Audit Report

OFFICE OF THE INSPECTOR GENERAL

COMMISSARY MANAGEMENT DATA

Report No. 94-169 July 25, 1994

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Department of Defense

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Acronyms

DeCA	Defense Commissary Agency

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

July 25, 1994

MEMORANDUM FOR DIRECTOR, DEFENSE COMMISSARY AGENCY

Subject: Audit Report on Commissary Management Data (Report No. 94-169)

We are providing this report for your review and comments. This audit is one of a series of audits conducted in response to the Chief Financial Officers Act of 1990. This report discusses selected management data used by the Defense Commissary Agency to measure its performance. Although the Agency is clearly meeting its mission, the assumptions underlying some performance goals are questionable. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, we request that the Director, Defense Commissary Agency, provide comments on three unresolved recommendations by September 26, 1994. This report identifies no quantifiable monetary benefits.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Robert J. Ryan, Audit Program Director, at (703) 604-9418 (DSN 664-9418) or Mr. Thomas D. Kelly, Audit Project Manager, at (215) 737-3886 (DSN 444-3886). The distribution of this report is in Appendix G. The audit team members are listed on the inside back cover of this report.

Robert J. Lieberman
Assistant Inspector General
for Auditing

20000320 099

Office of the Inspector General, DoD

Report No. 94-169 **July 25, 1994**
(Project No. 3LA-2070)

COMMISSARY MANAGEMENT DATA

EXECUTIVE SUMMARY

Introduction. The Defense Commissary Agency (DeCA) operates a worldwide commissary system for the resale of groceries and household supplies at the lowest practical price to members of the Services, their families, and other authorized patrons. DeCA is composed of 360 stores organized into 7 regions, 2 service centers, and a central headquarters located at Fort Lee, Virginia. DeCA employs about 22,000 personnel and, for FY 1993, spent about $1.2 billion of appropriated funds on business operations (mostly personnel costs) while making approximately $5.9 billion in sales.

This audit is one of a series of audits being conducted in response to the Chief Financial Officers Act of 1990, which requires annual audits of the financial statements of funds, such as DeCA's. In FY 1993, the Assistant Inspector General for Auditing, DoD, in coordination with the Office of Management and Budget and the Comptroller of the DoD, determined that, for the selected funds, the audit work would concentrate on the Act's requirement that financial statements provide information with which Congress, agency managers, and the public can assess management performance and stewardship.

To improve performance and customer service, in 1993 DeCA management established a working group to reevaluate its mission and to establish performance measures and goals. We support DeCA's effort and recognize that DeCA will need to redefine its measures and goals as performance is assessed and the effectiveness of measures is determined.

Objective. Our initial objective was to determine whether critical commissary management data were available, accurate, useful, and reliable and whether the data were provided to managers to operate, evaluate, and make major financial and nonfinancial decisions. In recognition of DeCA's relative newness and its strong commitment in FY 1993 to implement a performance and results program, we dropped our initial objective and focused on evaluating the adequacy and usefulness of selected DeCA performance targets.

Audit Results. Selected DeCA performance objectives were established based on questionable assumptions and data (Part II, Adequacy of Management Data).

DeCA did not verify that it was receiving the most favorable prices from manufacturers. As a result, DeCA's strategic goal of maximizing customer satisfaction may not be fully achieved because monetary benefits to customers may not be optimized (Part III, Finding A).

DeCA did not fully comply with the unit cost concept for improving visibility over operational costs. As a result, measuring progress toward DeCA's strategic goal of enhancing the effectiveness and efficiency of commissary operations at all levels will be impeded (Part III, Finding B).

DeCA's practice of physically observing and counting merchandise to determine in-stock rates did not provide useful management information with which to measure the improvement of customer service. As a result, DeCA will not make the most effective use of about $3.2 million in labor expenditures and will have misleading performance measurement data (Part III, Finding C).

Internal Controls. There was a material internal management control weakness in that there was no DeCA verification that manufacturer prices were the most favorable. The recommendations related to Finding A will correct that weakness. Part I contains information on the controls assessed and Part III contains details on the material weaknesses.

Potential Benefits. Implementation of the recommendations will improve the efficiency of DeCA operations. However, we could not quantify the monetary benefits.

Summary of Recommendations. We recommended that the Director, DeCA, develop procedures for regularly verifying that manufacturer prices of resale merchandise are most favorable; establish the verification of manufacturer prices, when warranted, as a strategy for increasing customer savings in DeCA's Strategic Plan; assign, in coordination with the Comptroller of the DoD, output measures and the responsibility for monitoring all significant commissary costs; develop unit cost goals for operations and departments within stores; and streamline or discontinue the practice of physically computing in-stock rates as a means of assessing and increasing customer service at the store level.

Management Comments. The Director, DeCA, did not agree to establish the verification of all manufacturer prices as a strategy, but stated that verification would be done when there was cause to suspect that prices are not most favorable. The Director, DeCA, did not agree to assign output measures and the responsibility for monitoring all significant commissary costs and stated that DoD unit cost guidance does not require all costs to be related to specific output. The Director, DeCA, partially agreed to develop unit cost goals, but stated that the development of unit cost goals at the commissary level for departments within stores would take up too many regional resources and would not be beneficial. A discussion of management comments and audit responses to those comments are in Part III of this report. Other management comments and audit responses are in Appendix C. The complete text of management comments is in Part IV of the report.

Audit Response. Management comments on three recommendations were not fully responsive. Our recommendation on the verification of manufacturer prices as part of the DeCA strategy to maximize customer savings has been clarified to encompass verification on a selected basis. Accordingly, we request that the Director, DeCA, reconsider his position and provide comments on the unresolved recommendations by September 26, 1994.

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

Part I - Introduction

Background

General. The Defense Commissary Agency (DeCA) was established in October 1991 to operate a worldwide commissary system for the resale of groceries and household supplies at the lowest practical price to members of the Services, their families, and other authorized patrons. DeCA is composed of 360 stores organized into 7 regions, 2 service centers, and a central headquarters located at Fort Lee, Virginia. DeCA employs about 22,000 personnel and, for FY 1993, spent about $1.2 billion of appropriated funds on business operations (mostly personnel costs) while having approximately $5.9 billion in sales. DeCA also collected about $310 million in customer surcharges and spent about $272 million of the funds on other operations (mostly supplies), new construction, and capital equipment. The Defense Finance and Accounting Service - Columbus Center provides DeCA with accounting and financial information support.

Legislative Initiatives. Three recent legislative initiatives essentially called for Federal agencies to reevaluate how they operate with emphasis on how well they provide services or output to customers. The initiatives are discussed below.

Chief Financial Officers Act of 1990. The Chief Financial Officers Act requires that reporting activities produce financial statements to fully disclose their financial position as well as provide information with which Congress, agency managers, and the public can assess management performance and stewardship. The latter objective of the Chief Financial Officers Act should be satisfied primarily in the financial statement, "Overview of the Reporting Entity." The overview should include information on whether and how the mission of the reporting entity is being accomplished and what, if anything, needs to be done to improve program performance. To help reporting entities fulfill the performance reporting requirements of the Chief Financial Officers Act, the Office of Management and Budget issued a memorandum on February 5, 1992, "Financial Statements and Performance Measures." The memorandum provides guidance for choosing appropriate measures and obtaining accurate data on program performance. The memorandum cited seven steps that reporting entities are to perform to assess mission accomplishment. The reporting entities are to:

- Identify mission, goals, and objectives of programs.

- Discuss performance information needs with potential users of the annual financial statements.

- Select program performance measures.

- Determine availability of data.

- Obtain data.

- o Analyze and assess the data.
- o Organize the presentation.

FY 1993 DoD Authorization Act. The DoD Authorization Act complemented the Chief Financial Officers Act by requiring that performance measures and corresponding goals be developed for each business area of the Defense Business Operations Fund. The Defense Business Operations Fund is made up of business areas, including commissary operations and resale stock. The performance measures are to evaluate how well agencies satisfy customer requirements through efficiency and effectiveness. Efficiency measures are to gauge the unit cost of providing the customer with an output. In the case of commissaries, DeCA selected sales as the output for measuring efficiency -- expressed as a total operational costs to sales ratio. Effectiveness measures are to gauge customer satisfaction in providing output. In the case of commissaries, DeCA selected the inventory in-stock rate and the turnover rate as outputs for measuring effectiveness.

Government Performance and Results Act of 1993. The Government Performance and Results Act complemented the performance measurement requirements of the Chief Financial Officers Act and the FY 1993 DoD Authorization Act. The Government Performance and Results Act essentially reiterated the Office of Management and Budget steps for choosing appropriate measures and obtaining accurate data on program performance. The new legislation's initiative was in requiring Congress to become involved in the performance measurement process and government agencies to prepare strategic and annual plans for achieving goals. Most government agencies were not expected to comply with the Government Performance and Results Act until FY 1998; however, in an attempt to become a pilot agency under the Government Performance and Results Act, DeCA began the planning process of developing strategic and annual plans during FY 1993.

Objective

Our initial objective was to determine whether critical commissary management data were available, accurate, useful, and reliable and whether the data were provided to managers to operate, evaluate, and make major financial and nonfinancial decisions. In recognition of DeCA's relative newness and its strong commitment in FY 1993 to implement a performance and results program, we dropped our initial objective and focused on evaluating the adequacy and usefulness of selected management data used by DeCA to monitor program performance and achieve mission goals.

Scope and Methodology

We concentrated our audit on three quantified performance measures established by DeCA to monitor program performance and to achieve mission goals. We evaluated:

o Price savings to customers of 25 percent (target objective),

o Total operational costs to sales ratio of .19 (target objective and business operations efficiency measure), and

o Inventory in-stock rates of 94 percent or better (business operations effectiveness measure and strategy for the target objective of improving customer service).

We evaluated the rationale for the establishment of the performance measures at DeCA's headquarters and the plans for accumulating data and reporting on the target objectives at 22 of 93 stores located within 2 regions of the continental United States. The two regions (southern and southwest) were selected because they had the highest and lowest percentage of grocery price savings to customers for FY 1993, according to the Wirthlin Group, a commercial firm that DeCA contracted in FY 1993 to measure customer savings. Of the 22 stores, 11 were selected because they had $2 million or more average monthly sales and were operating on the DeCA Interim Business System, a uniform operating system being installed at the store level. The remaining 11 stores were included because they were closely located to the stores meeting the primary selection criteria. We also obtained pricing information to determine customer savings at three other regions in the continental United States. To make comparisons of prices within DeCA regions and stores and among DeCA and other comparable retail markets, we selected a sample of 107 line items sold in FY 1993. Details on our audit sample are in Appendix D.

We also obtained and reviewed DeCA's Strategic Plan for FY 1994 through FY 1998 and FY 1993 sales and cost information. To make grocery price comparisons, we obtained and reviewed purchase price information from the Army and Air Force Exchange Service; the Defense Personnel Support Center; the Military Audits of Market Information, Incorporated; and the Wirthlin Group. Our Quantitative Methods Division evaluated the Wirthlin Group's sampling techniques used to compute customer savings. We used computer-processed data from DeCA and the Defense Finance and Accounting Service - Columbus Center in our review. We did not independently verify the accuracy of the source data because it was not within the scope of the audit.

This financially related audit was made from August 1993 to March 1994 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, the audit included tests of internal controls as were considered necessary. Appendix F lists the organizations that we visited or contacted during the audit.

Internal Controls

Internal Controls Assessed. We evaluated the implementation of the DoD Internal Management Control Program and internal controls applicable to ensuring that adequate and useful management data were available to assess and report commissary program performance and mission goal achievement.

Internal Control Weaknesses. The audit disclosed a material internal control weakness as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Internal controls were not adequate to ensure that DeCA verified it was receiving the most favorable manufacturer prices. The verification of manufacturer prices was not an assessable unit in DeCA's implementation of the DoD Internal Management Control Program. Implementation of Recommendation A.1 will correct the material internal control weaknesses we identified. No quantifiable monetary benefits were associated with the recommendation. A copy of the final report will be provided to the senior official responsible for internal controls within the Office of the Secretary of Defense and DeCA.

Prior Audits and Other Reviews

Since DeCA began operations on October 1, 1991, no audits specifically related to management data have been performed.

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Part II - Adequacy of Management Data

Management Data

The two target objectives and one effectiveness measure we reviewed did not provide an adequate basis for measuring and reporting performance in the areas of customer savings, operational costs, and customer service. Issues related to DeCA's performance in achieving customer savings, reducing operational costs in relation to sales, and improving customer service are discussed in Part III of this report.

Mission of DeCA

In FY 1993, DeCA management placed a high priority on establishing a sound and worthwhile performance measurement program. Key personnel from DeCA headquarters and its regions met during the summer of 1993 to rewrite DeCA's mission, emphasizing results, and to develop a 5-year strategic plan and a FY 1994 annual plan for measuring performance and achieving improvements in effectiveness and efficiency. The revised mission called for DeCA to "Operate an efficient and cost-effective commissary to provide a non-pay benefit that improves the quality of life of our patrons and enhances military readiness and the retention of quality personnel."

From that mission, DeCA identified the following 5 mission goals with 10 target objectives.

o Goal 1: Maximize customer satisfaction.

oo Target Objective: improve customer service at the commissary store level.

oo Target Objective: achieve 25 percent grocery price savings.

o Goal 2: Enhance the effectiveness and efficiency of commissary operations at all levels.

oo Target Objective: reduce appropriated support funding below $1 billion in constant FY 1993 dollars.

oo Target Objective: achieve a .19 total operational costs to sales ratio.

oo Target Objective: achieve 16 inventory turnovers during 12 months of sales.

o Goal 3: Ensure proper stewardship of funds and assets.

oo Target Objective: achieve full compliance with the Chief Financial Officers Act of 1990.

oo Target Objective: ensure that annual store stock physical inventory variances are within plus or minus 0.65 percent in the continental United States and plus or minus 1 percent outside the continental United States.

o Goal 4: Attract, develop, advance, and retain a dedicated, competent, and diversified workforce.

oo Target Objective: increase representation by 2 percent per year in employment categories that have an imbalance of minorities or females.

oo Target Objective: develop and implement training plans for every major commissary occupation by FY 1996.

o Goal 5: Communicate the value of the commissary benefit.

oo Target Objective: ensure that by FY 1998, 90 percent of commissary patrons know the level of savings achieved by shopping at the commissary.

DeCA also quantified effectiveness measures for its two business areas of the Defense Business Operations Fund. For the commissary operations business area, DeCA established an in-stock rate of 94 percent for FY 1994. DeCA also selected high in-stock rates as a strategy for achieving its target objective of improving customer service for the strategic goal of maximizing customer satisfaction. For the resale stock business area, DeCA established an inventory turnover rate of 14 times for FY 1994. DeCA selected an inventory turnover rate of 16 times as a target objective to achieve its strategic goal of enhancing the effectiveness and efficiency of commissary operations at all levels. An inventory turnover rate is determined by dividing the amount of purchases an organization makes in a year by its average inventory, which is an indicator of how well an organization uses its assets to generate revenue.

Data Used to Assess the DeCA's Performance

At the time of our audit, DeCA had not developed a comprehensive plan for accumulating information for each of its target objectives and effectiveness measures. For the two target objectives and one effectiveness measure that we reviewed, information had been gathered from a mixture of manual and automated systems. The Wirthlin Group computed customer savings by comparing commissary store prices for selected items to the prices of comparable retail stores. (DeCA had not decided how it will obtain information on customer savings in future years.) For its target objective of achieving a reduced operational costs to sales ratio, DeCA obtained cost and sales

information from automated systems operated by the Defense Finance and Accounting Service - Columbus Center. Cost information was processed and maintained in the Defense Business Management System. Sales information was processed and maintained in the Standard Finance and Accounting System. For its effectiveness measure of achieving high in-stock rates, DeCA obtained information from manual observations and a reporting system.

Audit Approach

Based on discussions with DeCA personnel and our analysis of DeCA's operations, we selected three management data elements that were considered key to evaluating DeCA's mission accomplishment. The three management data elements involved two target objectives from DeCA's strategic plan and one effectiveness measure from DeCA's resale business operations budget plan of the Defense Business Operations Fund. The effectiveness measure was also listed as a strategy for the target objective of improving customer service in DeCA's strategic plan. We assessed the rationale for the establishment of the target objectives and the effectiveness measure as a strategy at DeCA's headquarters and the plans for accumulating data and reporting on the objectives at 22 stores located within 2 regions of the continental United States.

Audit Results

Customer Savings. The management data that DeCA selected were not adequate in assessing customer savings because the data were not based on a valid projection of actual customer savings and the target objective may not represent the true potential for savings. By comparing the selling price of a sample of items at commissary stores to commercial stores of similar size, the Wirthlin Group reported that commissary customers achieved a 23.4 percent savings in FY 1993. However, the Wirthlin Group's estimates of savings were not a valid projection because random selection techniques were not employed. See Appendix A for our analysis of the Wirthlin Group's study and Appendix B for management comments and our audit response.

The 25 percent customer savings target has been used by commissaries for years. The target essentially represents the desired difference between how much a customer would save by purchasing an item at a commissary store versus a commercial retail market of similar size. A difference or savings to commissary customers should accrue because a commercial retail market must include in its selling price the cost of the item as well as a markup for labor, overhead, depreciation, profit, and so forth. By establishing the lower limit of the difference as the commissary selling price, it is assumed that commissary stores buy and sell items at the most favorable price -- an assumption not

regularly verified (see Finding A, Customer Savings). In addition, due to the flaws in the Wirthlin Group's study it is currently unclear how close DeCA is to its 25 percent customer savings target. DeCA needs a more reliable performance survey.

Operational Costs. The target objective of .19 operational costs to sales ratio was too easily attainable in relationship to planned improvement strategies. According to DeCA's strategic plan, a .19 operational costs to sales ratio is to be achieved by reducing total costs while maintaining or increasing sales. The key strategies for lowering DeCA's unit cost ratio are to:

o increase the eligible customer base by allowing reservists full access.

o reduce appropriated funding support for operations to less than $900 million by FY 1997. The requisite cost reductions would be accomplished with several initiatives, such as streamlining the DeCA organization.

If only the first strategy were successful (FY 1993 sales of $5.9 billion were maintained or increased), then a .19 operational costs to sales ratio would mean that total costs of at least $1.1 billion would be incurred, or $200 million more than in FY 1993. If only the second strategy were successful (costs requiring appropriated fund support reduced below $900 million), then a .19 operational costs to sales ratio could be achieved if sales would be only $4.7 billion, or $1.2 billion less than in FY 1993. Neither of those outcomes is desirable. However, if both the first and the second strategies were successful (sales totaled $5.9 billion and costs less than $900 million were incurred), then an operational costs to sales ratio of .15 would be achieved, which would be .04 less than the stated target objective. DeCA needs to establish a more aggressive operational costs to sales goal that is consistent with planned initiatives.

Customer Service. The management data that DeCA selected were not adequate in assessing customer service because the strategy or effectiveness measure of maintaining in-stock rates of 94 percent or higher was largely irrelevant in today's store operating environment. The use of in-stock rates as a store performance indicator of customer service predates the establishment of DeCA. When the Military Departments operated the commissaries, in-stock rate objectives of 94 percent or higher were used. The stock rates were valid indicators of performance when commissaries used large warehouses attached to the retail stores to meet day-to-day sales requirements. Keeping shelves in stock required stores to exert good supply management practices and employ ample manpower. Accordingly, the in-stock rate provided a means of measuring a store's ability to keep shelves filled. Today, however, commissary stores play a substantially diminished role in maintaining high in-stock rates.

Under DeCA, more efficient delivery systems have been put in place, which have eliminated the warehouses and much of the manpower from commissary store operations. The new delivery systems are based on the principle "just-in-time" and include frequent delivery and direct store delivery systems. The systems feature low stockage and emphasize prompt vendor delivery as a means of keeping merchandise in stock. As such, in-stock rates have little value to management as they represent only a specific time; and stock positions can change rapidly under frequent and direct delivery systems. The managers at the 22 stores we reviewed believed that in-stock rates should not be used to measure store performance in providing customer service. No managers could identify any customer service decisions made as a result of in-stock rates since the establishment of DeCA. DeCA needs to determine, with store manager participation, a useful performance measure for increasing and evaluating customer service, such as use of customer surveys.

Part III - Findings and Recommendations

Finding A. Manufacturer Prices

Prescribed procedures for verifying that DeCA was receiving the most favorable prices were not followed. The condition occurred because DeCA believed that sufficient competition already existed to ensure that manufacturer prices were most favorable. As a result, opportunities were being lost for further reductions in prices charged commissary customers.

Background

Commissary Benefit. Achieving customer savings may be DeCA's most important objective because savings represent the principal commissary benefit to service members and their families. To maximize savings, commissaries must buy merchandise at a manufacturer's most favorable price because, by law, the commissaries must sell the merchandise at the same price. As part of its strategic planning process, DeCA established a target objective of 25 percent savings for customers by FY 1998, which translates to about $1.5 billion in savings on FY 1993 sales of $5.9 billion.

Supply Bulletins. DeCA purchases most of its resale stock through supply bulletins issued by the Defense Personnel Support Center. Supply bulletins are essentially agreements by manufacturers to sell merchandise, particularly brand name items, to the government under certain terms and at specified maximum and most favorable prices. Within the continental United States, individual regions of DeCA place contractual orders against the supply bulletins based on store requirements. The orders are often established at prices less than those quoted in supply bulletins, based on agreements reached by the regions and the brokers or agents who represent the manufacturers. For overseas, the Defense Personnel Support Center places contractual orders based on store requirements. At the time of our review, DeCA was in the process of assuming the responsibility for awarding supply bulletins. DeCA plans to implement a new contracting arrangement, whereby a resale ordering agreement (a single contract agreement) will replace supply bulletins and region orders.

Commissary Prices

To determine whether manufacturers supplied merchandise at prices equal to or lower than the prices offered to their most favored customers, we reviewed in-house price comparison evaluations and made several price comparisons. For

our review, we selected 107 line items using judgmental and statistical sampling techniques (see Appendix D for our selection methodology). The 107 line items were supplied by 69 major manufacturers whose sales to the commissary system totaled about $2.5 billion in FY 1993. Our sample line items accounted for about $194 million of those sales. For comparison purposes, we requested and analyzed pricing information from five regions in the continental United States.

Commercial Retailers. Manufacturers sold merchandise to DeCA at prices higher than those sold to commercial retailers of similar size. To determine customer savings, the Wirthlin Group compared groups of like items (for example, jars of mayonnaise) sold in commissaries and similar retail stores. In total, the groups consisted of about 2,500 line items at each of the 30 stores sampled. The Wirthlin Group reported that commissary customers saved an average of 23.4 percent in FY 1993. However, about 71 percent of the Wirthlin Group's comparisons included matches of specific brand names and sizes. Where identical matches occurred, customer savings amounted to an average of 18.4 percent. We analyzed the profit and loss statements of two large commercial retail stores included in the Wirthlin Group study and found that both had incurred operating expenses of about 25 percent above the cost of merchandise sold. In other words, the commercial retailers would have had to sell merchandise at a loss if they charged only 18.4 percent more than the commissaries. It is possible that commercial retailers sold some of the items at a loss in order to attract customers to their stores, a sales tactic of marking down merchandise as "loss leaders." It is also possible that commercial retailers received a better price because they had storage facilities to buy in bulk. However, another possibility is that commercial retailers received more favorable prices from manufacturers than commissaries.

Before contracting with the Wirthlin Group, DeCA determined customer savings by conducting regional pricing surveys, such as the survey conducted by the southern region in early 1993. The southern region furnished stores with a cross-section list of 124 line items including grocery, dairy, meat, and produce products. One commissary reported that its selling price was higher for 36 (30 percent) of the line items than 1 or both of 2 comparable commercial retailers in the area. Customers at that commissary store paid an average of 20 percent more for the 36 line items than they would have if they had shopped at the commercial retailers. Again, higher commissary prices could be attributed to DeCA not receiving the most favorable price from manufacturers.

Exchange Service. Manufactures sold merchandise to DeCA at prices higher than they did to the Army and Air Force Exchange Service. Of the 107 line items in our sample, 53 were also sold in the exchange service. We compared the prices that DeCA (5 regions) and the exchange service paid during December 1993 for the 53 line items. For 17 of the 53 line items, DeCA paid less than the exchange service. However, for 17 other line items, DeCA paid

an average of 15 percent more than the exchange service. The Army and Air Force Exchange Service has the storage capability to buy in bulk and the ability to employ the loss leader sales tactic. It is also possible that DeCA did not receive the most favorable price from manufacturers. Appendix E contains details of our price comparison on the Army and Air Force Exchange Service and an additional comparison on regional prices.

Ensuring Favorable Prices

DeCA and the Defense Personnel Support Center did not follow contractual procedures for determining whether manufacturers were charging the most favorable prices for resale merchandise. In agreeing to the terms of supply bulletins, manufacturers warrant that all prices offered the government are as advantageous as the prices offered their most favorable customer. The warranty essentially takes the place of competition and other recognized means of determining price reasonableness such as price analysis. However, the warranty is subject to verification. The warranty specifically states:

> To assure compliance with the above warranty, the offerer agrees that the contracting officer shall have the right to examine books, documents, records, and any other evidence necessary to determine the basis for the price offered. Should such an examination reveal any instances of overpricing, the offerer agrees to reimburse the Government for the amount.

DeCA personnel believed that sufficient competitiveness was being achieved if periodic local price surveys showed that comparable merchandise was being sold for 25 percent less than at commercial stores. At the Defense Personnel Support Center, personnel told us that sufficient competitiveness was being achieved because of the desire of manufacturers to sell their products. The rationale of DeCA and the Defense Personnel Support Center essentially makes the customer responsible for making sure they receive most favorable prices. Such rationale may have logic regarding promoting competition but it should not be used as a substitute for ensuring that manufacturers comply with contractual requirements and that customers achieve maximum savings.

Instead of verifying vendor prices as most favorable, DeCA planned to increase customer savings by decreasing the costs to food manufacturers doing business with the commissary system. DeCA devised six strategies to achieve customer savings. It was to:

o improve the bill-paying process with increased emphasis on delivery ticket invoice and improvements in the reconciliation process.

o implement efficient consumer response.

o improve the buying practices of commissary buyers through education and training.

o use variable pricing, such as marking prices up and down.

o increase coupon availability and use and to increase electronic checkout.

o increase national and central buys for larger quantity discounts.

While the six strategies may result in increased efficiencies and reduced costs to manufacturers and customers, none have the potential and the direct impact of maximizing customer savings as ensuring that manufacturers are supplying merchandise at the most favorable prices.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Commissary Agency:

1. Develop procedures for regularly verifying that manufacturer prices are most favorable.

Management Comments. The Director, DeCA, partially concurred with the recommendation, but stated that validation of manufacturer prices on a regular or recurring basis through examination of books, documents, and other records would significantly increase the cost of doing business with the Government, and increase prices. Further, DeCA plans to develop formal criteria for the price audit of a manufacturer only when there is "probable cause" to believe a manufacturer's prices are not "most favorable." The target date for full implementation of the planned actions is March 31, 1995.

Audit Response. We agree that a targeted approach would be the most practical. DeCA's planned actions satisfy the intent of our recommendation.

2. Establish the verification of manufacturer prices, where warranted, as a strategy for increasing customer savings in the Defense Commissary Agency Strategic Plan.

Management Comments. The Director, DeCA, nonconcurred with the recommendation and stated that verification of manufacturer prices on a regular

or recurring basis would increase the cost of doing business with the Government, thereby increasing commissary prices. He also stated that verification of manufacturer prices would be counterproductive as a strategy for increasing customer savings.

Audit Response. Our recommendations were made with the intent that verifications would be performed only when warranted. The wording of Recommendation 2. has been clarified to that effect. With DeCA's establishment of "probable cause" criteria, it would be logical for DeCA to acknowledge this cost control mechanism in its strategic plan. We request that the Director, DeCA, reconsider his position and provide additional comments to this final report.

Finding B. Operational Costs

DeCA did not fully comply with the unit cost concept for improving visibility over operational costs. The condition occurred because the unit cost concept was not extended to measure the productivity of cost expenditures at all management levels. As a result, measuring progress toward DeCA's strategic goal of enhancing the effectiveness and efficiency of commissary operations at all levels will be impeded.

Background

Unit cost is a concept that DoD adopted to enhance the visibility of costs and to contribute to better management of resources. The unit cost, or cost per output, concept is that all costs incurred within a function should be related to an output of the function. The primary advantage of unit cost is that it provides management excellent visibility of cost drivers (those actions that contribute to increased costs and the production of an output) and allows management to track cost per output and to monitor productivity. It also encourages management to look at all costs so that managers can apply judgment to get the job done better and at less cost. The goal of unit cost is to capture data so that the cost of each output or product is as accurate as possible. The success of the unit cost concept depends on how well it is supported and the level of cost-consciousness reached and sustained by everyone in the process.

The primary output (reflection of primary mission of an organization) of DeCA is the dollar value of sales to customers. In its FY 1993 financial statements, DeCA reported that it had achieved a unit cost ratio of $0.207 per dollar value of sales. In its annual operating budget, the Comptroller of the DoD set DeCA's FY 1994 unit cost goal at $0.196 per dollar value of sales. For its strategic planning process, DeCA established a unit cost goal of $0.19 per dollar value of sales to be achieved by FY 1997. As part of DoD's improvement plan for the Defense Business Operations Fund, the Comptroller of the DoD has initiated action to reenergize the unit cost concept by establishing an expert team to continuously review, improve, and validate new measures.

Cost Expenditures

DeCA did not fully comply with the unit cost concept for improving visibility over operational costs because it did not establish unit cost goals for all of its significant cost expenditures. DeCA calculated its FY 1994 unit cost goal of

significant cost expenditures. DeCA calculated its FY 1994 unit cost goal of 0.196 by dividing all planned cost expenditures by the total estimated sales. As such, DeCA related all costs to sales, its primary output. Following the same reasoning, DeCA also established individual goals for each of its seven regions. However, DeCA did not establish individual goals for planned cost expenditures outside of its regions, which amounted to about $373 million (32 percent) of its budget. The cost expenditures included items such as second destination transportation charges ($127 million), centrally funded military pay ($78 million), service center fees ($30 million), and general and administrative expense ($27 million). The expenditures could be prorated to regions and included in the region's goals, or the expenditures could be related to secondary outputs (other than sales) with separate individual goals. In other words, the costs need to be related to or assigned to specific outputs and monitored by the management level that is in the best position to evaluate and influence productivity.

Management Levels

DeCA also did not establish unit cost goals for all its management levels. DeCA established FY 1994 unit cost goals for its regions, which established goals for their stores. However, no goals were established for operations and departments within the stores where most commissary costs are incurred. To determine the opportunity for reducing costs at the store level, we discussed the unit cost concept with the managers of 12 stores in the southwest region; and we reviewed cost information accumulated for the stores by the Defense Finance and Accounting Service - Columbus Center. The Defense Finance and Accounting Service - Columbus Center accumulates cost data based on store employees charging their time to any of 66 accounting codes, such as grocery department and meat department. That information is provided monthly to DeCA headquarters.

None of the 12 store managers were aware of their unit cost goal, understood the unit cost concept, or knew the cost of their store operations. Our analysis of store cost information showed a wide disparity in the cost of many operations and departments among similarly sized stores. For example, at the end of FY 1993 the commissary store at the Naval Training Center in San Diego achieved a unit cost of 0.1026 on sales of about $10.3 million. Less than 8 miles away, the commissary store at the North Island Air Station achieved a unit cost of 0.1003 on sales of about $8.1 million. On the surface, the stores appeared to be equally efficient, based on comparable unit cost ratios. However, the Naval Training Center store had only 27 percent more sales than the North Island Air Station store, but spent about 123 percent more on front end operations (cashiers). That is not to say that either operation was

inefficient. Rather, it serves as an illustration of how potential cost cutting areas can be identified by analyzing available cost information and establishing unit cost goals for store operations. Establishing unit cost goals for store operations and departments would also heighten the cost-consciousness of store managers and help them to focus on operations with the most potential for cost savings.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Commissary Agency:

1. Assign, in coordination with the Comptroller of the DoD, output measures and the responsibility for monitoring all significant commissary costs.

Management Comments. The Director, DeCA, nonconcurred with the recommendation. The Director stated that DoD unit cost guidance does not require that all costs be directly related to specific output. He stated that DeCA Headquarters and its service centers provide overhead support and manage centralized programs such as accounting and bill paying, transportation over water, and military personnel reimbursement. The Director believes that it is imprudent to put those overhead and support costs on a unit cost basis with sales. He further believes that it would not be prudent to prorate those costs to the respective regions or commissaries and include them in the regions' unit cost goals, because at present the regions and the commissaries do not have direct control over those costs.

Audit Response. The Director's comments are not responsive. We agree that unit cost goals should be assigned to management levels that have direct control over the costs. The issue is the assignment of output measures. DoD guidance provides that as much cost as possible should be allocated to an organization's outputs. Accordingly, overseas sales could be designated as an output measure for transportation over water costs of $127 million, regardless of what activity manages transportation costs. Similarly, sales of regions and stores who employ military personnel could be designated as an output measure for military pay of $78 million, regardless of what activity manages military pay. Also, an alternative output to sales, such as the number of vouchers processed, could not be designated as an output measurement for service center expenditures of $30 million. Allocating outputs to costs provides a means of measuring the efficiency of expenditures. We request that the Director, DeCA, reconsider his position and provide additional comments to this report.

2. Develop unit cost goals for operations and departments within stores.

Management Comments. The Director, DeCA, partially concurred with the recommendation. The Director stated that DoD policy is to establish unit cost goals at the lowest organization within a component, which is managed as a single entity. Within DeCA, the lowest organization is the region. He stated that development of unit cost goals at the commissary level and for departments within stores would be very time consuming and would require the expenditure of significant additional resources at the region level to oversee the administration of those unit cost goals, with no real significant benefits to DeCA. The Director further stated that DeCA would obtain and use financial data for management and cost analysis at region and Headquarters levels.

Audit Response. The Director's comments are not fully responsive. DoD guidance provides that the success of managing cost depends on the degree to which goals are allocated down to lower levels of the organization and states that this could be as low as a branch or even a section of an organization. DeCA's position that it would be too costly and too time consuming to extend unit cost goals to operations and departments within stores has not been substantiated. Commissary stores manage costs as single entities and would benefit from goal allocation. Allocating unit cost goals just to regions not only hinders the success of the unit cost concept but makes inefficient use of an automated accounting system set up to budget and capture cost expenditures at store level and lower. We request that the Director, DeCA, reconsider his position and provide additional comments to this report.

Finding C. Customer Service

DeCA's practice of physically observing and counting merchandise to determine in-stock rates did not provide useful management information with which to measure the improvement of customer service. The condition occurred because the practice has generated data that are unreliable and no longer relevant in today's commissary operating environment. As a result, DeCA will not make the most effective use of about $3.2 million in labor expenditures and will have misleading performance measurement data.

Background

The strategic goal of maximizing customer satisfaction was to be achieved by increasing customer savings as well as customer service at the store level. To increase customer service at the store level, DeCA established the strategy of maintaining high in-stock rates of items carried at stores. The Defense Business Operations Fund's in-stock effectiveness measure for commissary resale stock is 94 percent for FY 1994. For its strategic planning, DeCA established various in-stock rates to be maintained. Within the continental United States, the rate was 98 percent at a store's opening and 95 percent during operating hours. Outside the continental United States, the rate was 95 percent at a store's opening and 92 percent during operating hours.

DeCA Directive 70-6, "Financial Procedures for Store Management Support Center," July 23, 1993, provides procedures for stores to follow in computing and reporting in-stock rates. Stores are to compute in-stock rates by counting the number of shelf labels in the store and the number of items not in stock. The difference between the two is divided by the number of shelf labels. Commissary stores are to report quarterly, in statistical data reports, the average monthly combined in-stock rate for all chilled items (to include prepackaged meats and poultry), frozen goods, and semiperishable (dry) grocery items. Processed meats and produce are to be excluded in computing and reporting in-stock rates.

Physical Observance and Counting of Merchandise

The practice of physically observing and counting merchandise to determine in-stock rates is ineffective and too costly because it has generated data that are

unreliable and no longer relevant in today's commissary operating environment. To determine the effectiveness of computing and reporting in-stock rates, we reviewed operations and questioned managers at 22 stores in DeCA's southern and southwest regions. According to statistical data reports for the 3 months ended September 30, 1993, 20 of the 22 stores reported in-stock rates of 97 percent or better; the two other stores reported in-stock rates of 95 percent and 96 percent. However, the stores did not retain details on the computations. The stores' procedures for computing and reporting in-stock rates did not state how the computations should be documented, who should make the computations, and how often the computations should be made.

To determine how the 22 stores computed in-stock rates, we questioned managers and observed in-stock counts in December 1993 and January 1994. At the 22 stores:

o 6 counted shelf labels as the basis for computing in-stock rates. Other stores used less reliable means, including sales statistics and estimates.

o 13 included all required merchandise in their in-stock computations. The remaining nine stores did not include direct store delivery items, which included snack foods, bread, and dairy products. The 13 stores took an average of 1.17 hours to identify items not in stock, the range was from 0.5 hours to 3.5 hours. The wide range was attributed primarily to some stores merely making sight inspections rather than using scanning equipment.

o 2 stores made sufficient computations to project results as a monthly average. Most stores computed in-stock rates 1 day a week, once before stores opened and again in the afternoon during operating hours. Such computations provided only the daily average of in-stock rate for the 4 or 5 days the computations were made each month.

From our observations and discussions, we concluded that the 22 stores have not made effective computations of in-stock rates and the results generated have not been reliable. While in-stock computations could be made more effective, the cost of following current procedures would be prohibitive. For example, accurately identifying items not in stock could cost about $3.2 million a year. Additionally, counting shelf labels daily would add considerably to the annual cost. The 22 stores employed personnel of various skill levels to make in-stock computations, from inventory clerks to assistant store managers. Our computation of labor costs is based on an employee (GS-5, step 5) earning $12.47 an hour making two computations of 1.17 hours each, daily, for the 300 days that the 362 commissary stores are open each year. Moreover, dedicating additional resources to effectively compute in-stock rates as currently called for is not warranted because even reliable results would not have any relevancy to DeCA's strategic objective of increasing customer service at the store level. In today's store operating environment of maintaining little or no

backup stock, high in-stock rates are more a reflection of vendor delivery proficiency than store initiative (see Part II, Adequacy of Data, "High In-Stock Rates").

Recommendation for Corrective Action

We recommend that the Director, Defense Commissary Agency, streamline or discontinue the practice of physically computing in-stock rates as a means of assessing and increasing customer service at the store level.

Management Comments. The Director, DeCA, concurred with the recommendation. He stated that new standardized streamlined procedures for computing in-stock rates will be in place by September 1, 1994.

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Part IV - Additional Information

Appendix A. Analysis of the Wirthlin Group Study

The Market Basket Price Comparison Study was performed by the Wirthlin Group (the prime contractor) and what appeared to be four subcontractors. Although powerful market research tools have been applied by the subcontractors, the Wirthlin Group's study report produces no valid measure of price difference between commercial stores and DeCA commissaries. The five major steps of the study were to:

o identify the target population,

o determine how the population spends its money,

o select items that represent the expense categories for which segments spend their money,

o survey prices of the selected items in the locations or areas of interest, and

o analyze costs of selected items and aggregate items according to the relative importance of each.

The prime contractor wove together several data gathering and analysis techniques, none of which allowed for statistical inference, because of flaws in the selection process. The objective of the sampling plan used in the study was "to provide a sample that was representative of each of the Military Departments ... within the continental United States." To ensure that a representative sample was taken, the study purported to employ "purposive sampling by strata, which included DeCA Region and commissary size." The objective and purported methodology selected were appropriate. However, the 46 sampled commissaries were not selected randomly within cells (strata). Had this been done, the analysis could have been done using statistical inference with confidence and precision. Statistical estimates can only be made by random selection within cells. Without randomization, probabilities cannot be established and the coverage cannot be considered truly representative. Thus, the results produced in the study portray only the sites actually selected and tested. Nevertheless, the study purports to show savings of 23.4 percent based on a nonrepresentative but purposive sample. To imply that the calculated savings figure represents the universe of commissaries is invalid. Given the methodology described in the design and data analysis segment of the study report, it is impossible to know how far from the truth the 23.4 percent "savings" falls. Also, several questionable analysis procedures were used to get the various "average percent differences." Examples follow.

o In the Summary Report, Table 1 lists six regional savings percents. An unweighted means of those percents was used to calculate the 23.4 percent figure. Because the various cells have different universe sizes, the results should have been assigned weights before averaging.

o In the Summary Report, the use of paired comparisons using the Wilcoxon Signed Rank Test (a substitute, nonparametric method for the matched-pair "t" test) is discussed. To use this test, we must assume at least a rank measurement scale and have randomly selected pairs to compare. The selection of paired locations appears to have been totally judgmental, not allowing for a probabilistic hypothesis test. Also, the signed rank results are based on average ranks (medians). Taking the unweighted mean of these medians is not a valid analysis procedure.

In effect, the summary report gives little or no valid information on how much the commissaries may save the service member. The problem can be fixed for future studies if a proper statistical stratification is designed, executed, and analyzed.

Appendix B. Management Comments on the Wirthlin Group Study and Audit Response

Management Comments. The Director, DeCA, disagreed with our discussion on savings reported by the Wirthlin Group study. He stated that DeCA's estimated savings is an accurate and representative estimate of savings for commissary patrons. Stratified random sampling of commissaries was considered and rejected to ensure a representative number of commissaries was selected from the different Services, commissary regions and store sizes. He further stated that the selection of commissary locations is only one of the important steps in ensuring a representative estimate of savings. Equally important are the selection of commercial stores, the selection of product and service categories, the selection of specific items within those categories, the determination of buying patterns for the categories, and accurate and consistent collection of price data. The Director also stated that the savings estimate is based on the mean of the savings from the entire sample of commissaries. He stated that the sample does not ignore universe weights; rather it is self-weighting because it represents the commissaries in the system (proportional) based on the Service, regional geography, and store size.

Audit Response. The results of the Wirthlin Group study are technically inconclusive and should not be relied on for decision making. The use of statistical design with imbedded random selection has practicality wherever reliable and defendable estimates are required. The computational and statistical methodologies applied by the Wirthlin Group study depend on probability distributions; and probability distributions depend on selection with some element of randomness, such as simple random, stratified random, cluster random, and multistage random. Sampling can be purposive (designed with some thought as to what variables need to be highlighted in the result) and still be statistical if the ultimate cell selections are random. After variables are defined and established, multiple locations within those defined cells would still exist. The selections of specific locations (stores) within cells must be random to ensure representation of that cross-sectional cell. The defined cells would likely contain unequal numbers of locations. Thus, universe weights must be attached to avoid computational bias. Random selection and the assignment of weights are always possible and easily done. Nevertheless, the Wirthlin Group study purports to be representative without employing random sampling techniques and calculates estimated savings without assigning weights. Moreover, the Wirthlin Group study implies validity to its results by bounding its calculation of estimated savings with upper and lower limits. By not employing random sampling and assigning weights, the results of the Wirthlin Group study are potentially nonrepresentative and biased.

Appendix C. Other Management Comments and Audit Response

Management Comments on Internal Controls. The Director, DeCA, disagreed that internal controls were not adequate to ensure that useful management data were available to assess and report on commissary program performance and mission goal achievement in increasing customer savings, reducing operational costs, and improving customer service. He stated that the three performance measures that we reviewed were not the only information used to monitor commissary program performance and achievement of mission goals.

Audit Response. We recognize that the three performance measures we selected for review are not the only information used to monitor commissary program performance and achievement of mission goals. We selected the performance measures -- price savings to customers of 25 percent, total operational cost to sales ratio of .19, and inventory in-stock rates of 94 percent or better -- because they were identified by DeCA as directly relating to its mission of operating an efficient and cost-effective commissary to provide a nonpay benefit to its customers.

Management Comments on In-Stock Rates. The Director, DeCA, provided additional comments on the relevancy of in-stock rates. The Director stated that computing in-stock rates is relevant in today's operating environment. He stated that the in-stock rate is an important area in increasing customer service. About 18 percent of DeCA's comments received from patrons addressed products not being in stock in FY 1993 as compared to 11 percent to date in FY 1994. The Director believes that the decrease in comments about the in-stock rate implies that the commissary system is doing a better job of in-stock management and that continued monitoring of the in-stock rate emphasizes DeCA's commitment to continuous improvement in customer satisfaction by making sure desired products are available for selection. Customer service standards must be based on customer definitions of equality and service. In October 1991, representatives of all the Services confirmed that in-stock rates are an important dimension of quality.

Audit Response. We agree that customer satisfaction can be affected by whether or not an item is in stock. However, it has not been demonstrated that computing in-stock rates has had any effect on increasing customer satisfaction. The 7-percent decrease in customer complaints cited by DeCA cannot be correlated to any computation of in-stock rates. Based on our review, in-stock rates have remained virtually unchanged. At the 22 stores we evaluated in the southern and southwest regions, the average in-stock rate increased from 98.00606 percent to 98.03333 percent between the fourth quarter of FY 1993 and the second quarter of FY 1994. This suggests that customer stockage complaints have decreased even though in-stock rates have not changed. We believe a goal's relevancy depends on identifying realistic improvement and on how much influence management has over its achievement. At most stores, the

potential for improving in-stock rates is only about 2 percent and that figure is limited because lack of stock has been largely attributable to tardiness in vendor delivery as opposed to deficiencies in store stock management.

Appendix D. Sample Selection Methodology

We selected a sample of 107 line items to make price comparisons between and among commissary regions and stores and other comparable retail markets. For the sampled items, DeCA purchased about $194 million of merchandise in FY 1993 from 69 manufacturers. We selected the 107 line items from 3 sources.

Source 1: Military Audits of Market Information, Incorporated. The organization publishes an annual list of the top 400 line items sold to DeCA, excluding cigarettes and soda. For FY 1993, each line of the 400 line items had annual purchases of at least $1 million. We judgmentally selected 59 line items with annual purchases of $126.9 million for FY 1993.

Source 2: Military Audits of Market Information, Incorporated. The organization also publishes an annual list of cigarette and soda line items sold to DeCA. We judgmentally selected four cigarette and soda line items with annual purchases of $48.7 million for FY 1993.

Source 3: DeCA Master Stockage List. The list contains 2,725 line items that all commissary stores must keep in stock. We randomly selected 44 line items with annual purchases of $18.7 million for FY 1993.

Appendix E. Inspector General, DoD, Price Comparisons

DeCA Versus Army and Air Force Exchange Service (December 1993)

Commissary Prices	Items Compared	Annual Sales (millions)
Lower	17	$60
Same	19	30
Higher	17	18

For the 17 higher priced items, the aggregate commissary price was $30.16 as compared to $25.78 for the exchange service, a 15-percent difference.

Comparison of Five Regions Within the Continental United States (December 1993)

Region Prices	Items Compared	Annual Sales (millions)
Same	71	$137
Different	33	42

For the 33 differently priced items, the 5 regions' aggregate high price was $60.99 compared to an aggregate low price of $52.91, a 13-percent difference.

Appendix F.Organizations Visited or Contacted

Defense Organizations

Army and Air Force Exchange Service, Dallas, TX
Defense Commissary Agency, Headquarters, Fort Lee, Petersburg, VA
Defense Commissary Agency, Central Region Headquarters, Little Creek Naval Amphibious Base, Virginia Beach, VA
Defense Commissary Agency, Midwest Region Headquarters, Kelly Air Force Base, San Antonio, TX
Defense Commissary Agency, Northeast Region Headquarters, Fort Meade, Laurel, MD
Defense Commissary Agency, Northwest/Pacific Region Headquarters, Fort Lewis, Tacoma, WA
Defense Commissary Agency, Southern Region Headquarters, Maxwell Air Force Base, Montgomery, AL
- Cecil Field Naval Air Station Commissary Resale Store, Jacksonville, FL
- Eglin Air Force Base Commissary Resale Store, Eglin Air Force Base, Valpariso, FL
- Fort Gillem Commissary Resale Store, Forest Park, GA
- Fort McClellan Commissary Resale Store, Fort McClellan, Anniston, AL
- Fort McPherson Commissary Resale Store, Fort McPherson, Atlanta, GA
- Jacksonville Naval Air Station Commissary Resale Store, Jacksonville, FL
- Kings Bay Naval Submarine Base Commissary Resale Store, Kings Bay, GA
- Mayport Naval Station Commissary Resale Store, Mayport, FL
- Pensacola Naval Air Station Commissary Resale Store, Pensacola, FL
- Whiting Field Naval Air Station Commissary Resale Store, Milton, FL

Defense Commissary Agency, Southwest Region Headquarters, El Toro Marine Corps Air Station, Santa Ana, CA
- Beale Air Force Base Commissary Resale Store, Beale Air Force Base, Marysville, CA
- Camp Pendleton Marine Corps Air Station Commissary Resale Store, Camp Pendleton, CA
- Imperial Beach Naval Air Station Commissary Resale Store, Imperial Beach, CA
- March Air Force Base Commissary Resale Store, Riverside, CA
- McClellan Air Force Base Commissary Resale Store, Sacramento, CA
- Miramar Naval Air Station Commissary Resale Store, Miramar, CA
- North Island Naval Air Station Commissary Resale Store, North Island, CA
- Oakland Army Base Commissary Resale Store, Oakland, CA
- Presidio of San Francisco Commissary Resale Store, San Francisco, CA
- San Diego Naval Station Commissary Resale Store, San Diego, CA
- San Diego Naval Training Center Commissary Resale Store, San Diego, CA
- Travis Air Force Base Commissary Resale Store, Travis Air Force Base, Fairfield, CA

Defense Finance and Accounting Service - Columbus Center, Columbus, OH
Defense Logistics Agency
Defense Personnel Support Center, Philadelphia, PA

Non-Defense Organizations

American Logistics Association, Washington, DC
Military Audits of Market Information, Inc., Bethesda, MD
The Wirthlin Group, McLean, VA

Appendix G. Report Distribution

Office of the Secretary of Defense

Assistant Secretary of Defense for Personnel and Readiness
Comptroller of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Naval Audit Service

Department of the Air Force

Auditor General, Air Force Audit Agency

Defense Organizations

Director, Defense Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
National Security and International Affairs Division, Technical Information Center
National Security and International Affairs Division, Defense and National Aeronautics and Space Administration Management Issues
National Security and International Affairs Division, Military Operations and Capabilities Issues

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

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

Part V - Management Comments

DeCA Comments

DEFENSE COMMISSARY AGENCY
HEADQUARTERS
FORT LEE, VIRGINIA 23801-6300

REPLY TO
ATTENTION OF

CC

JUN 30 1994

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

SUBJECT: Audit Report on Commissary Management Data (Project No. 3LA-2070)

Reference: DoDIG Memorandum, dtd May 18, 1994, SAB.

I was disappointed that more changes had not been made to the referenced memorandum after the lengthy conversation we had when you forwarded the working draft report for my earlier review. As I indicated at that time, I believed your team had used incorrect and inappropriate criteria in arriving at your conclusions. Those conclusions were particularly accusatory since they addressed this Agency's ability to deliver the benefit and then concluded that we had failed in that mission.

It is with regret that I must forward the attached response because I have always appreciated the valuable function your unbiased review of DeCA initiatives and actions provided. In the past your input has been extremely valuable in my performance of the decision making process. However, I cannot agree with your conclusion that the current audit disclosed material internal control weaknesses as indicated by your statement "Internal controls were not adequate to ensure that useful management data were available to assess and report on commissary program performance and mission goal achievement in increasing customer savings, reducing operational costs, and improving customer service." The three performance measures reviewed by the DoDIG are not the only information used to monitor commissary program performance and achievement of mission goals. For example, DeCA also uses Customer Service Evaluation System, customer feedback program, budget reviews, internal IG assessments, as well as other measures. DeCA does not solely rely on the three performance measures, evaluated in this audit, to assess and report program performance as inferred in the report.

The report indicates that DeCA's target objective of achieving 25 percent customer savings by FY 1998 is the final target objective for savings. It is DeCA's objective for 1998 but does not reflect DeCA's true/full potential. DeCA's objective is to continually improve savings to the patron. All DeCA's strategic goals and objectives are reviewed annually in accordance with the Government Performance and Results Act of 1993 and Executive Order 12862, Setting Customer Service Standards.

Additionally, I disagree with the statement that the present level of savings identified through the Wirthlin study is not

valid. The Wirthlin Group, with their analytical expertise, and my staff of operations research professionals planned and executed the market basket survey taking into consideration the various aspects required to accomplish a valid statistically sound study. The Wirthlin Group and my analytical staff have addressed your concerns in the first attachment.

Attachment 2 provides DeCA's response to your findings and recommendations. If you have any questions, please contact me.

RICHARD E. BEALE, JR.
Major General, USA
Director

Attachments:
As Stated

Response to DoDIG Comments

We do not agree with the DoDIG assertion that the estimated savings determined in the *1992 Market Basket Price Comparison Study* is not an accurate and representative estimate of savings for commissary patrons. Moreover, a number of comments in the DoDIG Draft Report suggest the reviewer neither understands nor appreciates thoroughly the complexity of the study.

The draft report overstates the importance of random sampling of commissaries and wrongly concludes that because random selection of commissary locations was not used the estimated savings is not representative of actual savings. The following comments are taken from the DoDIG draft report:

> *The data gathering and analysis techniques used did not allow for statistical inferences because of flaws in the selection process.*
>
> *DoDIG agrees with the purposive sampling by strata up to the point where the actual commissaries were selected. Random within cell selection was not used. because of this, statistical inference with confidence and precision cannot be used.*
>
> *The DoDIG believes in stratification for getting representative coverage and maximum spread. Statistical estimates can only be made with random selection at locations within cells.*
>
> *The coverage is not truly representative since results with known probabilities are not possible without randomization.*
>
> *Lack of randomization within the strata/cells allows the existence of "non-sampling error" of unknown magnitude. The results produced in the study portray only the sites actually selected and tested.*
>
> *In the summary report, Table 1 - six regional savings percents. It appears that an unweighted mean of those percents has been calculated to arrive at the 23.4% figure. Since various cells have different universe sizes, it would seem implausible for a proper result to ignore universe weights.*
>
> *The DoDIG recommends for future studies the problem can be fixed, if proper statistical stratification is designed, executed, and analyzed.*

- Rather than *flawed*, as the DoDIG asserts, the sample selection process was *purposive*, that is done with purpose and foretnought. The use of stratified random sampling of commissaries was considered and rejected. The sampling approach was used to ensure a representative set of commissaries, while controlling for the three variables considered most important in possible variations in savings -- Service, DeCA region, and size. When judged by these three important criteria, the sample is representative of the CONUS commissaries in the DeCA system.

ATTACHMENT

- In an ideal world, random sampling within cell would be used; however, the actual selection was not arbitrary, as implied by DoDIG. It was done with purpose to meet other demands of the analysis. The selection of commissary locations is only one of the important steps in ensuring a representative estimate of savings Equally important are the selection of commercial stores, the selection of product and service categories, the selection of specific items within those categories, the determination of buying patterns for the categories, and accurate and consistent collection of price data. When these other factors were considered, the decision was made to use scanned price data for a portion of the data. This decision was made to enhance the representativeness of the savings estimate by including a larger number of grocery categories and items in the analysis than could have been collected on-site with given time and cost constraints. While generally available at both commissaries and commercial stores, scanned data were not available at all stores. Thus rather than random sampling, the median size commissary within each cell are selected, if price data were available at both commissary and commercial stores at that location. If not or in the case of multiple locations within a cell, the location(s) with available data that was nearest the median size was selected.

- The DoDIG draft report wrongly equates random selection and representativeness. Random selection does not guarantee representativeness. By its very nature the random process allows the chance that non-representative samples may be selected. Similarly, non-random processes that are rigorous, systematic, objective, and fair are commonly used to make representative estimates of systems. We believe that the *1992 Market Basket Price Comparison Study* does a excellent job in this regard, and that the approach provides a representative estimate superior to other approaches used in DoD.

- The DoDIG draft report correctly points out that "non-sampling error" of unknown magnitude exists. However, the implication that random selection of sites would eliminate non-sampling error is incorrect. Random selection, precision, and statistical inference attempt to quantify the extent of "sampling error."

- The DoDIG comments concerning regional savings and recommendations for future studies, illustrate the reviewer did not thoroughly understand the complexity of the study. The estimated savings are not the mean of the regional mean savings. The savings estimate is based on the mean of the savings from the entire sample of commissaries. This sample does not ignore universe weights; rather it is self-weighting since the sample is representative of the commissaries in the system (proportional) based on Service, regional geography, and size.

  Again, the recommendation of random sampling of commissaries within cell as a panacea in future studies is naive. It implies a "textbook" solution that suggests the selection of commissaries is the most important if not only variable in determining estimated savings. It ignores the "big picture," including the interaction among important considerations, such as selection of commissaries, selection of commercial stores, grocery category and item selection, shopping patterns, and accurate and consistent collection of prices.

The principal objective of the study was to accurately *determine differences between military commissary and private sector supermarket prices and the savings to an average patron, if 100 percent of that patron's purchases of such items are made at the commissary*. We believe the study accomplishes this objective in a superior fashion. Although providing a confidence interval for our estimate was not the main objective of the study, we felt some attempt to quantify a range within which actual savings might fall could be a useful guide to decision makers when comparing the importance of differences from year to year.

The DoDIG draft report correctly points out that "strictly speaking" we cannot, absent random sampling, generalize with statistical confidence to the entire system that the true estimate is expected to fall within that interval with some known probability. However, it was our judgement that, because of the objectivity and care taken to avoid bias, stratified proportionate nature of the sample, and actual sample results that generally reflect a symmetric distribution, the development of the confidence interval would provide useful insight to policy makers. This is clearly pointed out clearly on page 77 of the *1992 Market Basket Price Comparison Study*:

> *Because we did not use a random procedure it is impossible to calculate an exact probability that our estimate is with a specified confidence interval. However, we believe that the sample chosen was as likely, or more likely, to be representative of the savings distribution as a random sample. In order to estimate a confidence interval we have assumed that our sample, which had the benefit of stratification by Service, geographic region, and commissary size, is the equivalent of a simple random sample. In addition, we chose the Wilcoxon Signed Rank procedure to form our confidence interval which is quite robust. The Wilcoxon Signed Rank test is a distribution free procedure, which means that the data can have any distribution symmetric about the mean and need not be in the shape of a normal bell curve.*

DEFENSE COMMISSARY AGENCY REPLY

SUBJECT: Audit Report on Commissary Management Data (Project No. 3LA-2070)

Finding A. Customer Savings

Additional Facts:

Approximately 25% of purchases for commissaries are solicited on a competitive basis utilizing specifications or a commercial item description. The resultant contracts for these items, as with most other DOD contracts, do not contain a price warranty provision. The remaining 75% of commissary resale purchases are made on a brand name basis. Selection of the brand to be purchased is based on customer preference, which is largely influenced by the quality of the product and its relative price. The different brands of similar items compete on the shelf for customer selection. This results in true market place competition where the manufacturer's price structure is geared to sell to the commissary patron as opposed to the government. Consequently, pricing in the brand name resale arena is an extremely dynamic, complex, and volatile process. Offers are made to DeCA and private industry based on numerous variables which may be accepted in whole or in part. Among these variables are: (a) promotions with allowances for displays, government or commercial coupons, and in-store demonstrations, (b) allowances for warehouse slotting, distribution, and advertising (in-store and external), (c) period of purchase (forward buying), (d) vendor stocking, (e) guaranteed sales, (f) zone pricing, (g) delivery frequency, (h) quantity discount, (i) payment terms, and (j) store shelf space allocation, etc. The final price accepted by DeCA is the result of negotiations which consider all of these factors and current market conditions.

The current price warranty provision contained in the contractual arrangements for brand name resale merchandise provides for the contractor to offer to the "government" prices as advantageous as the prices offered the most favorable customer for comparable quantities under similar terms and conditions. The above variables must be considered in determining whether the same terms and conditions were utilized as a basis for the unit price offered to the government and the manufacturer's most favored commercial customer. The warranty provision does not require the supplier to offer all government entities (e.g., all DeCA regions/stores or AAFES) the same price, as inferred by the report, only that none of the prices offered to the government will be higher than the most favored commercial customer. To ensure compliance with the warranty, "the offeror agrees that the Contracting Officer shall have the right to examine books, documents, records, and any other evidence necessary to determine the basis for the prices offered. The examination will compare the

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average price paid by the Government versus commercial customers for the same item during the offeror's latest fiscal year. Should such an examination reveal any instances of overpricing, the offeror further agrees to reimburse the Government for that amount." The intent of the provision is not to conduct regular or ongoing audits of prices offered, but to provide for examination of the records when the contractor's price is inconsistent with the price in the market place or other information available would indicate that the contractor may not be offering the most favorable prices.

Currently, pricing inconsistencies are researched at store level with action taken by the ordering officer to obtain adjustment from the contractor when appropriate. If necessary, the issue is elevated to the region or higher until the matter is resolved. This is largely an informal process. DeCA Acquisition Regulation Supplement currently requires notification to DPSC "whenever brand name items listed in the Supply Bulletins are offered for purchase by anyone, other than the Supply Bulletin contractor or authorized representative, at a lower unit delivered price than that available from the Supply Bulletin."

The report refers to a savings of only 18.4% for exact matches as referred to in the Wirthlin Group Report. This figure is misleading as it is not weighted as it should be when computing patron savings. For example, if a patron buys an item and saves 10% and 9 units of an item (costing the same) that saves 30%, the real savings to the patron is 28% and not 20% (10 plus 30 divided by 2). Only by using a weighted average is the <u>true</u> savings determined.

Page 17 of the draft report refers to a DeCA strategy of using variable pricing, such as marking prices up and down to achieve customer savings. This was considered, but it is currently prohibited by law.

Recommendation. We recommend that the Director, DeCA:

1. Develop procedures for regularly verifying that manufacturer prices are most favorable.

2. Establish the verification of manufacturer prices as a strategy for increasing customer savings in the DeCA Strategic Plan.

Action Taken.

1. Concur in part. The recommendation suggests a schedule of regular and recurring manufacturer price audits. The cost of doing business with the government versus the commercial sector influences both the price offered for specific brands as well as the brands that are offered to the government for resale.

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Validation of contractors' prices on a regular or recurring basis through examination of the books, documents and other records of the contractor would significantly increase the cost of doing business with the government and have the result of increasing prices as opposed to price reduction. Validation in this manner is inconsistent with streamlining the government process and development of business partnership with industry. Therefore, DeCA intends to develop a set of formal criteria which will lead to a price audit of a manufacturer only when there is "probable cause" to believe, based either on input from patrons, from DeCA personnel, or from other sources, that price(s) which a manufacturer has provided to DeCA are not "most favorable." DeCA is currently in the process of issuing Resale Ordering Agreements (ROA) to replace brand name supply bulletins and brand name blanket purchase agreements. Instead of a unit price warranty provision, the ROA will contain a warranty provision which guarantees that the terms and conditions of the contractor's offers are as advantageous as the offers made to any commercial customer. Target date for full implementation of planned actions is March 31, 1995.

2. Nonconcur. Validation of contractors' prices on a regular or recurring basis through examination of the books, documents and other records of the contractor would significantly increase the cost of doing business with the government and have the result of increasing prices as opposed to price reduction. Therefore, verification of manufacturer prices in this manner is counterproductive as a strategy for increasing customer savings. Our plan for improving the buying practices and thus increasing customer savings is fully explained on page 17 of the draft report.

Finding B. Operational Costs

Additional Facts:

We do not agree with the following statements in the finding:

"DeCA did not fully comply with the unit cost concept for improving visibility over operational costs. The unit cost concept was not extended to measure the productivity of all cost expenditures at all management levels."

- DoD unit cost guidance does not require all costs be directly related to a specific output. The DoD Comptroller Policy Memorandum, dated October 15, 1990, on Unit Cost Resourcing Guidance states the following:

-- "Cost center managers, at all levels, should only be held accountable for costs if they know what they are and have some influence over those costs." (Refer to Section 7, paragraph B.1.).

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-- "An activity's earnings may reflect the sum of a number of different outputs, some on the basis of unit cost and some on another basis." (Refer to Section 10, paragraph C.3.).

-- "Some outputs may not have measurable units and will be funded on an actual cost or negotiated rate basis." (Refer to Section 7, paragraph A).

-- "Other outputs may be expressed on a unit cost basis, depending on the ability to develop unit cost measurements and who determines the level of work load." (Refer to Section 7, paragraph A.2.). (Note that the policy states "may," not "shall," and "... depending on the ability to develop unit cost measurements...").

- At Agency level, DeCA has established a unit cost goal that includes all costs. However, below Agency level, DeCA did not establish unit cost goals for costs outside of its seven regions because:

-- The DeCA unit cost output is commissary sales. This output applies directly only to the regions. They own, operate, and manage the commissaries that generate sales.

-- The DeCA Headquarters and Service Centers do not directly manage operations affecting sales. They provide overhead support and manage centralized programs such as accounting and bill paying, transportation over the water, military personnel reimbursement, and support from DLA and DPSC. It does not make good cost management sense to put these overhead and support costs on a unit cost basis with sales. For example:

--- The reimbursement of Military personnel costs to the Services is fixed and will not be affected by sales increases or decreases. Another example is workman's compensation; reimbursement to the Department of Labor is a fixed cost and will not be affected by sales increases or decreases. Therefore the regions and their commissaries have no control over the costs.

--- The reimbursement of costs for support from DFAS and DLA are not directly related to sales. That is why these programs are managed centrally at the Agency level and not funded at the region level. To develop a separate secondary output and unit cost for these requirements would be difficult and not be meaningful because the reimbursement is based on rates established by those Agencies.

--- Service center costs are not driven by sales.

--- Transportation costs are affected not only by sales but by other significant factors as well, such as shipping rates negotiated by other Agencies DeCA is mandated to use.

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- It would not make sense to prorate these costs to the regions or their commissaries and include them in the regions' unit cost goals because:

-- These costs are not directly affected by sales.

-- The regions and the commissaries cannot exercise direct control over these costs.

-- The DoD Comptroller Unit Cost Resourcing Guidance states that "Cost center managers, at all levels, should only be held accountable for costs if they know what they are and have some influence over these costs." (Emphasis supplied.)

- As stated in the Defense Business Operations Fund FY 1994 Budget Estimates Executive Summary, in regard to cost goals, "the type of goal depends on the nature of the business: some unit cost goals are established at the Departmental level; some activities have so many outputs that the goals are expressed in terms of change in cost from the prior year; other activities have goals expressed in terms of cost per billable hour." In accordance with DBOF concepts, DeCA has reduced these expenditures from prior years. For example, second destination transportation in FY 1994 is projected at $121.7 million, a reduction of 4 percent; and military pay expense is projected at $47 million in FY 1994, is a reduction of 40 percent from FY 1993.

"DeCA calculated its FY 1994 unit cost goal of .196 by dividing all planned cost expenditures by total estimated sales....These cost expenditures include items such as second destination charges ($127 million), centrally-funded military pay ($78 million), service center fees ($30 million), and general and administrative ($27 million)."

- The dollar amounts shown in this paragraph are incorrectly stated and do not total $373 million in cost expenditures outside the regions. The following are costs outside the regions from FY 1994: second destination transportation ($121.7 million), centrally-funded military pay ($47.0 million), service center fees ($23.9 million), DeCA headquarters ($28.5 million) and general and administrative ($134.9 million) for a total of $356.0 million.

"However no cost goals were established for operations and departments within the stores where most commissary cost are incurred".... "None of the 12 store managers were aware of their unit cost goal, understood the unit cost concept, or knew the cost of their store operations".... "Establishing unit cost goals for store operations and department"....

- The DoD Comptroller Policy Memorandum on Defense Business Operations Fund Financial Policy states in Section 6, Financial Management, paragraph 6.2.4, "Components will provide financial

goals to each level of activity managed in the DBOF, based on approved operating and capital budgets." Section 9, Definitions, paragraph C defines an "activity" as "the lowest organization within the component which is managed as a single entity."

- The lowest organization within DeCA managed as a single entity is the region. DeCA operates its commissaries on a region-based concept. Major operational and funding decisions are made and controlled at the region level. Region Directors/Commanders are held accountable for controlling commissary costs within their regions. As a result, DeCA did not establish unit cost goals at the commissary or department levels.

- Although commissary managers do not receive funding based on unit cost goals, they do receive cost targets bi-weekly from their region based on dollar targets/work hours. It is incorrect to state that "None of the 12 store managers...knew the cost of their store operations" because although they did not have unit cost goals, they do receive financial goals and cost data in other forms that are effective at that level for the day to day management of commissary operations and costs.

- Development of unit cost goals at the commissary level and for departments within stores would be very time consuming. It would require the expenditure of significant additional resources at region level to oversee the administration of these unit cost goals, with no real significant benefits to DeCA from the methods currently used by DeCA.

Recommendation. We recommend that the Director, DeCA:

1. Assign in coordination with the Comptroller of the DoD, output measures and the responsibility for monitoring all significant commissary costs.

2. Develop unit cost goals for operations and departments within stores.

Action Taken.

1. Nonconcur. DoD unit cost guidance does not require all costs be directly related to a specific output. This guidance further states that an activity's earnings may reflect the sum of a number of different outputs, some on the basis of unit cost and some on another basis. DeCA's unit cost output is commissary sales. This output applies directly only to the regions. DeCA Headquarters and Service Centers provide overhead support and manage centralized programs such as accounting and bill paying, transportation over the water, military personnel reimbursement, and support from DLA and DPSC. We have determined that it does not make good cost management sense to put these overhead and support costs on a unit cost basis with sales. Further, it would not make

sense to prorate these costs to the regions or their commissaries and include them in the regions' unit cost goals because the regions and the commissaries cannot exercise direct control over these costs. The DoD Comptroller Unit Cost Resourcing Guidance states that cost center managers should only be held accountable for costs if they have some influence over these costs.

2. Concur in part. The DoD Comptroller Policy Memorandum on Defense Business Operations Fund Financial Policy states, "Components will provide financial goals to each level of activity managed in the DBOF and defines an "activity" as "the lowest organization within the component which is managed as a single entity." The lowest organization within DeCA managed as a single entity is the region. Development of unit cost goals at the commissary level and for departments within stores would be very time consuming. It would require the expenditure of significant additional resources at region level to oversee the administration of these unit cost goals, with no real significant benefits to DeCA from the methods currently used by DeCA. Instead of establishing unit cost goals for operations and departments with stores, we agree with obtaining and using this financial data for management and cost analysis at region and Headquarters levels. We are already pursuing this with the DoD Comptroller in developing our unit cost reports.

Finding C. Customer Service

Additional Facts:

The report is correct in that computing the in-stock rate is time consuming; however, the report is incorrect in the assumption that it is irrelevant in today's environment. The in-stock rate is an important area in increasing customer service as it is one of the major concerns addressed in our comments received from patrons. For FY 1993, about 18 percent of our comments received from patrons addressed products not being in-stock as compared to 11 percent to date in FY 1994. This decrease in comments about the in-stock rate implies that the commissary system is doing a better job in stock management; however, there is room to improve. Continued monitoring of the in-stock rate emphasizes our commitment to continuous improvement in customer satisfaction by making sure desired products are available for selection. Executive Order 12862, Setting Customer Service Standards, requires measurement of standards based on customer definitions of quality and services desired. In October 1991, representatives of all services confirmed that in-stock rates are an important dimension of quality. This indicator is completely appropriate.

Recommendation. We recommend that the Director, DeCA, streamline or discontinue the practice of physically computing in-stock rates

as a means of assessing and increasing customer service at the store level.

Action Taken. Concur. Customer satisfaction is important to DeCA as well as becoming more efficient. To improve efficiency, new standardized streamlined procedures for conducting in-stock rates will be put in place by September 1, 1994.

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