Audit Report

OFFICE OF THE INSPECTOR GENERAL

EUROPEAN STARS AND STRIPES

Report No. 94-032

January 26, 1994

Department of Defense

Acronyms

ABIF	Army Banking and Investment Fund
ADP	Automatic Data Processing
AFIS	American Forces Information Service
AR	Army Regulation
CID	U.S. Army Criminal Investigation Command
CINCEUCOM	Commander in Chief, U.S. European Command
COBOL	Common Business Oriented Language
CONUS	Continental United States
DFU	Data File Utility
ES&S	European Stars and Stripes
GAO	General Accounting Office
MOA	Memorandum of Agreement
OMB	Office of Management and Budget
USAREUR	U.S. Army, Europe
USEUCOM	U.S. European Command

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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January 26, 1994

MEMORANDUM FOR COMMANDER IN CHIEF, U.S. EUROPEAN COMMAND
DIRECTOR, AMERICAN FORCES INFORMATION SERVICE
COMMANDER/PUBLISHER, EUROPEAN STARS AND STRIPES

SUBJECT: Audit Report on the European Stars and Stripes (Report No. 94-032)

We are providing this final report for your review and comments. It concerns the operations and internal controls of the European Stars and Stripes organization. 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 Commander/Publisher, European Stars and Stripes, provide final comments by March 22, 1994, as stipulated in "Response Requirements for Each Recommendation" at the end of the finding.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. Raymond D. Kidd, Program Director, at (703) 614-1682 (DSN 224-1682) or Ms. Anne Bonds, Acting Project Manager, at (703) 614-6302 (DSN 224-6302). Appendix F lists the distribution of this report. The audit team members are listed inside the back cover.

Robert J. Lieberman

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Office of the Inspector General, Department of Defense

Report No. 94-032
(Project No. 3FH-5006)

January 26, 1994

AUDIT REPORT ON THE EUROPEAN STARS AND STRIPES

EXECUTIVE SUMMARY

Introduction. The European Stars and Stripes (ES&S) organization publishes a daily newspaper, *The Stars and Stripes*, for DoD personnel stationed in Germany, Italy, the United Kingdom, and other DoD activities in the U.S. European Command. The newspapers are distributed primarily through contractor- and ES&S-operated bookstores that also sell books and magazines. Stars and Stripes is a DoD nonappropriated-fund activity, but receives appropriated-fund support. The U.S. Army, as the executive agent for ES&S, provides administrative and logistical support.

This audit was requested by the Director, American Forces Information Service (AFIS), who asked us to review ES&S operations, and by the U.S. Army Criminal Investigation Command (CID), which asked for audit assistance in its investigation of fraud and other improprieties in the ES&S organization. The DoD Hotline also received several allegations that required evaluation.

Subsequent to our audit, the U.S. Congress enacted legislation that directs the Secretary of Defense to transfer the bookstore operations of ES&S to the military exchanges by October 1, 1994. The act was signed into law on November 30, 1993.

Objective. The objectives of the audit were:

o to assist the CID in its investigation, and to determine the validity of hotline and other allegations;

o to evaluate the effectiveness and efficiency of ES&S;

o to evaluate whether internal controls ensured that obligations and costs complied with applicable laws, and that funds, property, and other assets were safeguarded against waste, loss, unauthorized use, or misappropriation; and

o to determine whether ES&S had taken actions to reduce appropriated-fund support as directed by Congress, and to evaluate the effectiveness of any actions taken.

Audit Results. ES&S was not operated efficiently because its managers did not recognize the importance of establishing and enforcing internal controls. The lack of adequate controls contributed significantly to the existing financial difficulties, and funds and property had not been safeguarded against waste and unauthorized use. Appropriated-fund support for transportation costs had been reduced because newsprint was procured from a local source. Most of the hotline and other allegations were valid when made; however, most had been corrected at the time of our audit, or the situation had changed.

Internal Controls. A material internal control deficiency existed because the Federal Managers' Financial Integrity Act had not been implemented. Consequently, internal controls were not adequate to ensure that policies and procedures for operating a nonappropriated-fund business were implemented. For details of controls assessed, see Part I. The finding gives details of the internal control weaknesses.

Potential Benefits of Audit. The audit should result in improved management, compliance with laws and DoD and Army guidance, and potential monetary benefits of about $9.0 million during the next 6 years (Appendix D).

Summary of Recommendations. Our recommendations, if implemented, will improve operations, internal controls, and compliance with laws and regulations.

Management Comments. We received comments from the Commander in Chief, U.S. European Command, and the Commander/Publisher, European Stars and Stripes. Management concurred with Recommendation 1., and partially concurred with Recommendation 2. and the monetary benefits resulting from Recommendation 2. See Part II for a discussion of management's comments and Part IV for the complete text of the comments.

Table of Contents

This report was prepared by the Financial Management Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, (703) 614-6303 (DSN 224-6303).

Part I - Introduction

Background

Stars and Stripes, with organizations in the European and Pacific theaters, is a DoD nonappropriated-fund activity. The mission of the European Stars and Stripes (ES&S) is to produce a quality, reasonably-priced daily newspaper that provides current news to DoD personnel and their dependents serving in the European theater. Complementing the newspaper are ES&S bookstores that offer a wide selection of commercial publications. Appropriated funds pay for the shipment of commercial publications from the United States to Darmstadt, Germany. Distribution of newspapers and other publications from Darmstadt to the sales outlets is provided by ES&S drivers and commercial air freight. *The Stars and Stripes* newspaper is funded in part by income from direct sales, subscriptions, and some paid advertising. However, publishing and distributing costs of *The Stars and Stripes* are not fully recouped by sales and advertising. ES&S also provides printing support for U.S. military bases, units, communities, and civilian organizations. In FY 1992, ES&S had a net operating loss of $4.3 million. For the first 6 months of FY 1993, the net operating loss was $3.4 million. ES&S received $2.25 million of appropriated fund support in FY 1992 that paid for transportation, maintenance, utilities, and payroll and travel for U.S. military personnel.

ES&S is under the operational direction of the Commander in Chief, U.S. European Command (CINCEUCOM), Stuttgart, Germany. The ES&S Commander/Publisher in Darmstadt, who coordinates with and receives support from CINCEUCOM's staff, oversees and directs matters pertaining to day-to-day operations. The American Forces Information Service (AFIS), Alexandria, Virginia, provides policy and broad operational guidance to ES&S and is the DoD point of contact for ES&S issues in the United States. The U.S. Army, as the executive agent for ES&S, provides administrative and technical support.

As of June 1, 1993, ES&S had 128 bookstores, 29 of which were scheduled to be closed by the end of FY 1995. ES&S employees operated 14 of the 128 bookstores, and contractors operated the other 114. Bookstores were located in Belgium, Germany, Greece, Italy, the Netherlands, Spain, Turkey, and the United Kingdom. ES&S also operated three bookstores in Panama. *The Stars & Stripes* had a daily circulation of about 76,000 copies and was distributed to the countries where bookstores were located.

After our draft report was issued, Public Law 103-160 was signed on November 30, 1993. Section 353 of the Law directs the Secretary of Defense to transfer responsibility for bookstore operations from ES&S to the military exchanges. The outcome of that reorganization will affect some recommendations in this report.

Objectives

The Director, AFIS, asked us to review the efficiency of operations at ES&S. Also, the Commander, Second Region, U.S. Army Criminal Investigation Command (CID), asked for our assistance in the CID's investigation of alleged fraud and other improprieties in the ES&S organization. CID began its investigation after receiving information from confidential sources about suspected wrongdoing and unauthorized business practices at ES&S. The objectives of our audit were:

o to assist the CID in its investigation, and to determine the validity of hotline and other allegations;

o to evaluate the effectiveness and efficiency of ES&S;

o to determine whether internal controls ensured that obligations and costs complied with applicable laws, and that funds, property, and other assets were safeguarded against waste, loss, unauthorized use, or misappropriation; and

o to determine whether ES&S had taken actions to reduce appropriated fund support as directed by Congress, and to evaluate the effectiveness of any actions taken.

Scope and Methodology

During our survey, we learned that ES&S had not implemented the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255); therefore, further audit effort was not required to evaluate its implementation. Consequently, we extensively tested internal controls.

In addition to assisting the CID, we followed up on prior recommendations to determine whether management and operations had been improved. We evaluated the effectiveness and efficiency of the ES&S organization by discussing operations with management and operating personnel, examining and testing financial documents, and identifying management procedures at ES&S Headquarters. We also visited five bookstores in Germany to observe operations and discuss procedures and concerns expressed by bookstore personnel. Two of these stores were operated by employees of ES&S; the other three were operated by contractors who received monthly commissions on their sales.

Our evaluation covered controls over automatic data processing (ADP), ordering and distribution of resale merchandise, accounting procedures, newspaper distribution, contracting procedures, vehicle requirements, insurance coverage, the use and control of assets, and use of internal review personnel.

Using statistical sampling methods, we tested data on four store management issues. To test the effect of late deposits, we used a two-stage sampling procedure employing stratification within geographic regions. To test the cost of overorders, we used a stratified random sample. To test monetary loss because of management's failure to follow up on shortages, we used simple random sampling. Finally, to determine the effect of poor inventory accountability for University of Maryland textbooks, we used a simple random sample. All projections are listed in Appendix A of this report, with appropriate confidence levels and precision of estimates.

Scope Limitations. We did not review the content of the newspaper or the technical aspects of its production. We also did not evaluate inventory procedures or controls in the central distribution warehouse. At the time of our audit, management consultants from Coopers & Lybrand, a certified public accounting firm, had recently completed a review in this area, and management was implementing suggested improvements.

Audit Period, Standards, and Locations. This economy and efficiency audit was made from January through June 1993 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. The documents reviewed were for FYs 1987 through 1993. Appendix E lists the organizations we visited or contacted.

Investigation Assistance. At the request of the CID, we provided them with the results of our assistance separately. Our review of the hotline and other allegations showed that most of the allegations were valid at the time they were made. However, most had been corrected at the time of our audit, or the situation had changed.

Appropriated-Fund Support. We reviewed the changes in appropriated-fund support for ES&S from FYs 1987 through 1992 to determine whether the support had decreased since Congress directed it in 1986. In FY 1992, ES&S received $2.25 million in appropriated-fund support; this was a decrease of about 42 percent since FY 1986. However, the decrease in support had not been constant. Support increased from FYs 1988 to 1989 and from FYs 1990 to 1991. "Transportation of things" was the largest category that caused variations in the level of appropriated-fund support.

In September 1990, the contract to provide newsprint to ES&S was awarded to the lowest bidder, a German firm. Purchasing the newsprint from a local firm reduced the transportation costs paid from appropriated funds, since the newsprint was not shipped from the continental United States (CONUS); because the new contract for newsprint went to the lowest bidder, there was an added benefit of reduced appropriated-fund support.

Internal Controls

Controls Assessed. We assessed the internal controls over sales income, ADP, ordering and distribution of commercial publications, special orders, textbook inventories, distribution of the ES&S newspaper, funds and other assets, accounts payable, and adherence to laws and regulations.

Internal Control Weaknesses. ES&S had not implemented the Federal Managers' Financial Integrity Act of 1982; Office of Management and Budget (OMB) Circular No. A-123, "Internal Control Systems," August 4, 1986; and DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. As a result, we found a material deficiency as defined by Public Law 97-255, OMB Circular No. A-123, and DoD Directive 5010.38. Important internal controls were missing, and established controls were ignored. See Part II of this report for a discussion of the internal control weaknesses. If implemented, Recommendations 2.a., 2.b., 2.d., 2.i., 2.n., 2.o., 2.q., 2.t., and 2.v. will correct the weaknesses we identified. For details of potential benefits resulting from our recommendations, see Appendix D. A copy of the final report will be provided to the senior official responsible for internal controls at ES&S.

Prior Audits and Other Reviews

The Defense Audit Service issued Report No. 806, "Report on the Review of the Management of the European and Pacific Stars and Stripes," on August 18, 1977. That report focused on consolidating certain functions of the European and Pacific operations. The U.S. Army Audit Agency issued Report No. EU 75-302, "Report of Audit of European Stars and Stripes for the Twelve Months Ended 9 January 1974," on October 3, 1974. The auditors made recommendations that, if implemented, would have improved ES&S operations. Those two audits were the most recent audits of ES&S by Government auditors.

Two studies were also done of ES&S operations. An October 1987 study by a Stars and Stripes Advisory Task Force (the Rosen Commission) made recommendations that, if implemented, would have improved ES&S operations. In June 1992, consultants from Coopers & Lybrand made recommendations to improve the efficiency of operations. Appendix B summarizes findings from the prior audit report and studies that are repeated in this report.

Other Matters of Interest

We analyzed the timeliness of deposits of bookstore sales receipts by comparing weekly sales reports to the corresponding bank deposit slips. Due to a lack of inventory accountability, we did not expect to be able to determine whether daily sales were being correctly reported. However, based on a statistical sample, we concluded that ES&S bookstores were promptly depositing receipts from the reported sales. On average, receipts were deposited within 3 working days after the sales were made. Nevertheless, at some bookstores, receipts were deposited from 7 to 23 days late. When we discussed this with ES&S managers, they developed and implemented a schedule for bookstore deposits and directed regional sales managers to train bookstore managers in the importance of depositing receipts promptly. Implementation of the schedule should improve the timeliness of deposits.

Part II - Finding and Recommendations

European Stars and Stripes Operations

The European Stars and Stripes (ES&S) organization was not operated efficiently. Managers had not established the internal controls necessary to safeguard funds, property, and other assets, and to ensure efficient operations. Also, managers were not complying with DoD and Army regulations. The lack of adequate internal controls was a major cause of the financial problems at ES&S, and there was no assurance that funds, property, and other assets were safeguarded against waste, loss, unauthorized use, and misappropriation. Improvements in operations would save an estimated $1.3 million annually and would also result in a one-time savings of $2.0 million.

Background

Although audits and studies of ES&S operations had disclosed inefficient management practices, the recommendations for improvement had been largely ignored for almost 20 years. Prior to the substantial troop drawdown in Europe, which began in 1992, the ES&S bookstores earned enough income to obscure these inefficiencies. However, the drawdown reduced sales income, emphasized control weaknesses, and contributed to the financial problems at ES&S.

Operating the Nonappropriated Fund Activity

Both military and civilian managers worked to fulfill the ES&S mission of providing news to DoD personnel serving in the European theater. However, neither group had implemented DoD's procedures for financial management of nonappropriated fund business activities or established the internal controls needed to ensure efficient operations. Discussion of the most significant operational shortfalls and internal control weaknesses follows.

Federal Managers' Financial Integrity Act of 1982. ES&S managers had not implemented the Federal Managers' Financial Integrity Act of 1982 because they were unfamiliar with the requirements of DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. After receiving guidance from Headquarters, U.S. European Command (USEUCOM), ES&S managers had identified assessable units and conducted risk assessments during FY 1992, but they had not developed a management control plan or conducted internal management control reviews on the assessable units. Consequently, they had not documented and tested established internal controls and had not identified the areas that needed controls.

Accuracy of Automatic Data Processing. The ES&S computer system lacked the system documentation and controls required by the General Accounting Office (GAO) for ADP systems. In its October 1987 report, "Stars and Stripes Advisory Task Force," the Rosen Commission had recommended creating a documentation book for all existing systems. At the time of our audit, management had not acted on this recommendation. Computer programmers who were no longer employed by ES&S at the time of our audit had developed the in-house application program, called the Distribution System. Those programmers had not documented the more than 1,800 menu options available for the program. Rather, they had notified system users verbally of the format needed for data input in order for the program to generate products required by the users. The programmers also had not required users to formally notify programmers when they no longer needed specific products.

As a result of the lack of documentation, the programmers employed by ES&S at the time of our audit were not aware of the system's total capabilities; they learned about the system as users made them aware of problems with data entry or output. The programmers and their support staff were beginning to document the application program and determine the procedures and output products that were still needed for ES&S operations.

In our review of the ES&S IBM AS/400 computer system's controls, we found that over one-half of the general controls and one-third of the application controls required by the GAO for the Government's automated systems were missing. Consequently, there was no assurance that reliable data were being processed or provided to management. For example, ES&S programmers had allowed system users to access data file utility (DFU) screens to enter data directly into the 16 master files. DFU screens do not use edit checks or establish audit trails to ensure the accuracy or verify the sources of the data being entered.

The program language for the Distribution System was Common Business Oriented Language (COBOL). The IBM AS/400 system could read and manage programs in COBOL; however, because the machine language it used was Report Program Generator, it could not compile COBOL to show what the programs were doing. As a result, programmers could not evaluate the formula used for distributing merchandise to ES&S bookstores, which was a critical need at the time of our audit.

Periodicals and Paperbacks. The Rosen Commission had recommended that to reduce the costs of handling, inventorying, and managing unsold periodicals, ES&S should reduce the number of periodicals available for sale to the 200 best sellers and should reduce inventories to increase net profits. ES&S did not concur with these recommendations. At the time our field work ended, ES&S was distributing too many periodical titles to the bookstores in excessive quantities, and was also distributing excessive quantities of paperbacks to the bookstores.

Periodicals. As of the end of May 1993, about 750 periodical titles were being distributed to the bookstores. Many of these titles had similar subject matter. For example, 49 titles were adult periodicals, and 37 titles dealt with cars, motorcycles, four-wheel-drive vehicles, and related topics. On visits to some bookstores in Germany, we saw large assortments of these titles. Some of the titles contained almost identical subject matter. One bookstore operator said that most of the adult titles, particularly the more sexually explicit ones, did not sell as well as the more popular titles.

We reviewed the return rates for 21 of the sexually explicit titles. Magazines sent to the bookstores and returned unsold ranged from 51.6 percent to 88.2 percent, with an average return rate of 68.1 percent. We discussed the high return rates with the general manager, who said that in addition to the return rate, sales and income data should be considered when determining which titles the bookstores should sell.

Our analysis of the most recent sales data for the 21 titles showed that each title made a gross profit (less commission) ranging from $3 to $54 per bookstore. The average number of copies sold for each title ranged from 3 to 29 per store.

We also analyzed return and sales data for a sample of 15 car and motorcycle magazines. Return rates ranged from 42.4 percent to 84.5 percent, with an average of 63 percent. We found that each title earned a gross profit (less commission) ranging from $2 to $8 per bookstore. Copies sold per store ranged from two to seven. The income from the titles with the low gross profit margins is probably insufficient to cover the handling, shipping, and administrative costs for those titles. Titles that do not earn sufficient gross profit should not be sold in the bookstores. Nevertheless, although some titles did not sell well, ES&S continued to offer them for sale.

ES&S merchandising personnel also ordered more copies of each title than were needed, based on customer demand. Using statistical sampling techniques, we reviewed orders placed with 29 ES&S distributors for 113 different titles between March and May 1993. Periodicals costing $504,288 were ordered in excess of the quantity that would be needed to allow for a 35-percent return rate. If ES&S reduced orders to achieve a 35-percent return rate, we estimated that a one-time savings of about $2.0 million could be realized, since funds invested in inventory could be used for other purposes. The overordering also resulted in the unnecessary use of appropriated funds to pay for shipping the magazines from the continental United States to ES&S warehouses. Also, both ES&S and bookstore operators' labor was used to handle, store, inventory, and manage the large volume of unsold magazines.

The Distribution System produced a report, "Periodical Sales Rank Exception Listing," which suggested order quantities needed to achieve a 50-percent return rate, based on sales and return data. The Periodicals Supervisor was not using that report, because he was not aware of the information it contained. He based his reorders on a cursory review of return rates and a schedule that adjusted order quantities for the troop drawdown in Europe. We believe that the use of this report, revised to reflect a return rate of 35 percent, would result in orders for more reasonable quantities of periodicals. Ordering smaller quantities of periodicals should reduce the costs of shipping, handling, storing, and return processing, and should allow ES&S to make more efficient use of funds that were previously invested in inventory.

Paperbacks. ES&S managers were placing orders for paperback books based on an expected return rate that was too high. The clerk responsible for paperback orders told us that order quantities for the 11 categories of books were based on an expected return rate of 50 percent. We reviewed the "Paperback Sales Report" for November 10, 1992, through March 24, 1993. Our analysis showed that paperbacks with a retail value of $3.3 million had been shipped to the bookstores; of that total, $1.4 million worth of books were returned unsold and were destroyed. Return percentages ranged from 3 percent to 79 percent.

We believe that an expected return rate of 50 percent is too high. Statistics from the American Booksellers Association showed that for FY 1991, the average return rate for all independent book retailers in the U.S. was 9.97 percent. That percentage would probably not be a reasonable expectation for the ES&S market; however, reducing orders to reflect a return rate of no higher than 35 percent would minimize transportation and labor costs.

Bookstore Merchandise Shortages. ES&S managers did not comply with Army Regulation (AR) 215-1, "The Administration of Army Morale, Welfare, and Recreational Activities and Nonappropriated Fund Instrumentalities," September 10, 1990. Therefore, ES&S had not developed procedures to determine why the bookstores were not receiving periodicals that were being distributed from the warehouse. AR 215-1 requires investigation and accounting for lost merchandise.

Using statistical sampling techniques, we selected a sample of 34 of the most popular magazines from a listing of 920 titles for which shortages were reported between January 1, 1992, and April 15, 1993. We found that 97 of the 119 contractor-operated bookstores reported nonreceipt of about 146,000 copies of the 34 titles, with a retail value of $364,000. On an annual basis, this converts to retail shortages of about $282,000. We also determined that the bookstores reporting the shortages frequently returned (for credit) quantities of the magazines that were originally reported as not received. Therefore, we concluded that it was likely that bookstore operators were falsely reporting shortages of magazines, selling as many as possible, and returning the unsold portions for credit. When management learned of our concerns, they researched the issue further.

On May 26, 1993, the ES&S Internal Review Division tested merchandise shipment controls by shipping an extra bundle of magazines to three bookstores. One store reported the extra bundle, but the other two did not. To verify the test results, an auditor then visited one of the two bookstores and purchased a magazine that the bookstore manager had not reported as being received. False reporting may explain why 61 (43 percent) of 143 bookstores had inventory overages for the August 1992 physical inventory. For inventories taken prior to August 1992, overages were refunded to the bookstore operators.

Contractual agreements with bookstore operators required that when a bookstore's physical inventory showed more inventory on hand than was accounted for in ES&S inventory records, the bookstore operator was paid for the overages. Likewise, the operator was responsible for any shortages. We were told that the Acting Comptroller had, without amending contractual agreements, changed procedures in March 1993 to allow credit only for overages up to the amount of inventory shortages identified in previous physical inventories. At the time of our audit, ES&S had incurred an unrecognized obligation to pay bookstore managers about $226,000 for inventory overages identified during the August 1992 physical inventory. The obligation would probably have to be paid if the bookstore managers contested the change in ES&S procedures. In order to properly implement the change in policy, ES&S should amend its contracts with bookstore operators.

Delayed Return of Outdated Merchandise. ES&S managers had not established or implemented controls to ensure that the bookstores returned outdated magazines and paperbacks when directed to do so. It is standard practice for distributors and publishers to allow their customers to return unsold periodicals and paperback books for credit when the merchandise becomes outdated. The returns must be made within a reasonable period in order to be credited. ES&S procedures directed bookstore operators to return merchandise at specific times; however, no controls were in place to ensure that the operators were making the returns in a timely manner.

Because no controls were in place, many bookstores had become overstocked with outdated merchandise. To reduce the old stocks, ES&S had an amnesty program to allow bookstore operators credit for merchandise for which they normally would not have received credit. As of April 1993, we determined that about $500,000 in merchandise had been returned late. Of that amount, about $105,000 was in amnesty returns for which ES&S would receive no credit from publishers and distributors. ES&S should have established procedures to ensure that merchandise was returned when directed. Bookstores should not have been allowed credit for merchandise returned too late. Also, the ES&S sales representatives for the bookstores should have conducted periodic inspections for outdated merchandise in their assigned stores. If these controls had been in place, the amnesty program would not have been needed.

Special Order Program. In accordance with USEUCOM Directive 15-8, "Public Affairs - European Stars and Stripes," June 3, 1985, ES&S operated a special order program as a service to ES&S customers. The program was expanded in October 1992, which increased its losses and contributed to ES&S's financial problems. Further, functions of the special order program were not adequately segregated to reduce the risk of fraud.

Operating Loss. Before October 1992, the special order program operated on a limited basis. If an item was not available at a particular bookstore, but was in the ES&S distribution system, a customer could complete a special order form to obtain the item. If the item was not in the distribution system, the customer was told how to order it directly from the publisher. This program operated at a small loss, as noted in ES&S Internal Review Report No. 15-91, "Special Order Program," issued on July 16, 1992. The report stated that the expenses of the special order program exceeded revenues by about $28,000 for FY 1991.

In October 1992, ES&S's Bookstore Operations Division began using special-order software and installed six toll-free telephone lines for customers to place special orders. The expansion was intended to increase the sales, reliability, and accountability of special orders. For the 6 months ending March 31, 1993, gross profit from sales was $19,000, and related expenses were $72,000, for a loss of $53,000.

We analyzed the special order program to determine the sales volume that would be required to cover costs. We found that although sales increased significantly when the program was expanded, the program probably would not be able to generate the annual sales of $1.9 million needed to break even. Discontinuing the expanded program would save ES&S an estimated $106,000 per year.

Lack of Segregation of Duties. Personnel in the special order section of the Bookstore Operations Division accepted orders; collected payments; ordered, received, and shipped merchandise; and initiated refunds. One clerk could order merchandise, receive it, and either retain it or ship it to an unauthorized person.

In Report No. 15-91, the ES&S Internal Review Division had identified the lack of segregated duties. The auditors recommended that the functions of the special order program be segregated. Although management concurred with the recommendation, the condition still existed at the time of our audit.

University of Maryland Textbook Program. Under an arrangement begun in 1956, ES&S procured, stored, and sold textbooks used in courses offered by the University of Maryland to DoD personnel overseas. ES&S was not billing the university for air and handling charges, and had not established inventory procedures for the textbook warehouse to ensure that inventory data were accurate.

Air and Handling Charges. As a result of the Rosen Commission's report, ES&S signed a Memorandum of Agreement (MOA) with the University of Maryland. The university agreed to reimburse ES&S for the cost of textbooks, plus air shipment and handling charges for obsolete and excess textbooks that were on hand after the publisher's recall date. However, ES&S did not bill the University of Maryland for those charges between August 1989 and March 1993. Similarly, ES&S was not being reimbursed for air and handling charges when obsolete and excess textbooks were returned to the publishers for credit. The MOA did not require the university to pay air shipment and handling charges for textbooks returned to publishers. Because of these oversights, ES&S lost about $9,753 annually in reimbursement from the university.

Inventory Accountability. ES&S did not establish inventory procedures for the February 1993 physical inventory of the University of Maryland textbook warehouse. Consequently, there was little assurance that the inventory results were reliable. We noted inadequacies in the methods used to conduct inventories.

o Cutoff dates were not established for receipts and issues, and the inventory took about 2 weeks to complete.

o Recorded balances of textbook quantities were provided to the counting employees with both the master computer listing and stock cards.

o Disinterested personnel did not observe or conduct the inventory.

Based on our random sample, 250 (31.25 percent) of the 800 titles' recorded balances in the ES&S textbook warehouse were misstated (see Appendix A for a discussion of the sampling plan). The $750,000 recorded value of the textbook inventory was misstated by about $98,000 (4,100 textbooks).

At the beginning of each school term, the value of the textbook inventory is determined, and the University of Maryland is charged interest on any amount over $500,000. Therefore, accurate inventory figures are essential to ensure that the University of Maryland is billed for the correct amount.

The establishment of inventory procedures has been a continuing problem for ES&S. It was described in the U.S. Army Audit Agency's "Report on the Audit of the European Stars and Stripes," October 3, 1974. The report recommended that cutoff dates be used for receiving and issuing inventory, and that disinterested personnel observe inventories. The ES&S Commander at that time agreed with the recommendations, but no action was taken.

Staff Reductions. ES&S managers viewed unilateral, across-the-board reductions in staffing levels as the most appropriate method of reducing costs. However, no staffing studies had been conducted to determine whether the number of personnel should be reduced, and ES&S had not asked USEUCOM for assistance in performing such a study. Between September 30, 1990, and September 30, 1991, ES&S had eliminated 80 positions (filled by 33 U.S. citizens and 47 local nationals). Between January and October 1992, ES&S spent $420,310 on contract labor to support operations of the central distribution warehouse. This added expense might not have been necessary if ES&S managers had made better plans for personnel reductions.

At the time of our audit, ES&S managers planned to eliminate another 102 positions (filled by 50 U.S. citizens and 52 local nationals) by the end of FY 1993. The goal of the planned reduction was greater efficiency in operations. Approximately 67 of the 102 positions were eliminated based on specific business decisions. ES&S planned to begin printing only one edition of *The Stars and Stripes*, and also planned to close bookstores where troop population was declining. However, the remaining one-third of the reductions appeared to be an across-the-board cut, not connected to any specific reduction in operations.

Newspaper Operations. ES&S managers were not effectively using resources in the Newspaper Operations Division. They established the new position of district manager to manage newspaper distribution and sales without performing a market analysis or evaluating the position's effectiveness after it was established. They also did not maximize an increase in revenue because they did not request approval for an increase in the price of the Sunday edition when the daily edition's price was increased.

District Managers. Between March and May 1992, the circulation manager developed a plan to centralize newspaper operations at ES&S headquarters. The plan included establishing the position of district manager and setting a goal to increase market penetration to 50 percent. The district managers were to increase distribution, train home delivery carriers, increase sales by third-party vendors, and verify newspaper counts for managers of Stars & Stripes bookstores. Previously, these tasks had been performed by sales representatives from the Bookstore Operations Division and by route drivers.

During the period that the 19 district managers were employed, from October 1992 through April 1993, market penetration averaged 36.2 percent, and ranged from 35.0 percent in October 1992 to 38.8 percent in February 1993. However, since February 1993, market penetration had steadily declined; for the week ending May 22, 1993, market penetration was 36.8 percent. Also, between September 1992 and May 1993, newspaper sales declined 36.0 percent, although the available market (estimated number of households) declined only 14.8 percent. Because ES&S did not perform a market analysis before establishing the new positions and did not evaluate the positions' effectiveness, it was not known whether the benefits received from establishing the district manager staff exceeded the costs associated with the positions. ES&S also did not know if the size of the district manager staff was adequate or excessive. As a result, ES&S may have been spending funds on salaries and benefits for positions that were not needed.

Price of Sunday Edition. On March 1, 1993, when the price of *The Stars and Stripes* daily edition was raised from 35 to 50 cents, ES&S did not ask USEUCOM to approve increasing the price of the Sunday edition from 50 to 75 cents. Most newspapers in the United States charge higher prices for their Sunday editions. Management did not raise the price of the Sunday edition because they believed that its sales would decrease significantly. As of the week ending May 22, 1993, total newspaper sales had decreased only 5.8 percent. ES&S historical circulation data indicated that the decline in sales following a price increase averaged about 3 percent. Allowing for the 3 percent reduction, we estimated that ES&S could have realized about $800,000 annually in additional sales revenue by requesting that USEUCOM approve a price increase for the Sunday edition. However, the increase in revenue would probably not be as great in future years because of the reduction of troop strength in Europe.

Lost Interest. ES&S was not maximizing interest income on funds in bank accounts, funds maintained by the cashier operation, and petty cash. ES&S did not effectively use the Army Banking and Investment Fund (ABIF).

The ABIF, which provides centralized banking and investment opportunities, is the only means of investment authorized for nonappropriated-fund instrumentalities that operate under Army responsibility. ES&S had established an account with the ABIF in March 1992. At the same time, ES&S also maintained six non-ABIF checking accounts (two U.S. dollar accounts and four foreign currency accounts) and nine non-ABIF deposit accounts. These accounts were established so that bookstore managers could deposit daily sales receipts and ES&S could pay its vendors; funds were periodically transferred to the primary dollar checking account. Funds were allowed to accumulate in the checking and deposit accounts, one of which paid only 2.5 percent interest, rather than being promptly transferred to the ABIF. Consequently, ES&S lost the opportunity to earn about $92,800 annually in additional interest.

The cashier operation and petty cash fund also kept excessive funds on hand. ES&S maintained a cashier operation so its employees could cash personal checks to obtain U.S. dollars or German deutsche marks. Our review showed that this fund contained more cash than was needed. The cashier operation was scheduled to be closed on June 18, 1993; however, we estimated that ES&S could have earned interest income of $1,600 annually if the fund had been limited to what was needed. Our review of petty cash funds showed that 9 of the 10 funds with balances greater than $500 were too large; the funds could have been reduced by a total of about $12,000 to earn additional interest income of at least $600 annually.

About $95,000 of additional interest could have been earned in the 12 months ending March 31, 1993, if ES&S had transferred excess funds to the ABIF.

Payment for Commercial Newspapers. ES&S was paying for newspapers printed by other publishers without ensuring that the papers were actually received. For newspapers that were delivered directly to the bookstores (the *Wall Street Journal*, the *International Herald Tribune*, and *USA Today*), bookstore managers did not send receiving reports to accounts payable clerks to be compared with vendors' invoices. Nevertheless, payment was made without this necessary documentation. Consequently, about 55,000 papers per month, valued at $40,320, were paid for without evidence of receipt. Although finance personnel were aware of this inappropriate practice, payment was directed by the circulation manager, who was not in the Finance and Accounting Division. The acting comptroller was aware of the practice, but did not insist on the required documentation.

Unit Cost of Periodicals. ES&S accounting personnel were paying for periodicals without verifying the accuracy of prices billed by distributors. Merchandising personnel updated the unit cost of specific titles based on order acknowledgments they received from distributors. These unit costs appeared on the receiving acceptance reports that were forwarded to the Accounts Payable Branch for verification and payment. When the cost printed on the acceptance report did not agree with the invoice price, personnel in Accounts Payable used historical unit costs from previous invoices instead of contacting the Merchandising Branch to reconcile the prices.

We reviewed the pricing changes made by the Accounts Payable Branch for four major periodical distributors between October 1992 and March 1993. Unit costs were reduced $34,000 and increased $40,000, for a total of $74,000 in changes. Because the two branches did not verify prices, distributors may have quoted ES&S one price for periodicals, but billed at a different rate.

Contracting. ES&S contracting personnel did not always follow established procedures. Contracts for consulting services were awarded to sole source vendors, the contracting officer's authorized warrant was exceeded, and the contract for disposal of returned merchandise did not protect the interests of ES&S.

Sole Source Contracts. During the 11-month period ending March 31, 1993, ES&S awarded six contracts for consulting services to a sole source, Coopers and Lybrand. The contracts, which had a total value of $310,719, were awarded without adequate sole source justification as required by AR 215-4, "Nonappropriated Fund Contracting," Chapter 3-10, October 10, 1990. For example, the justification did not state that efforts had been made to ensure that offers were solicited from as many potential sources as possible, and did not state that the contracting officer had determined that the anticipated cost was fair and reasonable. Consequently, ES&S managers had no assurance that Coopers and Lybrand was the only firm that could have provided the consulting services at the lowest cost. See Appendix C for a detailed listing of the statements of work and dollar value for the six Coopers and Lybrand consulting contracts that were awarded as sole source contracts.

Contracting Officer's Warrant. The ES&S contracting officer awarded a contract that exceeded the authorized warrant issued by the Principal Assistant for Contracting, U.S. Army, Europe (USAREUR). Our review of 14 contracts awarded for the 8-month period ending April 30, 1993, showed that because of a modification to 1 contract for the purchase of 10 Volkswagen sedans, the contract's value increased to $103,600. This amount exceeded the contracting officer's $100,000 warrant and had not been ratified by a contracting officer with a higher warrant. AR 215-4 prohibits a nonappropriated fund contracting officer from issuing a contract modification if it increases the total contract price to an amount exceeding the officer's authorized limit. The prohibition applies even if the modification is within the authorized limit.

We also identified a purchase of six Volkswagen delivery trucks valued at $116,800, which was divided into two contracts to avoid exceeding the authorized limit. AR 215-4 also prohibits the splitting of purchase requests to avoid monetary limitations. An outside group such as the Internal Review Division could have periodically reviewed the Contracting Division, noted actions that were not in compliance with AR 215-4, and made recommendations to ensure compliance.

Disposal of Returned Merchandise. The contracts for disposal of returned magazines and paperback books did not require that returned goods be destroyed when they were transferred to the recycling contractors. The Support Services Division issued purchase requests that did not direct the contractors to destroy the returned merchandise. Therefore, the ES&S contracting officer did not include such a clause. Consequently, resale items could be misappropriated, and ES&S would have no recourse against the recycling contractors.

Vehicle Use. ES&S Headquarters maintained more vehicles than were needed to accomplish its mission. Our analysis of vehicle use showed that as of

May 1993, ES&S Headquarters had almost 2 delivery vehicles available for each of the 26 drivers assigned to make 1 day's deliveries. A maximum of 19 vehicles are used on any shift. Therefore, we estimated that of the 50 available vans and trucks, 24 could be eliminated. These vehicles could be disposed of at a public auction.

The headquarters fleet of 29 sedans was also larger than needed. When we reviewed trip tickets for April 1993, we found that only 15 of the 29 sedans were driven more than 10 days during the month. Of the 14 sedans used for 10 days or less, one sedan was awaiting disposal, and another was awaiting repair for the entire month. ES&S managers planned to replace eight of the high-mileage sedans with new vehicles that were delivered to ES&S in May 1993. Unless valid requirements can be identified, 10 or more sedans should be sold at public auction.

In February 1992, ES&S purchased a computer system, the automated Transportation and Motor Pool System (the system), at a cost of $12,500. The system was designed to monitor vehicle use and maintenance. ES&S employees had not recorded pertinent data in the system since January 1993, and the data recorded before that date were incomplete. Controls had not been established and enforced to ensure that vehicle users supplied all information that was needed. Proper use of the system would have assisted management in determining vehicle requirements, and could have prevented the purchase of unneeded vehicles.

Insurance. ES&S property and cargo shipments of merchandise shipped from the United States were not adequately insured, and claims were not submitted for damaged merchandise. This happened because management did not adhere to AR 215-1.

Property. When we reviewed the insurance coverage for ES&S property, we identified the following inadequacies:

o AR 215-1 requires that nonappropriated fund computers and building contents be insured for their actual cash value, and that vehicles be insured at their actual cash value or the value stated in a national automobile valuation guide. ES&S insured its vehicles, computers, and building contents based on original cost less accumulated depreciation. While this method is appropriate for financial records, it underinsured ES&S's assets. As a result, during FY 1992, ES&S's vehicles were underinsured by about $978,600.

o ES&S had an insurable interest in buildings that cost about $4.4 million and building improvements that cost about $2.5 million. The buildings and improvements were not insured because managers believed that ES&S had to own the buildings in order to obtain insurance coverage. We estimated that about $80,000 per building would not have been covered by insurance if ES&S had experienced a total loss.

o ES&S duplicated insurance coverage on unlicensed vehicles and computers by insuring the property both as individual items and as items in the contents of buildings. Consequently, for FY 1992, ES&S paid $3,000 in insurance premiums for duplicate coverage that could have been better spent to obtain additional coverage on uninsured items, as indicated above.

o The property book record (maintained by the Support Services Division) and the fixed asset general ledger record (maintained by the Finance and Accounting Division) were incomplete. The records also had not been reconciled to each other as recommended in the Coopers and Lybrand study, "European Stars and Stripes Systems Evaluation Manual," June 1992. The study recommended that the property book and the general ledger records be reconciled annually; however, at the time of our audit, ES&S management had taken no action. ES&S probably insured assets that it no longer owned, and may not have insured assets that it owned.

Cargo Shipments. ES&S did not report cargo values monthly for insurance purposes, as required by AR 215-1. AR 215-1 states that within 10 days after the end of the month, nonappropriated-fund instrumentalities should submit a statement of insured values. The last statement submitted by ES&S was dated August 11, 1991, for the period October 1, 1990, through September 30, 1991. Consequently, in-transit merchandise shipped from the United States, valued at about $2.2 million per month, had not been insured since the end of FY 1991.

Reimbursement Claims. ES&S failed to submit insurance claims for damaged resale merchandise because there were no established claim procedures. The insurance officer either was never notified of such incidents, or was unaware that the damages were covered. As a result, ES&S wrote off $26,544 worth of damaged merchandise for the 10 months ending March 1993. The losses resulted from water and handling damages; according to AR 215-1, those damages were eligible for insurance reimbursement.

Internal Review Division. ES&S managers were not effectively using internal review personnel to evaluate operations and recommend corrective actions. According to data maintained by ES&S's internal review personnel, only about 40 percent of the staff's available time was spent on audit-related activities in 1992. In addition, the staff spent only $460 (15 percent) of the $3,000 travel budget allotted to the Internal Review Division during FY 1992. Internal review personnel could have been used more productively to identify solutions to problems facing ES&S managers. Such problems included loss of control in receipts and issues of merchandise from the warehouse, lack of procedures for inventory, and lack of internal controls. Instead of asking the Internal Review Division to recommend solutions to these problems, ES&S awarded contracts totaling about $310,000 to management consultants from Coopers & Lybrand during the 11-month period ending March 31, 1993. ES&S managers also did not act on valid recommendations made by its internal review staff, as stated earlier in this report.

Audit Coverage. There was a lack of adequate audit coverage of ES&S, as required by DoD guidance. Audits were not being performed on an annual basis.

DoD Instruction 7600.6, "Audit of Nonappropriated Fund Instrumentalities and Related Activities," April 16, 1987, requires annual audits for any nonappropriated-fund activity, such as ES&S, that has annual revenues or expenses of $5.0 million or more. The instruction also states that the preferred audit coverage shall be performance audits. The last audit of ES&S was an audit of the balance sheet as of September 30, 1990, which was made by a certified public accounting firm.

The completion of annual performance audits, performed in compliance with Government auditing standards as established by the Comptroller General of the United States, would probably have resulted in recommendations for corrective actions to improve the efficiency of ES&S operations.

Recommendations for Corrective Action

1. We recommend that the Commander in Chief, U.S. European Command:

a. Direct the European Stars and Stripes to implement the Federal Managers' Financial Integrity Act and to report internal control weaknesses as required.

b. Require that a staffing study be made to determine where the European Stars and Stripes should make planned reductions in personnel.

2. We recommend that the Commander/Publisher, European Stars and Stripes:

a. Implement the Federal Managers' Financial Integrity Act in accordance with DoD and EUCOM guidance.

b. Develop and implement procedures to improve controls over automatic data processing. At a minimum, the following steps should be taken:

(1) Require that computer personnel continue their efforts to establish system documentation, and establish a system to periodically obtain feedback from users on whether menu options and output products are applicable.

(2) Implement the controls required by the General Accounting Office for automated systems.

(3) Rewrite the Distribution System application program (developed in-house) into Report Program Generator machine language.

c. Require that managers use customer demand to determine quantities of periodicals and paperbacks to be ordered for the bookstores. Specifically, require that merchandising personnel do the following:

(1) Perform regular analyses of periodical titles sold in the bookstores, and cancel orders for any titles for which the return rate is 65 percent or higher.

(2) Request that computer personnel revise the "Periodical Sales Rank Exception Listing" report to suggest order quantities that allow for a 35-percent expected rate of return, and upon revision of the report, use it when placing orders for periodicals.

(3) Order paperbacks to be sold in the bookstores in quantities that allow for an expected return rate of no more than 35 percent.

d. Implement control procedures to minimize the amount of lost merchandise, to accurately document the distribution and return process, and to account for missing merchandise.

e. Amend contractual agreements between the European Stars and Stripes and bookstore operators to discontinue the practice of paying inventory overages, regardless of prior shortages.

f. Implement procedures to improve the timeliness of returns of outdated merchandise. Specifically:

(1) Deny credit to bookstores that return merchandise after established deadlines.

(2) Require sales representatives to periodically inspect their assigned bookstores for outdated merchandise.

g. Discontinue the special order program in its expanded form.

h. Implement procedures to ensure that the European Stars and Stripes bills the University of Maryland for air shipment and handling charges on textbooks. Specifically, do the following:

(1) Compute and collect air and handling charges for all excess textbooks purchased by the University of Maryland between August 1989 and March 1993.

(2) Implement procedures to ensure that in the future, the University of Maryland is billed for air and handling charges for obsolete and excess textbooks that are on hand after the publisher's recall date.

(3) Amend the current Memorandum of Agreement to ensure that the University of Maryland reimburses the European Stars and Stripes for all air and handling fees for unsold textbooks (specifically, those returned to publishers for credit).

i. Develop and implement inventory procedures for the textbook warehouse. Specific procedures to be established should include the following:

(1) Establish cutoff procedures to be used for receipts and issues, and ensure that the inventory is completed within 2 working days.

(2) Remove the recorded textbook balances from the master inventory listing and eliminate all stock record cards.

(3) Require that disinterested personnel observe inventories.

j. Conduct a staffing study, with assistance from the U.S. European Command, to determine necessary staffing levels; until the study is complete, delay any across-the-board personnel reductions that are not directly associated with reducing business operations.

k. Implement procedures to increase efficiency in the Newspaper Operations Division. At a minimum, do the following:

(1) Conduct periodic evaluations of the effectiveness of the district manager positions and adjust the size of the staff as necessary.

(2) Require Newspaper Operations personnel to conduct a market analysis to establish a reasonable goal for market penetration.

l. Request that the U.S. European Command approve a price increase for the Sunday edition of *The Stars and Stripes* from 50 cents to 75 cents.

m. Implement procedures to maximize interest income. Specifically, do the following:

(1) Withdraw funds weekly from all bank accounts not associated with the Army Banking and Investment Fund (leaving on deposit the minimum balances required by the banks) and deposit the funds with the Army Banking and Investment Fund.

(2) Limit the cashier operation and the petty cash fund to actual disbursing requirements, and deposit the remaining funds with the Army Banking and Investment Fund.

n. Require that all disbursements of funds be supported by original purchase orders, receiving reports, documents that support returns, and vendors' invoices.

o. Implement specific procedures that require accounts payable personnel to verify periodical unit prices with merchandising personnel, to ensure that disbursements are for the correct amounts.

p. Require that the Internal Review Division conduct periodic audits of the European Stars and Stripes Contracting Division to help ensure compliance with contracting regulations that govern nonappropriated-fund instrumentalities.

q. Amend the merchandise disposal contracts to include a clause that requires recycling contractors to ensure that returned merchandise is protected until destroyed.

r. Use the automated Transportation and Motor Pool System, or some other method, to periodically identify vehicle requirements. When the requirements have been identified, sell all unneeded vehicles at public auction.

s. Insure European Stars and Stripes assets for their correct value, in accordance with Army Regulation 215-1. Specifically, do the following:

(1) Insure European Stars and Stripes computers and building contents for their actual cash value.

(2) Insure European Stars and Stripes vehicles for their actual cash value, or for the values given in a national automobile valuation guide.

(3) Insure European Stars and Stripes-occupied buildings for their actual cash value, and insure building improvements at cost. If this is not feasible, insure only those buildings and building improvements that, if destroyed, would create a financial hardship for the European Stars and Stripes.

(4) Insure cargo shipments in accordance with Army Regulation 215-1. Specifically, report cargo values on a monthly basis to ensure that losses are covered.

t. Take a physical inventory of European Stars and Stripes-owned assets, and reconcile the count to the property book and fixed asset general ledger records. Ensure that both records contain all the information needed to reconcile them to the "Insured Exposure Report." When the inventory and reconciliation are complete, insure those assets that were not previously insured, and drop coverage for assets no longer owned and any assets that are already insured as building contents.

u. Develop and implement standard operating procedures for the insurance program, in accordance with Army Regulation 215-1. Specifically, define the reporting and filing requirements for all incidents and claims.

v. Use the Internal Review Division for audit-related activities; specifically, to identify problem areas for the European Stars and Stripes, both at headquarters and at field locations.

w. Require that audits of the European Stars and Stripes organization be done annually, and that the audits follow Government auditing standards established by the Comptroller General of the United States as implemented by the IG, DoD.

Management Comments and Audit Response

Comments on Recommendations. The Commander in Chief, U.S. European Command, concurred with Recommendation 1. The comments were fully responsive; however, the response stated that ES&S is defined as an Internal Management Control element of USEUCOM, according to EUCOM Directive 50-8. Consequently, Army guidance would not be applicable. In the final report, we have revised the section entitled "Federal Managers' Financial Integrity Act of 1982" and Recommendation 2.a. to reflect EUCOM guidance.

The Commander/Publisher, European Stars and Stripes (the Commander), concurred with all parts of Recommendation 2. except for Recommendation 2.k.(1), which recommended eliminating the district manager positions in the Newspaper Operations Division. The Commander concurred in part with Recommendation 2.g., which recommended discontinuing the expanded form of the special order program.

On Recommendation 2.k.(1), the Commander stated that only five of the district manager positions were filled over and above existing staff prior to the inception of the Newspaper Circulation Department, and that two of these new positions were part-time and have since been eliminated. He stated that the actual addition to the ES&S payroll was only $94,000. The Commander agreed that where possible, ES&S should evaluate areas where similar duties of district managers and bookstore sales managers could be combined to benefit both departments. However, in some cases, particularly in Germany, the volume of newspaper accounts to be serviced would restrict the ability of a bookstore sales manager to provide adequate service for both functions. The Commander also believed that because there is a need to maintain stability of sales in a decreasing market and the district manager is responsible for increasing sales, the benefits received from these positions outweigh the costs.

We disagree in part with management's comments on Recommendation 2.k.(1). As we stated in our draft report, at the time of our audit, newspaper market penetration had increased approximately 2 percentage points, and actual sales had decreased in a greater proportion than the decrease in the available market since the time ES&S had established the district manager positions. ES&S did not adequately analyze the market before establishing these positions and has not evaluated their effectiveness. However, since the U.S. Congress recently passed legislation to transfer responsibility for Stars and Stripes bookstore operations to the military exchanges, we believe the district manager positions will be essential for ES&S to maintain market share and aggressively pursue increased sales. Nevertheless, there should be some periodic evaluation of the necessary staffing level for the district manager positions, especially when the available market changes significantly because of declining troop strength. In the final report, we have revised the section entitled "Newspaper Operations, District Managers," and Recommendation 2.k.(1).

In response to Recommendation 2.g., the Commander agreed that the special order program was losing over $100,000 per year. However, he stated that because the program is required by EUCOM Directive 15-8, ES&S can take no action on this recommendation until 6 months after the directive is revised. We do not consider these comments fully responsive. In our draft report, we recognized that the special order program is required by EUCOM Directive 15-8; we understand its value to ES&S customers. However, we did not recommend eliminating the program altogether. The intent of Recommendation 2.g. was that ES&S restore the special order program as it was operated prior to October 1992, without the special order software and toll-free telephone lines. This corrective action can be taken without a revision of EUCOM Directive 15-8.

We did not consider management's comments to Recommendation 2.c.(2) to be fully responsive. The recommendation concerned revision of the "Periodical Sales Rank Exception Listing" report to reflect suggested order quantities for an expected return rate of 35 percent. Although management's actions are likely to reduce periodical orders to reasonable quantities, they do not address this recommendation.

The comments on Recommendation 2.j. were responsive to our recommendation in the draft report. However, we revised our recommendation because it did not clearly request assurance that a staffing study would be done or ask for a completion date. This final report includes the revised Recommendation 2.j.

The comments on Recommendation 2.r. were responsive, since ES&S identified vehicle requirements and has begun to sell all unneeded vehicles. However, the Commander stated that the Transportation Motor Pool system (the system) was not used because it did not meet the requirements of a motor pool the size of ES&S. The procurement request for the system noted that it was the "USAREUR standard for Transportation Motor Pool automation," and was "necessary to modernize ES&S dispatch, maintenance and transportation office administration." The request also noted that the USEUCOM Inspector General had recommended automation of the ES&S Vehicle Operation Program in August 1988. If the system did not meet the requirements for a motor pool the size of ES&S, we do not believe ES&S managers should have spent the funds to procure the system. An automated or manual system should be used to track vehicle usage and maintenance, and provide periodic evaluations of vehicle requirements. In the final report, we have revised the recommendation to allow another method of identifying vehicle requirements.

Comments on Potential Monetary Benefits. The Commander concurred with the potential monetary benefits resulting from Recommendations 2.d., 2.g., and 2.h., and nonconcurred with the monetary benefits resulting from Recommendations 2.k., 2.l., and 2.m. He also concurred with Recommendation 2.c., but proposed a revision to the projected monetary benefits.

The Commander stated that a one-time savings would result from Recommendation 2.c., but that the savings would be reduced because of the actual costs over a 6-year period. We believe that the estimated savings we calculated are valid. Since the benefit is a one-time savings, there is no reason to calculate its cost over a 6-year period.

The Commander did not concur with Recommendation 2.k., because he believed the cost of eliminating the district manager positions would exceed any benefits realized from adopting the recommendation. As we stated in the "Comments on Recommendations" section, because of the pending transfer of the Bookstore Operations Division to the military exchanges, we have revised the section entitled "Newspaper Operations, District Managers" and Recommendation 2.k.(1). We have also revised Appendix D, "Summary of Potential Benefits Resulting from Audit," to show the potential monetary benefit as an undeterminable amount.

The Commander disagreed with the amount of the monetary benefit projected for Recommendation 2.l. He stated that our calculations should have considered an average decline in circulation of 3 percent and the expected reduction in troop strength of 27 percent by the end of FY 1995. After reviewing more recent sales data from ES&S, we determined that management's comments about declining troop strength were valid. Consequently, we have revised the section entitled "Newspaper Operations, Price of Sunday Edition." We also recalculated Appendix D, "Summary of Potential Benefits Resulting from Audit" to show lower estimates for increased revenue because of the expected decline in troop strength. However, our recalculation does not consider the 27-percent decline immediately, as shown in management's computations. Instead, we recognized a gradual decline of 9 percent for FY 1994, 18 percent for FY 1995, and the full 27-percent decline for the last 4 years of the benefits claimed. We believe this is a more precise estimate.

The Commander disagreed with the amount of the monetary benefit projected for Recommendation 2.m. We reviewed our audit work and found a minor error in calculating the amount of the benefit. Therefore, in the final report, we have revised the section entitled "Lost Interest" and Appendix D, "Summary of Potential Benefits Resulting from Audit," to show the correct amounts. However, we believe that we correctly calculated the estimated benefit ES&S should receive by transferring excess funds to the ABIF. The ES&S Comptroller provided us with an analysis of additional interest that could have been earned if funds in the dollar checking account had been transferred to the ABIF. However, as we stated in our draft report, additional interest could also be earned by transferring excess funds from all checking accounts (both U.S. and foreign currency) and deposit accounts, and by reducing balances on hand in the cashier operation and petty cash funds. The ES&S analysis did not consider the effects of the excessive balances maintained in the other accounts, especially the deutsche mark account.

Response Requirements for Each Recommendation

Responses to the final report are required from the Commander/Publisher, European Stars and Stripes, for Recommendations 2.c.(2), 2.g., 2.j., 2.k.(1), 2.r., and the benefits described in Appendix D for Recommendations 2.c., 2.l., and 2.m. The response should indicate whether management concurs or nonconcurs, should propose corrective actions for the recommendations, and should give completion dates for the proposed actions. See Part IV for the complete text of management's comments.

Part III - Additional Information

Appendix A. Results of Statistical Sample

(All projections are shown with 90-percent confidence levels.)

Finding Topic	Statistical Results
Late deposits * (tested using a two-stage sampling process). Time period: 4 months.	Percentage of deposits late: 21.9 percent ± 8 percent Value of late deposits: \$2.57 million ± \$1.05 million
Cost of overorders of periodicals between March and May 1993 (tested using stratified sampling).	Value of overorders: \$504,288 ± \$220,602 million
Losses from lack of followup on bookstore shipping shortages (tested using simple random sampling). Criterion: Stores with gross shortages of more than \$100 and 100 or more copies short (high-risk titles).	Number of stores: 97 stores ± 12 stores Number of copies short: 146,210 ± 44,743 Value of high-risk titles: \$364,347 ± \$111,497
Inventory accountability for University of Maryland textbooks (tested using simple random sampling).	Number of copies not accounted for: 4,100 copies ± 670 copies Value of copies not accounted for: \$97,942 ± \$37,901

* This issue is discussed in "Other Matters of Interest" in Part I.

Appendix B. Followup on Prior Audit Report and Prior Studies

Audit Report

U.S. Army Audit Agency Report No. EU 75-302, "Report of Audit European Stars and Stripes for the Twelve Months Ended 9 January 1974," October 3, 1974.

Prior Audit Recommendations. The auditors recommended that inventory instructions be developed, to include cutoff procedures for the receipt and issue of purchased publications, and that disinterested personnel observe inventories.

Repeat Finding. ES&S did not prepare inventory instructions for the February 1993 physical inventory of the University of Maryland textbook warehouse. Consequently, cutoff procedures were not established for receipts and issues of textbooks, and disinterested personnel did not observe inventories taken.

Studies

Rosen Commission, "Stars and Stripes Advisory Task Force," October 1987.

Prior Study Recommendation. The commission recommended that to reduce the costs of handling, inventorying, and managing unsold periodicals, ES&S should reduce the number of periodicals available for sale to the 200 bestsellers.

Repeat Finding. At the end of May 1993, about 750 periodical titles were being distributed to the bookstores, and periodicals costing $504,288 had been overordered during the previous 3 months.

Prior Study Recommendation. The commission recommended creating a documentation book for all ADP systems. The book should fully document the system, computer files, input forms, and output reports.

Actions Taken. At the time of our audit, the programmers and their support staff were beginning to document the application program and to determine what procedures and output products were applicable to current ES&S operations.

Repeat Finding. ES&S had not documented its ADP system or the more than 1,800 menu options available to users.

Coopers and Lybrand, "European Stars and Stripes Systems Evaluation Manual," June 1992.

Prior Study Recommendation. The consultants recommended that an annual reconciliation be made between ES&S's hand receipt record, maintained by the Support Services Division, and the fixed asset general ledger record, maintained by the Finance and Accounting Division.

Repeat Finding. As of June 1993, the hand receipt record and the fixed asset general ledger record had not been reconciled.

Appendix C. Sole Source Contracts Awarded to Coopers & Lybrand

ES&S awarded the following sole source contracts to Coopers & Lybrand for consulting services.

o Evaluation of the ES&S accounting system against GAO standards. Contract NAFSS1-92-M-0514, awarded on April 28, 1992, for $45,670.

o Consultant services for planning and implementation of a new warehouse distribution system. Contract NAFSS1-92-M-0831, awarded on September 14, 1992, for $48,000.

o Consultant services for implementation of plans and methods to correct current problems related to internal control systems at ES&S. Contract NAFSS1-93-M-0067, awarded on October 27, 1992, for $85,000, amended on November 4, 1992, to reduce the total cost by $25,000, amended on December 1, 1992, to extend the contract period for an additional 30 days and to increase the total cost by $14,000. The contract amount, after amendments, totaled $74,000.

o Consultant services for implementation of controls within the inventory accounting area, which were determined to be necessary as the result of a study by Coopers and Lybrand. Contract NAFSS1-93-M-0229, awarded on January 19, 1993, for $54,250.

o Consultant services for evaluation of the point-of-sale system. Contract NAFSS1-93-M-0249, awarded on January 26,1993, for $30,067.

o Consultant services for the implementation of procedures designed to improve the internal control environment and to increase operational efficiency. Contract NAFSS1-93-M-0250, awarded on January 26, 1993, for $58,732, amended on March 2, 1993, to rescind the original task and to include the development of a comprehensive plan to restructure ES&S and the Pacific Stars and Stripes.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.a.	Economy and efficiency. Implementation should result in improved overall management.	Nonmonetary.
1.b.	Economy and efficiency. Implementation should identify those positions that can be eliminated and determine when they can be eliminated.	Nonmonetary.
2.a.	Compliance with law. Implementation should result in compliance with the Federal Managers' Financial Integrity Act and improved internal controls.	Nonmonetary.
2.b.	Internal controls. Implementation should result in improved control over ADP systems; managers should have greater assurance that they receive accurate data.	Nonmonetary.
2.c.	Economy and efficiency. Implementation should reduce ES&S's investment in excessive inventories of periodicals.	Funds put to better use; $2.0 million in FY 1994.
2.c.	Economy and efficiency. The costs of handling, inventorying, and managing unsold periodicals and paperbacks should be reduced. Appropriated-fund support for transporting periodicals and paperbacks from the continental United States should also be reduced.	Undeterminable. We know of no basis on which to compute the monetary benefit.

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
2.d.	Internal controls. Implementation should result in improved controls over merchandise issued to bookstores.	Funds put to better use; $1.69 million in FYs 1994 through 1999.
2.e.	Economy and efficiency. Implementation should reduce losses by discontinuing the payment of inventory overages to bookstore operators.	Nonmonetary.
2.f.	Economy and efficiency. Implementation should provide for more timely return of outdated merchandise, and ES&S should receive full credit from publishers and distributors.	Nonmonetary.
2.g.	Economy and efficiency. Implementation should reduce operating losses.	Funds put to better use; $636,000 in FYs 1994-1999.
2.h.	Economy and efficiency. Implementation should reduce losses by billing the University of Maryland for air and handling charges for obsolete and excess textbooks on hand beyond the publisher's recall date, and for textbooks returned to publishers.	Funds put to better use; $58,000 in FYs 1994 through 1999.
2.i.	Internal controls. Implementation should result in accurate inventories.	Nonmonetary.
2.j.	Economy and efficiency. Implementation should identify positions that can be eliminated and determine when they can be eliminated.	Nonmonetary.

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
2.k.	Economy and efficiency. Implementation should result in more efficient use of funds for salaries and benefits.	Undeterminable. We know of no basis on which to compute the monetary benefit.
2.l.	Economy and efficiency. Implementation should increase revenues from newspaper sales.	Funds put to better use; $4.0 million in FYs 1994 through 1999.*
2.m.	Economy and efficiency. Implementation should increase interest income.	Funds put to better use; $570,000 in FYs 1994 through 1999.
2.n.	Internal controls. Implementation should result in improved controls over disbursements.	Nonmonetary.
2.o.	Internal controls. Implementation should result in improved controls over disbursements.	Nonmonetary.
2.p.	Compliance with regulation. Implementation should result in compliance with contracting guidance in AR 215-4.	Nonmonetary.
2.q.	Internal controls. Implementation should reduce the risk that resale items may be misappropriated.	Nonmonetary.

* Total benefits are calculated to allow for declining troop levels in Europe, as follows:

FY 1994: $800,000

FY 1995: $700,000

FYs 1996 through 1999: $2.5 million

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
2.r.	Economy and efficiency. Implementation should generate working capital and decrease vehicle operating costs, including maintenance and insurance costs.	Undeterminable. We know of no basis on which to compute the fair market value and operating costs of vehicles to be eliminated.
2.s.	Compliance with regulation. Implementation should result in compliance with insurance guidance in AR 215-1.	Undeterminable. Increased recoveries from insurance for future damages cannot be estimated.
2.t.	Internal controls. Implementation should result in improved controls over insured assets and an accurate inventory of assets.	Nonmonetary.
2.u.	Compliance with regulation. Implementation should result in compliance with insurance guidance in AR 215-1 and reduced losses from damaged textbooks.	Undeterminable. Increased recoveries from insurance for future damages cannot be estimated.
2.v.	Internal controls. Implementation should result in improved controls over operations.	Nonmonetary.
2.w.	Compliance with regulation. Implementation should result in compliance with Government auditing standards for performance audits, and should improve the use of audits as a management tool.	Nonmonetary.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Special Assistant to the Secretary of Defense (Public Affairs), Washington, DC
Comptroller of the Department of Defense, Washington, DC

Department of the Army

Army Central Insurance Fund, U.S. Army Community and Family Support Center, Alexandria, VA
Headquarters, Second Region, U.S. Army Criminal Investigation Command, Heidelberg, Germany
Darmstadt Resident Agency, Second Region, U.S. Army Criminal Investigation Command, Darmstadt, Germany

Unified and Specified Commands

Headquarters, U.S. European Command, Stuttgart, Germany

Other Defense Organizations

American Forces Information Service, Alexandria, VA
Headquarters, European Stars and Stripes, Darmstadt, Germany
Stars and Stripes Bookstore, Vogelweh Shopping Center, Kaiserslautern, Germany
Stars and Stripes Bookstore, Rhein Main Shopping Center, Rhein Main Air Base, Germany
Stars and Stripes Bookstore, Abrams Building, Frankfurt, Germany
Stars and Stripes Bookstore, Heidelberg Shopping Center, Heidelberg, Germany
Stars and Stripes Bookstore, Downs Barracks, Fulda, Germany

Appendix F. Report Distribution

Office of the Secretary of Defense

Special Assistant to the Secretary of Defense (Public Affairs)
Comptroller of the Department of Defense

Department of the Army

Secretary of the Army
Auditor General, Army Audit Agency

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Commander, Naval Supply System Command

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)

Unified Command

Commander in Chief, U.S. European Command

Other Defense Organizations

Director, American Forces Information Service
Commander/Publisher, European Stars and Stripes
  Senior Official Responsible for Internal Controls, European Stars and Stripes
Commander, Army and Air Force Exchange Service
Commander, Navy Exchange Service

Non-Defense Federal Organizations

Office of Management and Budget
- U.S. General Accounting Office, National Security and International Affairs Division, Technical Information Center
- 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 Committee on Government Operations
    - House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

U. S. European Command

HEADQUARTERS
UNITED STATES EUROPEAN COMMAND
Office of the Chief of Staff
APO AE 09128-4209

8 November 1993

MEMORANDUM FOR Inspector General, Department of Defense (Attn: Director, Financial Management Directorate), 400 Army-Navy Drive, Arlington, VA 22202-2884

SUBJECT: Draft Report on the European Stars and Stripes (Project No. 3FH-5006)

1. Reference: DODIG memorandum dtd 10 Sep 93, SAB.

2. This memorandum responds to your request for comment on the draft DOD IG Audit Report on European Stars and Stripes. The audit will serve as a useful road map to guide needed management actions in many important areas and to enable European Stars and Stripes to become a more efficient and profitable enterprise during the years ahead.

3. HQ USEUCOM comment for recommendations 1a and 1b follows:

a. Recommendation 1a. Concur. EUCOM Directive 50-8, Internal Management Control Program, 28 May 1986, directly implements DoD Directive 5010.38 within the Headquarters of U.S. European Command, including European Stars and Stripes. HQ USEUCOM does not fall under the purview of Army Regulation 11-2. EUCOM Directive 50-8 specifically defined European Stars and Stripes as a USEUCOM IMC element and directed the Commander, European Stars and Stripes to implement the IMC process to include performing vulnerability (risk) assessments, developing plans for subsequent actions (management control plan), conducting internal management control reviews or taking other management actions to correct weaknesses and to improve controls and reporting on actions and status of the IMC process in the organization.

Corrective Action: By memorandum HQ USEUCOM will reiterate the requirement to implement fully the IMC process with emphasis on managers developing management control plans, identifying areas requiring internal controls, and testing and improving internal controls. Follow-up inspections/visits will insure compliance. Estimated completion date: 30 November 1993.

b. Recommendation 1b. Concur.

Corrective Action: By memorandum HQ USEUCOM will direct the European Stars and Stripes to conduct a realistic study within its chain of command of its manpower requirements. Follow-up inspections/visits will insure compliance. Estimated completion date: 30 November 1993.

ECCS 8 November 1993

SUBJECT: Draft Report on the European Stars and Stripes (Project No. 3FH-5006)

4 Commander, European Stars and Stripes comment is forwarded as enclosure (1).

1 Encl
CDR ES&S memo dtd 1 Nov 93

Richard F. Keller
RICHARD F. KELLER
Lieutenant General, USA
Chief of Staff

CF:
Director, Joint Staff, OJCS
Director, AFIS
Commander, ES&S

2

DEPARTMENT OF DEFENSE
EUROPEAN STARS AND STRIPES
APO 09211-4211

ECSS-CDR 1 November 1993

MEMORANDUM THRU Headquarters, U.S. European Command, ECCS, ATTN: LTG Richard F. Keller, APO AE

FOR Department of Defense, Inspector General, 400 Army Navy Drive, Arlington, VA 22202-2884

SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

The following information is provided regarding the Draft Report on the European Stars and Stripes (Project No. 3FH-5006):

Finding/Recommendation 2.a. Concur. Corrective Action: ES&S will implement the Federal Manager's Financial Integrity Act in accordance with EUCOM guidance. A management control plan will be developed and internal management control reviews will be conducted on internally assessable units.
Estimated Completion Date: 31 Dec 93.

Finding/Recommendation 2.b.(1) Concur. Corrective Action: The Technical Systems Department is currently re-writing the entire Bookstore Operations ADP system. During this re-write, all programs are being documented. Documentation includes user instructions, as well as program code documentation. ES&S has established a Computer Steering Committee to ensure technical resources are matched to user needs. The following schedule will apply to rewriting the purchase order system - estimated completion date, 7 Jan 94; rewrite receiving system - estimated completion date, 18 Mar 94: rewrite distribution system - estimated completion date, 27 May 94; rewrite inventory control system - estimated completion date, 5 Aug 94; and rewrite returns system - estimated completion date, 15 Oct 94.
Estimated completion date: 15 Oct 94.

Finding/Recommendation 2.b.(2) Concur. Thirteen of the sixteen general controls required by the GAO on computer systems are now in place. Two controls will be implemented by 2 Oct 94 and the remaining GAO control "2 persons present in the computer room at all times" will be implemented by having all computer input activities logged on a magnetic tape. Daily back-ups of these tapes are stored on site with a monthly back-up stored off site. 18 of the 27 application controls are now in place. The remaining nine applications will be completed by 15 Oct 94 in conjunction with the rewrite of the computer software.

ECSS-CDR
SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

Estimated completion date: 15 Oct 94.

Finding/Recommendation 2.b.(3) Concur. Corrective Action: Technical Systems has documented the existing Distribution System and is in the process of re-writing the application in RPG language.
Estimated completion date: 1 Dec 93.

Finding/Recommendation 2.c.(1) Concur. Corrective Action: Bookstore operations personnel in the Periodical Unit were trained on 21 Jul 93 on the use of the sales analysis report and instructed to use it continuously when reordering any periodical. In conjunction, the department director established a Merchandise Purchase Budget in October 1992 to control all purchases and inventories. All periodicals are being reviewed in terms of order quantities and changes, and where appropriate changes have been made in the quantities being procured. All periodical orders are continually reviewed using the Sales Analysis Report, on a publisher by publisher basis, when reorders are made.
Completion date: Action completed.

Finding/Recommendation 2.c.(2) Concur. Corrective Action: Merchandise personnel have been trained and are using the "Periodical Sales Rank Exception Listing" report to determine order quantities when placing orders for periodicals. Reviews of each major publisher have been accomplished as follows: Worldwide - 6 Jul 93; HDG - 9 Jul 93; Time Warner - 9 Jul 93; Curtis - 6 Jul 93; and Kable - 21 Jul 93.
Completion date: Action completed.

Finding/Recommendation 2.c.(3) Concur. Corrective Action: ES&S is ordering paperbacks to be sold in the bookstores to allow for an expected average return rate of no more than 35 percent.
Completion date: Action completed.

Finding/Recommendation 2.d. Concur. Corrective Action: A new procedure was established 2 Jun 93 to account for merchandise deliveries. A waybill is sent with each truck shipment, shipping tallies are sent in advance of shipment to bookstore managers, who are required to report their shipment variance over $50.00 to headquarters within seven (7) days of merchandise receipt. In addition, the quality control administrator in the central distribution center perform double counts of selected shipments. Accountability controls have been established to track and report each shipment variance. Internal Review will monitor the controls and procedures as part of their established audit program. The new procedure for merchandise

-2-

ECSS-CDR
SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

accountability was put into place on 2 June 93 and the new procedure for waybills was implemented on 25 Sep 93.
Completion date: Action completed.

Finding Recommendation 2.e. Concur. Corrective Action: ES&S Contracting Office will issue a bilateral modification to all Bookstore Concessionaire Contracts amending the Contract to exclude any reference of payments to the Contractor for inventory overages. Such modification will be issued to Bookstore Operations for dissemination to all bookstore concessionaire contractors for signature.
Estimated completion date: 1 Jan 94.

Finding/Recommendation: 2.f.(1) Concur. Corrective Action: A bookstore procedure was put in place in 18 May 1993, which provides each bookstore manager with a computerized Late Return Tally for magazines and in 16 July 1993 for paperbacks. Each bookstore manager has been instructed that no credit will be given for late returns submitted after the cut-off date. In June 1993, the Inventory Accounting Manager was requested to advise the European Sales Manager of any store submitting more than $500.00 in late returns so the Sales Representatives can follow-up and provide additional training if necessary. Each Area Sales Manager has been informed of the Late Returns Log and the requirement to provide training to bookstore managers with late returns that exceed this level.
Completion Date: Action Completed.

Finding/Recommendation: 2.f.(2) Concur. Corrective Action: Sales Representative have always been required to monitor their stores for outdated merchandise. This requirement will be more closely enforced by bookstore management. This item will be a topic of discussion during the sales manager's meeting scheduled for 4 Nov 93.
Completion Date: Action Completed.

Finding/Recommendation: 2.g. Concur in Part. Corrective Action: The special order program furnishes a valuable service to our customers but it is a requirement found in EUCOM Directive 15-8. We concur that the program loses in excess of $100,00 per annum.
Estimated completion date: 6 months after revision of ED 15-8.

Finding/Recommendation: 2.h.(1) Concur. Corrective Action: The University of Maryland was invoiced by ES&S on 9 Sep 93 for all air and handling charges for all textbooks purchased between August 1989 and March 1993. Collection will be in accordance with standard operating procedures (SOPs).

-3-

ECSS-CDR
SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

Estimated completion date: 9 Dec 93.

Finding/Recommendation: 2.h.(2) Concur. Corrective Action: On 25 Feb 93, the staff in the textbook unit was notified to invoice the University of Maryland for the air and handling charge of $2.50 per textbook for any obsolete or excess book. Bookstore management will ensure review and enforcement of this action.
Completion Date: Action Completed.

Finding/Recommendation: 2.h.(3) Concur. Corrective Action: The current MOA with the University of Maryland will be renewed in March 1994. An amendment will be added to clarify University of Maryland responsibility for air and handling charges on textbooks returned to the publisher for credit. The University of Maryland is currently being invoiced for these shipping charges.
Estimated Completion Date: 31 Mar 94.

Finding/Recommendation: 2.i.(1) Concur. Corrective Action: The next inventory of the textbook warehouse will be conducted in December 1993. Cutoff procedures for receipts and issues will be developed and implemented. This item will become an area of interest in the ES&S Internal Management Control (IMC) program.
Estimated Completion Date: 31 Dec 93.

Finding/Recommendation: 2.i.(2) Concur. Corrective Action: The next inventory of the textbook warehouse will be conducted in December 1993. Recorded textbook balances will be removed from the master inventory listing. Stock record cards were eliminated on 15 Oct 93. This recommendation will be included in the ES&S IMC program.
Estimated Completion Date: 31 Dec 93.

Finding/Recommendation: 2.i.(3) Concur. Corrective Action: During the warehouse inventory scheduled for December 1993, Internal Review staff will serve as disinterested observers.
Estimated Completion Date: 31 Dec 93.

Finding/Recommendation: 2.j. Concur. Corrective Action: ES&S has delayed across-the-board personnel reductions that are not directly associated with reducing business operations, until a manpower study, coordinated by ES&S and the U.S. European Command, has been completed.
Completion date: Action completed.

Finding/Recommendation: 2.k.(1) Nonconcur. Five (5) district

-4-

ECSS-CDR
SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

managers (DM) were hired over and above the current staff prior to the reorganization that created the newly formed Newspaper Circulation Department. Two of the new hires were part-time and have been eliminated. The actual addition to ES&S payroll was approximately $94,000. It is essential that a dedicated newspaper circulation work force be in place to ensure stabilization of sales in a decreasing market. ES&S is evaluating areas where combining dual job functions of newspaper circulation district managers and bookstore sales managers works in the best interest of both departments. Positions have been combined in the UK, Italy, Spain, Turkey, and Stuttgart areas. ES&S will continue to combine these duties where possible. In Germany, this is not possible due to the fact that each DM is responsible for an average of 50 to 60 accounts. These accounts include bookstores, AAFES, News vendors, home delivery carriers, and vending machine locations, which are serviced on a weekly basis. To add the bookstore sales managers responsibilities to the district managers would be too demanding and both operations would receive inadequate service. A DMs first and foremost responsibility is to assess the potential for additional sales by increasing new accounts receivable, and ensure all accounts are collected and current. Therefore, benefits received outweigh the costs.

Finding Recommendation: 2.k.(2) Concur. Corrective Action: ES&S Marketing Department, until dissolved in October 1993, conducted monthly population studies based on input from the component commands. This effort will continue through newspaper operations staffing. Using these figures, ES&S compares net newspaper sales to historically track penetration levels and project future sales. A Coopers and Lybrand study established a penetration goal of 50% and ES&S contends that this target is practical and legitimate. A readership poll conducted in August 1993, will give additional data on how ES&S can improve penetration by better responding to reader needs.
Estimated completion date: 1 Dec 93.

Finding/Recommendation: 2.l. Concur. Corrective Action: An analysis and proposal will be prepared and presented to the Chairman of Board of Directors for consideration and approval as an action to be presented to the Board of Directors of European Stars and Stripes.
Estimated Completion Date: 31 December 1993.

Finding/Recommendation: 2.m.(1) Concur. Corrective Action: ES&S has significantly reduced operating cash balances to minimum

-5-

ECSS-CDR
SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

operational requirements. Excess cash balances have been transferred to the Army Banking and Investment Fund (ABIF) to maximize interest income. ES&S will establish procedures that weekly streamline all cash not required for the day-to-day operations into the ABIF investment account.
Estimated Completion Date: 31 Dec 93.

Finding/Recommendation: 2.m.(2) Concur. Corrective Action: On 18 June 93, ES&S closed its cashier operation. All petty cash funds were reviewed on 20 Oct 93 and imprest balances were adjusted to necessary operating levels. Excess balances will be transferred to an interest bearing account to maximize earnings.
Estimated Completion date: 30 Nov 93.

Finding/Recommendation: 2.n. Concur. Corrective Action: All disbursements of funds are supported by original purchase order, receiving reports, documents supporting returns, and vendor's invoices in accordance with standard operating procedures (SOPs). This will be an item of emphasis for the IMC program.
Completion date: Action completed.

Finding/Recommendation: 2.o. Concur. Corrective Action: Procedures were implemented on 30 Jun 93, which requires Accounts Payable personnel to verify periodical prices with merchandising personnel. These and additional procedures will be incorporated into written operating instructions no later than 31 Dec 93. This will be an item of emphasis for the IMC program.
Completion date: Action completed.

Finding/Recommendation: 2.p. Concur. Corrective Action: ES&S Internal Review will conduct periodic audits of the ES&S Contracting Division to ensure compliance with NAF contracting regulations.
Estimated Completion Date: 30 Jun 94.

Finding/Recommendation: 2.q. Concur. Corrective Action: All ES&S personnel have been instructed to ensure thorough reviews of statements of work. All contracts for the disposal of returned merchandise have been reviewed and modified to state that items are to be destroyed upon receipt by the contractor. All contracts for disposal of returned merchandise were rewritten by 12 Jun 93.
Completion Date: Action Completed.

Finding/Recommendation: 2.r. Concur. Corrective Action:

-6-

ECSS-CDR
SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

The Automated Transportation Motor Pool system was not used, because it does not meet the requirements of a motor pool of our size. However, vehicle requirements for ES&S have been identified. The initial sale of excess vehicles was completed 15 Oct 93. The final sale will be conducted in April 1994.
Estimated Completion Date: 30 Apr 94.

Finding/Recommendation: 2.s.(1) Concur. Corrective Action: ES&S will update insurance coverage for all computers and building contents for their actual cash value.
Estimated Completion Date: 30 Jun 94.

Finding/Recommendation: 2.s.(2) Concur. Corrective Action: ES&S will insure vehicles for their actual cash value or for the values given in a national automobile valuation guide.
Estimated Completion Date: 30 Nov 93.

Finding/Recommendation: 2.s.(3) Concur. Corrective Action: Each facility occupied by ES&S will be reviewed to assess and obtain appropriate insurance coverage. ES&S has begun a full inventory of fixed assets and reconciliation of the general ledger. The fixed asset system will be updated to proved better descriptions, serial number identification, and location. ES&S will modify the insurance work sheets to correct duplications of coverage.
Estimated Completion Date: 31 Mar 94.

Finding/Recommendation: 2.s.(4) Concur. Corrective Action: Effective September 1993, ES&S will submit a "Form B: Declaration for Insurance" directly to the insurance carrier, Johnson Higgins, monthly for cargo insurance on all inventory purchases recorded for the month.
Completion Date: Action Completed.

Finding/Recommendation: 2.t. Concur. Corrective Action: A physical count of ES&S property is scheduled for 1-30 Nov 93, using military personnel from the Darmstadt Community. The 100% inventory will be used to establish a complete property book, reconcile the fixed asset general ledger records, and provide data for the Insured Exposure Report. ES&S Insurance Section will modify coverage as needed based on this inventory.
Estimated Completion Date: 30 Jun 94.

Finding/Recommendation: 2.u. Concur. Corrective Action: ES&S will develop and implement standard operating procedures for the insurance program, IAW AR 215-1, which will define the

-7-

ECSS-CDR
SUBJECT: Draft Report on the European Stars and Stripes Project No. 3FH-5006

reporting and filing requirements for all incidents and claims.
Estimated completion Date: 31 Dec 93.

Finding/Recommendation: 2.v. Concur. Corrective Action: The ES&S Internal Review section is being used more for audit related activities such as identifying problem areas, recommending improvements to internal control systems, and following up on management actions to correct deficiencies. A recent report reflects time spent on these matter has increased from 40% in FY92 to 55% in FY93. ES&S is in the process of recruiting a third member of the audit team, who will be working primarily at field locations.
Estimated Completion Date: 31 Mar 94.

Finding/Recommendation: 2.w. Concur. Corrective Action: ES&S will arrange for audit service to be conducted in FY94 in accordance with DoDI 7600.6.
Estimated Completion Date: 31 Mar 94.

-8-

ECCS-CDR
SUBJECT: Draft Report on European Stars and Stripes Project No. 3FH-5006 (Appendix D. Replies)

Monetary Benefit/Reference 2.c Concur. ES&S concurs with the monetary benefit cited of $2.0 million of funds put to better use in FY94. However, the actual monetary cost at 6% over six years is $720,000. This approach results in a reduction of $1,280,000 in the reported monetary benefits.

Monetary Benefit/Reference 2.d Concur. Using the information provided in Appendix A of the draft report, ES&S agrees that the annual monetary benefit of improved controls over merchandise shipments to bookstores would be in the range of $195,750 to $368,395. Over a six year period, ES&S could expect savings in a range of $1.1 million to $2.2 million.

Monetary Benefit/Reference 2.g Concur. Elimination of the ES&S Special orders Program could reduce operating expenses by approximately $106,000 in FY94. During FY94-99, ES&S could save approximately $636,000.

Monetary Benefit/Reference 2.h Concur. Corrective Action: ES&S has billed the University of Maryland for $58,000 for air and handling charges of textbooks.

Monetary Benefit/Reference 2.k Nonconcur. The district manager force should remain in place in order to provide ES&S strong stability at a time when our market is declining. The reported cost savings would be more than off-set by revenue losses due to a corresponding reduction of paid circulation (12% sales reduction X 65,000 paid subscribers = 7,800 copies X $.50 X 362 delivery days = $1.411,800). This equates to a $8.5 million revenue loss versus a $3.9 million expense.

Monetary Benefit/Reference 2.1. Nonconcur. As stated on page 5 of this document in our response to recommendation 2.1., the issue of a Sunday price increase will be submitted to the Board of Directors for decision. However, if the price increase is adopted, we disagree with the report's estimated monetary benefit of $7.2 million. While it is true that the increased sales price would increase revenues, it would also cause a certain percentage of subscribers to cancel their subscriptions. At current Sunday sales of 67,454, and assuming sales would not decline due to troop strengths or negative reaction to a 50% rate increase, the added revenue for FY94-99 would be $5,261,412. However, neither of the above assumptions are valid. There is an expected decline in troop strength of 27% by the end of FY95. Troop strength decline would place the Sunday sales at an estimated 49,241 copies. History of circulation rate increases show an initial decline of 8-10% on effective date, climbing to an average loss

-9-

ECCS-CDR
SUBJECT: Draft Report on European Stars and Stripes Project No. 3FH-5006 (Appendix D. Replies)

of 3% at the end of the first year. This translates to an increase in circulation revenue of $3,725,280 during FY 94-99.

Monetary Benefit/Recommendation 2.m. Nonconcur. ES&S calculations based on the audit data indicate a net savings of $35,000 per year or $210,000 versus the cited $579,000 over FY94-99.

-10-

ECSS-CDR
SUBJECT: **Draft Report on the European Stars and Stripes Project No. 3FH-5006 (Internal Control Weakness Reply)**

FINDING/RECOMMENDATION: Internal Controls. Concur. Corrective Action: ES&S is currently in the process of implementing the recommendations to correct internal control weaknessess. ES&S believes that recommendations noted in 2.a., 2.b., 2.d., 2.i., 2.n., 2.o., 2.q., 2.t., 2.v., and 2.w. would correct the weaknesses identified.

STEVEN S. HOFFMAN
Colonel, USAF
Commander/Publisher

Encl
1. Summary of Benefits

CF:
HQUSEUCOM/PA
HQUSEUCOM/CM
HQUSEUCOM/IG
AFIS/DIRECTOR

SUMMARY OF MONETARY BENEFITS
(For the Period of FY94-FY99)

REFERENCE	AS REPORTED BY DOD	AS ESTIMATED BY ES&S
2.c.	$ 2,000,000	$ 720,000
2.d.	1,690,000	1,690,000
2.g.	636,000	636,000
2.h.	58,000	58,000
2.k.	3,900,000	0
2.l.	7,200,000	3,725,280
2.m.	579,000	210,000
TOTAL:	**$ 16,063,000**	**$ 7,039,280**

AGIDOD

1 NOVEMBER 1993

Encl 1

Audit Team Members

Nancy L. Hendricks	Director, Financial Management Directorate
Raymond D. Kidd	Audit Program Director
Donald G. Stoll	Audit Project Manager
Virginia Anne Bonds	Acting Audit Project Manager
Stanley J. Arceneaux	Auditor
Young J. Jin	Auditor
Mark A. Pricco	Auditor
Mary E. Vitale	Auditor
Susanne B. Allen	Editor
Judy L. White	Administrative Support
Dr. Francis M. Ponti	Technical Director, Quantitative Methods Division