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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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MAY 22, 1979

The Honorable Warren G. Magnuson  
Chairman, Committee on Appropriations  
United States Senate

The Honorable Jamie L. Whitten  
Chairman, Committee on Appropriations  
House of Representatives

The two major military exchange systems--the Army and Air Force Exchange Service and the Navy Resale System Office--each operate a mail-order catalog system to serve authorized patrons, primarily overseas. In fiscal year 1978 these two systems generated sales of about \$58.5 million in nonessential items and profits of \$1.9 million which were distributed to support other morale, welfare, and recreation programs. On the basis of our analyses, we concluded that consolidating the two systems would reduce annual nonappropriated fund operating costs by about \$1 million and appropriated funds by about \$488,000 a year. (See enc. I.)

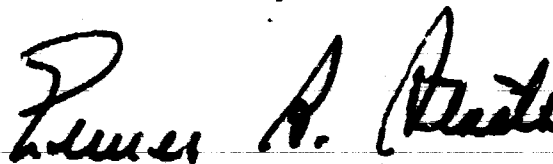
Department of Defense (DOD) officials were aware several years ago that savings were possible. Exchange officials determined in 1975 that consolidating the catalog systems was feasible and would result in savings. In 1978 the Defense Audit Service reported that a consolidated catalog system would be cost effective and that DOD should consider it. All of the military services except the Navy agreed; its principal concerns with consolidation have been that the exact amount of savings has not been determined and an equitable sharing of the total profits from a consolidated operation has not been proposed. In February 1979 DOD requested exchange officials to make another feasibility study. DOD officials told us that they plan no further action until the new study is completed.

We believe that the feasibility of consolidating these systems has been demonstrated and that further delays would only waste scarce resources. Consolidation could increase profits, lower prices to the patrons, and save taxpayers almost \$500,000 annually. We recommend that the Secretary of

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Defense curtail the new study and direct the exchange systems to consolidate their mail-order catalog systems. In acting on the fiscal year 1980 Defense Appropriation Act, your Committees should prohibit the use of appropriated funds to support separate systems, as a means of expediting this matter.

We are sending copies of this report to the Chairmen, House and Senate Committees on Armed Services; the Chairman, House Committee on Government Operations; the Chairman, Senate Committee on Governmental Affairs; the Secretary of Defense; the Director, Office of Management and Budget; the Secretaries of the Army, Navy, and Air Force; and other interested parties.



Comptroller General  
of the United States

Enclosures - 2

**POTENTIAL SAVINGS RESULTING FROM CONSOLIDATION OF  
EXCHANGE MAIL-ORDER CATALOG SYSTEMS**

The Army and Air Force Exchange Service (AAFES) and the Navy Resale System Office (NAVRESO) operate separate catalog sales systems as part of their worldwide resale programs. A description of the items and authorized patrons of the two systems is in enclosure II.

Our comparison below shows consolidating the two systems into the larger AAFES system would eliminate NAVRESO's annual operating costs of about \$2.5 million and increase AAFES' operating costs by an estimated \$1.4 million.

	<u>Cost of NAVRESO's FY 1978 catalog operations (note a)</u>	<u>Increased AAFES' cost to operate a consolidated catalog system (note b)</u>	<u>Estimated savings</u>
Personnel costs	\$1,029,000	\$ 375,000	\$ 654,000
Catalog production	800,000	605,000	195,000
Other expenses	<u>666,000</u>	<u>457,000</u>	<u>209,000</u>
Total	<u>\$2,495,000</u>	<u>\$1,437,000</u>	<u>\$1,058,000</u>

a/The NAVRESO accounting system combined these costs with the cost of supporting Navy exchange stores and ships' stores afloat program in the Pacific area. We allocated costs to catalog operations on the basis of estimates of percent of total effort. NAVRESO officials agreed with our estimates.

b/We asked AAFES' personnel to estimate increased personnel and other costs of its catalog operations to absorb NAVRESO's catalog operations. On the basis of our review, these estimates appear reasonable.

Consolidating duplicate procurement, warehousing, administration, accounting, and distribution of similar items into a single system would substantially reduce personnel costs. For example, to support catalog operations the Navy's Mail-Order Division employs 35 persons in its warehouse branch in Yokosuka, Japan. The annual cost of these employees is about \$396,000. They are responsible for receiving and storing merchandise from suppliers and for

issuing and shipping merchandise to customers. AAFES performs similar functions with similar merchandise for common customers at its catalog warehouse in Yokota, Japan. AAFES said it could absorb the Navy's warehousing activities with an increase of nine employees at about \$104,000--a savings of \$292,000.

Catalog costs would be reduced through the design, publication, and distribution of a single catalog. Consolidating duplicate functions would reduce other expenses such as data processing and accounting.

Other advantages of consolidating the catalog systems include (1) greater volume discounts from a single-service procurement and (2) reduced costs in inventory investment. These savings can be passed on to the patrons through reduced catalog prices.

#### APPROPRIATED FUND SAVINGS

The catalog systems used appropriated funds to support their operations. Consolidation in the following areas would save about \$257,000 in military personnel costs and \$231,000 in operation and maintenance costs.

--The Navy's Fleet Mail Center in Yokohama, Japan, estimates it could operate with up to 15 fewer military employees if it were not required to process mail-order shipments to NAVRESO's catalog customers. About \$257,000 is appropriated for these enlisted personnel. AAFES expects that this function could be consolidated with no appreciable increase in personnel.

--In Japan, NAVRESO stores merchandise for its catalog operations that was purchased from U.S. suppliers. In many instances, the merchandise (primarily audio equipment) is sold to customers who order it delivered to the United States. Appropriated funds of about \$100,000 were used in fiscal year 1978 for transporting merchandise from the United States to Japan for storage and back to the United States for delivery on catalog sales orders. These charges to appropriated funds would be avoided under a consolidated AAFES system. AAFES said it ships all U.S. suppliers' merchandise either from its warehouse in Georgia or directly from the supplier.

---Appropriated funds of about \$131,000 were used during fiscal year 1978 to support the Navy's catalog operations in Yokosuka, Japan. AAFES' officials told us that a consolidated catalog system would require less inventory and eliminate the need for the Navy warehouse in Japan.

### FEASIBILITY OF CONSOLIDATION

The Armed Forces Exchange Coordinating Committee, composed of representatives from each exchange system, reported in December 1975 that consolidation was feasible and would result in overall savings. AAFES and the Marine Corps Exchange System agreed to use a consolidated catalog system. NAVRESO wanted further study and assurances that income from a consolidated system would be more than the income it now receives from its separate catalog system. In April 1976 NAVRESO indicated no interest in pursuing the consolidation issue.

The Defense Audit Service reviewed this area and reported in July 1978 that a consolidated mail-order catalog system would (1) be cost effective, (2) benefit all three exchange systems through shared revenues, and (3) achieve pricing parity for catalog items. The Audit Service concluded that the Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics) should consider consolidating catalog systems, with the requirement that each exchange system share catalog revenues. AAFES agreed but NAVRESO disagreed. NAVRESO questioned whether any savings would result and stated that it would lose a disproportionate amount of income through consolidation.

In response to the audit report, the Department of Defense (DOD) requested the Armed Forces Exchange Coordinating Committee to again study the feasibility of consolidating the two catalog systems and forward the study and services' comments to DOD by November 30, 1979. We discussed our findings with DOD officials who told us they would not take any action on consolidation until the study was completed.

DOD MAIL-ORDER CATALOG SYSTEMS

The military exchange program was established to (1) provide reasonably priced goods and services that otherwise would not be available to military personnel and (2) generate profits to support morale, welfare, and recreation activities on military installations. DOD operates three separate exchange systems--the Army and Air Force Exchange Service(AAFES), Dallas, Texas; the Navy Resale System Office (NAVRESO), Brooklyn, New York; and the Marine Corps Exchange System, Quantico, Virginia. Each system operates retail outlets on military installations throughout the world, and each system has different organizational structures, management practices, and methods for distributing profits.

The AAFES catalog system is centrally administered by the catalog center in Dallas, Texas. In addition, there are warehouses in Atlanta, Georgia; Giessen, Germany; and Yokota, Japan. The Yokota operation is supported by four small warehouses in Taiwan, the Philippines, Thailand, and South Korea.

The NAVRESO catalog system is centrally administered by the Mail-Order Division of the Navy Exchange, Yokosuka, Japan, and is under the Commander of Yokosuka fleet activities and the technical guidance of NAVRESO. Merchandise from the Far East and U.S. suppliers is warehoused in Yokosuka, and merchandise from European suppliers is warehoused in Rota, Spain.

In addition to administering the catalog system, the Mail-Order Division

- provides other overseas Navy exchanges with Japanese merchandise and ships' stores afloat in the Pacific with foreign merchandise,
- prepares and distributes price agreement bulletins for Japanese merchandise, and
- provides central procurement and warehouse facilities for mail-order items which are also sold at retail stores of the Yokosuka exchange system.

All overseas military personnel, their dependents, and Federal civilian employees are authorized to buy items from both the AAFES and NAVRESO catalogs. Military personnel and their dependents in the United States can only buy from the American section of the AAFES catalog; they cannot use

the NAVRESO catalog. About 10 percent of AAFES catalog users and about 50 percent of NAVRESO catalog users are Navy personnel. About 33 percent of NAVRESO catalog users are Army or Air Force personnel. Marine Corps personnel use AAFES.

Both catalogs offer overseas personnel basically the same items at generally identical prices. The 1978 NAVRESO catalog contains about 3,000 audio, camera, tableware, jewelry, and gift items. Of the NAVRESO catalog items, 640 (about 21 percent) are identical to AAFES catalog items; these items accounted for about 85 percent of NAVRESO catalog sales. Many other NAVRESO items are similar to the AAFES catalog items, differing primarily in brand name, pattern, or other variations. The AAFES catalog has a wider selection of items than the NAVRESO catalog.