES did not require the unpaid consultants to file confidential financial disclosure reports or attend annual ethics training. The purpose of financial disclosure is to assist an agency in identifying possible conflicts of interest and ensuring that the integrity of the organization is protected. Because AAFES did not require financial disclosure statements from its unpaid consultants, it failed to anticipate and avoid apparent conflicts of interest and did not protect itself from the appearance of impropriety.

Financial Conflict of Interest and Impartiality. The AAFES use of unpaid consultants did not comply with conflict of interest statutes. Special Government employees are prohibited from making decisions, giving advice or making recommendations on particular Government matters if it could have a direct effect on an organization or company in which the employee is serving as an officer, director, trustee, general partner, or employee. The unpaid consultants used by AAFES had financial interests in companies that did business with AAFES. We determined that two of the three unpaid consultants used by AAFES were paid directors and shareholders of AAFES vendors. Although the unpaid consultants did not possess procurement authority and did not appear to influence or participate in making specific procurement decisions; to a reasonable person, the unpaid consultants' involvement in AAFES activities created the perception that AAFES lacked the ability to be impartial. It is a basic obligation of public service that Government employees act impartially and not give preferential treatment to a private organization. Even the appearance of partiality or preferential treatment is a violation of the regulations on standards of conduct.

Compliance with the Federal Advisory Committee Act

The Federal Advisory Committee Act (FACA). The AAFES use of unpaid consultants may have created a Federal advisory committee within the meaning of FACA, yet AAFES did not comply with the requirements of the Act. Title 5, United States Code, Appendix 2, "Federal Advisory Committee Act," was enacted by Congress to control the growth and operation of the various committees, boards, task forces and commissions that were established to advise offices and agencies in the executive branch of the Federal Government. Its purpose was to ensure that the advice that was provided was objective and accessible to the public. FACA and its implementing regulations provide exemptions for certain advisory meetings or groups and expressly excludes from its scope any committee composed wholly of full-time Federal employees. The participation of the unpaid, non-Government consultants in AAFES board of directors' meetings took those meetings outside the scope of the FACA exemptions. Further, the court concluded in the Association of American Physicians and Surgeons v. Clinton, 997 F.2nd 898 (D.C.Cir. 1993), that when a consultant's role in a group of

Federal officials is functionally indistinguishable from that of the other members, whether or not they possess decision-making authority, then that group becomes a federal advisory committee and is subject to the requirements of the FACA.

Participation in Board of Directors' Meetings. AAFES permitted the unpaid consultants to participate in board of directors' meetings and to perform a role that was similar to the actual board members. Consultants regularly attended board meetings and, although not voting members, sat with the board members through entire board meetings and freely participated in board discussions. The unpaid consultants' photographs were displayed in the boardroom along with those of the officially appointed board members, and the consultants were issued AAFES building passes rather than contractor passes. The consultants were also issued Armed Forces Exchange Identification Cards that allowed them to enter and shop at exchanges worldwide.

Review of Unpaid Consultants' Participation. The former Commander, AAFES, did not believe that the unpaid consultants' working relationship with the AAFES board of directors required compliance with FACA. He stated that the Board should not be subject to FACA because the unpaid consultants worked individually as opposed to a collective body and were present at meetings only to observe and offer advice as needed. AAFES General Counsel reviewed the arrangement that it had with the unpaid consultants to determine whether it was consistent with the requirements of FACA. The AAFES General Counsel stated that an independent auditor may conclude that the AAFES board of directors should have been subject to the requirements of FACA. AAFES General Counsel recommended that substantive changes be made to the way the unpaid consultants assist the Commander, AAFES and the board of directors; or that the requirements of the FACA be met. We agree with the AAFES General Counsel recommendations.

Policy on the Use of Unpaid Consultants

AAFES did not have a policy in place that specifically outlined how the unpaid consultants would be utilized or what their role and responsibilities within AAFES would be. There was no guidance that defined the functions that the unpaid consultants could or could not perform. Further, there were no controls in place to avoid potential conflicts of interest. AAFES did not address the need for the unpaid consultants to comply with the provisions of the standards of ethical conduct that relate to conflicting financial interests and impartiality in performing official duties.

Conclusion

The working relationship that AAFES had with its unpaid consultants did not comply with ethical standards of conduct or conflict of interest statutes. Specifically, AAFES did not identify the unpaid consultants as special Government employees and did not require the unpaid consultants to file financial disclosure reports or attend annual ethics training. Further, AAFES allowed the unpaid consultants to attend and participate in board of directors' meetings in such a way that the Board appears to have been converted to a Federal advisory committee, without complying with the requirements of the FACA. As a result of these actions, AAFES was not able to prevent the appearance of, or the potential for, conflicts of interest.

Recommendations and Management Comments

We recommend that the Commander, Army and Air Force Exchange Service:

1. Direct consultants to file financial disclosure reports and to participate in annual ethics training to eliminate the potential for, or appearance of, conflicts of interest and to ensure compliance with the rules governing ethical standards of conduct.

Management Comments. The Army and Air Force Exchange Service concurred and stated that the current consultants were notified that they would be required to file a financial disclosure report and attend annual ethics training. The Army and Air Force Exchange Service also stated that future consultants would be required to file financial disclosure reports before performing any official work associated with the position.

2. Restructure the relationship between the board of directors and the consultants to ensure that the board of directors is not considered to be a Federal advisory committee, or else take steps to ensure that the board of directors complies with Federal Advisory Committee Act.

Management Comments. The Army and Air Force Exchange Service concurred and agreed to restructure the consultants' relationship with the board of directors and implement those changes prior the January 2001 meeting.

3. Establish policy on the use of unpaid consultants.

Management Comments. The Army and Air Force Exchange Service concurred and stated that an Exchange Operating Policy would be developed and published no later than January 1, 2001.

Appendix A. Audit Process

Scope and Methodology

Work Performed. We conducted the audit on use of unpaid consultants by the DoD exchanges in response to a Congressional request. This audit report addresses the propriety of the military exchanges using consultants in certain instances, and whether the use of the consultants complied with ethics laws and regulations. We conducted the review from December 1999 to August 2000. We reviewed applicable information and documentation dated May 1971 through June 2000. During the audit we reviewed the exchanges' rationale for using or not using unpaid consultants. Specifically, to accomplish our audit objectives, we:

- reviewed applicable ethics standards and Federal statutes;
- interviewed personnel from the all three military exchange services to obtain an understanding of how unpaid consultants are used, the frequency of their use, and the advice that they provide;
- reviewed and evaluated the no-fee service contracts and agreements used by the exchanges to formalize the consulting arrangement;
- contacted and visited several exchange sites to determine how the consultants were used at the base level versus headquarters level;
- interviewed retail buyers at AAFES to determine the amount of influence the unpaid consultants have over purchasing merchandise for resale; and
- obtained and evaluated Federal and DoD policies on the use of consultants and their participation in advisory committees.

Limitations to Scope. We did not review the management control program because the scope of the audit was limited to addressing those areas of concern identified in the congressional request. Further, we limited our review to the use of unpaid consultants because the allegations only referenced unpaid consultants.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the Defense Contract Management high-risk area.

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

Audit Type, Period, and Standards. We performed this program audit from December 1999 through August 2000 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD and several private companies. Further details are available upon request.

Prior Coverage

No prior coverage has been conducted on the use of unpaid consultants during the last 5 years.

Appendix B. Summary of Allegations

The summary of the allegations made to the Special Oversight Panel on Morale, Welfare and Recreation, Committee on Armed Services, U.S. House of Representatives by a constituent, and our audit results, are discussed below.

Allegation 1. The Army and Air Force Exchange Service inappropriately engaged consultants who were financially affiliated with companies that did business with the exchange.

Audit Results: The allegation was substantiated. We determined that AAFES had three unpaid consultants who provided retail business and financial advice to the Commander. Of the three unpaid consultants, two were paid directors and shareholders of AAFES vendors. We determined that the use of unpaid consultants by AAFES did not comply with existing laws, regulations, and ethical standards. Specifically, AAFES did not treat the unpaid consultants as special Government employees and therefore did not require them to file confidential financial disclosure reports and attend annual ethics training. As a result, AAFES was unable to readily identify potential conflicts of interest. For a full discussion of the use of unpaid consultants by AAFES, see the finding section of this report.

Allegation 2. As a result of the relationship between AAFES and the consultants, AAFES made improper procurement actions.

Audit Results. The allegation was not substantiated. We found no evidence to suggest that consultants influenced the procurement decisions of AAFES. The unpaid consultants provided global retailing advice and did not specifically recommend particular brands to AAFES personnel. We also found that the interaction between the unpaid consultants and the retail buyers was limited. AAFES personnel stated that procurement decisions are based on an evaluation of the product and are selected for resale based on such factors as quality, price, value, consumer trends, customer acceptance, industry sales, and past sale history. Further, they stated that stock assortment is limited by store space and funds.

Appendix C. Report Distribution

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Assistant Secretary of the Army (Financial Management and Comptroller)
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
Commander, Navy Exchange Service Command
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House Committee on Armed Services
Special Oversight Panel on Morale, Welfare and Recreation
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

Army and Air Force Exchange Service Comments

DEPARTMENTS OF THE ARMY & AIR FORCE
Headquarters Army & Air Force Exchange Service
Dallas, Texas 75266-0202

22 SEP 2000

SUBJECT: Response to Draft Audit Report on the Use of Unpaid Consultants by the DoD Exchange Services (Project No. D2000CK-0082, 8 Sep 00)

Mr. Paul J. Granetto
Director, Corporate Management Directorate
Inspector General, Department of Defense
400 Army Navy Drive
Arlington, VA 22202-2885

1. Concur. Use of unpaid Consultants by AAFES did not fully comply with existing laws and regulations governing standards of ethical conduct.

2. AAFES will take the following steps to comply with the audit recommendations:

   a. Audit Recommendation - Direct Consultants to file financial disclosure reports and to participate in annual ethics training to eliminate the potential for, or appearance of, conflicts of interest and to ensure compliance with the rules governing ethical standards of conduct.

   I have already notified my current Consultants that they must file financial disclosure reports and participate in annual ethics training to ensure compliance with the rules governing ethical standards of conduct. In the future, we will require candidates wishing to serve as Consultants to the AAFES Commander to file financial disclosure reports before assuming any duties associated with the position.

   b. Audit Recommendation - Restructure the relationship between the board of directors and the Consultants to ensure that the board of directors is not considered to be a Federal Advisory Committee, or else take steps to ensure that the board of directors complies with the Federal Advisory Committee Act.

   I have directed the AAFES Chief of Staff and the Director, Corporate Planning & Communications to restructure the relationship between the board of directors and the Commander's Consultants to ensure they are not considered to be a Federal Advisory Committee. With respect to specific findings of the audit, AAFES will make the following changes before the January 2001 meeting of the AAFES Board of Directors:

22 SEP 2000

SUBJECT: Response to Draft Audit Report on the Use of Unpaid Consultants by the DoD Exchange Services (Project No. D2000CK-0082, 8 Sep 00)

1). Notify the AAFES Board of Directors (BoD) of the limited role of the Consultants during BoD proceedings. At future BoD gatherings, the Consultants will not be seated at the Board table, but will sit as a group at a separate table along with other BoD support staff. They will be asked to speak on specific matters relevant to their individual areas of expertise and to evaluate and report on the effectiveness of AAFES Board meetings.

2). The AAFES Commander will remove his consultants from AAFES BoD meetings at his discretion during the discussion of any topics or during any BoD proceedings that, in his opinion, would present the consultants with a conflict of interest. Guidelines for restructuring AAFES Board meetings will be published by 1 January 2001.

3). Require the AAFES General Counsel to attend Board Meetings to ensure AAFES stays in full compliance with all legal and ethical issues.

4.) Require the Commander's Consultants to present reports or information papers to the Board independently and not in consultation with each other.

5.) Display pictures of the AAFES Commander's Consultants separately from those identifying officially appointed members of the AAFES Board of Directors.

6.) Revoke the Consultants' Armed Forces Exchange Identification Cards that allow them to enter and shop at exchanges worldwide. Additionally, AAFES personnel will escort the Commander's Consultants during all visits to exchange facilities.

c. Audit Recommendation - Establish policy on the use of unpaid Consultants.

22 SEP 2000

SUBJECT: Response to Draft Audit Report on the Use of Unpaid Consultants by the DoD Exchange Services (Project No. D2000CK-0082, 8 Sep 00)

I have instructed the Director, Corporate Planning & Communications to develop and publish an Exchange Operating Policy (EOP) outlining the role and responsibilities of the unpaid AAFES Commander's Consultants. The EOP will identify them as Special Government Employees and will prohibit them from making decisions, giving advice, or making recommendations on particular government matters if it could have a direct effect on an organization or company in which the employee is serving as an officer, director, trustee, general partner, or employee. The EOP will be published not later than 1 January, 2001.

3. We believe these actions will bring AAFES into full compliance with audit recommendations by the end of this calendar year.

CHARLES J. WAX
Major General, USAF
Commander

Audit Team Members

The Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

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