



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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PROCUREMENT, LOGISTICS,
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RELEASED

MARCH 19, 1982

The Honorable William V. Roth, Jr.
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate



Dear Mr. Chairman:

Subject: Review of Prices Paid by Military
Commissaries on Brand Name Vendor
Supply Bulletin Contracts (PLRD-82-55)

On October 19, 1981, you requested our assistance in auditing brand name vendor supply bulletin contracts. These are annual indefinite quantity contracts negotiated by the Defense Personnel Support Center, the Federal contracting activity for military commissaries. The commissaries use these contracts to purchase grocery items from vendors at prices that are supposed to be as advantageous as those offered commercial customers. Specifically, you asked us to determine whether vendors were complying with the price reduction clause, which states that when a vendor reduces prices to commercial customers, the commissaries should receive the same reduction.

We audited six vendors to determine if commissaries were obtaining prices comparable to commercial customers. We found some price discrepancies at four of these vendors where commissaries paid more for grocery items than other customers. We also found that vendors made allowances, financially beneficial to commissaries, which were not available to commercial customers. Nevertheless, the price discrepancies we found were not necessarily indications of vendor noncompliance with the price warranty provisions in brand name vendor supply bulletin contracts. We discussed our observations with your Office on December 16, 1981, and it was agreed that we should discontinue our review.

Some vendors provided us with proprietary data. To prevent this report from being restricted, as provided by 18 U.S.C. 1905, we have excluded all references to individual companies, brand names, and products.

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At your request, we did not obtain written comments. We did, however, discuss the report with vendors, Army and Air Force commissary officials, and Defense Personnel Support Center officials, and have incorporated their comments where appropriate.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine (1) if the Defense Personnel Support Center was negotiating prices with vendors and (2) if commissaries were receiving the same prices, discounts, and reductions that vendors were making available to their commercial customers.

Your Office provided us with a list of 25 potential vendors to audit. Because of time constraints, we selected six vendors from the list whose headquarters were conveniently located within our regional office structure.

At the vendors' offices, we compared commissary invoices with commercial customer invoices and discussed pricing policies and practices with officials. We selected 852 invoices for comparison. The number of invoices reviewed at each vendor ranged from 59 to 305. Invoices from both small and large commercial customers were included in the sample. The most recent sales periods, which varied from vendor to vendor, were reviewed. Because vendors supply many product lines to commissaries, we concentrated on those products with high sales volumes. Since we did not use statistical sampling techniques, no projections beyond our observations can be made. In addition to comparing invoices, we assessed vendors' pricing policies and practices for their consistency with brand name contract price warranty provisions. At some vendors, commissary sales were not segregated from military exchange sales but combined into the category of military sales. The military exchange pricing provisions are similar to commissary brand name contracts. Therefore, we refer to military prices when our analyses include both.

At the Defense Personnel Support Center, we discussed with officials their process of issuing and administering supply bulletin contracts.

We made this review in accordance with our current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

DEFENSE PERSONNEL SUPPORT CENTER'S ROLE IN ISSUING SUPPLY BULLETIN CONTRACTS

The Defense Personnel Support Center is responsible for issuing supply bulletin contracts to brand name vendors. A vendor wanting

to sell its merchandise to commissaries first enters into a contract with the Center. As part of this contract, the vendor submits a list of products, prices, terms, and conditions for all sales, which the Center distributes to the commissaries. The services will then set up an account with the vendor so commissaries can order merchandise from the list.

We found that while the Center is responsible for contracting with brand name vendors, it does not negotiate or verify prices or terms and conditions that vendors submit for publication in supply bulletins to assure compliance with price warranty provisions. Also, the Center does not monitor or audit vendors' price reductions to commissaries and other customers after award of contracts to determine whether commissaries are getting equivalent prices. According to Center officials, there are no regulations requiring them to verify brand name vendor compliance. In addition, Center officials are unaware of any widespread pricing violations, and therefore, do not believe they should undertake a program to verify vendor compliance. Center officials noted that the inherent competition among vendors serves to assure reasonable prices in commissaries.

PRICE DISCREPANCIES

Discrepancies are price differences which could not be adequately explained and resulted in commissaries paying more than a commercial customer. The following examples of price discrepancies were selected because, in our judgment, they may be related to commissary operations.

Within our comparative sample of 852 invoices, we found 6 price discrepancies. At one vendor, we noticed on two invoices that commissaries were paying from 5 cents to 8 cents more for their products than a commercial customer. We estimated the additional cost to commissaries was \$1,500. This difference was caused by the vendor developing uniform prices for its product. According to the vendor, the services want vendors to sell their products to all commissaries at the same price. Since the vendor's commissary pricing zones and commercial marketing regions do not coincide, prices may be different.

We discussed this example with Army and Air Force commissary officials. They stated that the services do not have a uniform pricing policy and that the vendor should have offered the lower prices to the commissaries in that region. Although the services may not have a formal policy on vendors selling their products to commissaries at the same price, vendors expressed the belief that commissaries want uniform prices.

To determine the extent of this type of discrepancy, we screened the vendor's list prices for 540 items in effect for February 1982 in one region. The commissary and commercial prices were equal for 473 items. The prices favored commissaries for 65 items and favored commercial customers for the remaining 2 items.

We found some price discrepancies were due to vendors' pricing policies and practices. These discrepancies were caused because vendors did not offer commissaries the same price discounts in the same period they were offered to commercial customers. It was, however, the vendors' policy to offer their products to commissaries at prices as low as, if not lower than, their prices to commercial customers over time.

Two vendors told us they did not offer commissaries the same "deals" as commercial customers because of the unique requirements imposed by commissary customers. For example, one vendor believes commissaries will not handle price-off packages, which is the way many commercial customers received discounts. Furthermore, commissaries supposedly want the discount periods to run on a monthly basis only, whereas, commercial customers may get discounts on a weekly basis or in response to competitive situations. A third vendor told us it did not offer the same discounts because its logistics and production facilities could not support nationwide promotions to all its customers at the same time.

We evaluated the alternative deals the above three vendors offered commissaries to determine if prices were comparable to commercial customer prices over time. At one vendor, military customers were paying about 25 percent less than commercial customers were paying for products for the past 2 years. At the second vendor, we found 20 price discrepancies which resulted in commissaries paying about \$7,500 more than commercial customers in 1981. Vendor officials admitted an oversight in not offering commissaries price reduction deals offered their commercial customers. They also believed the oversight was probably caused by a reduction in the product lines listed in the military supply bulletin. In order to preclude future occurrences of commercial customers receiving price reductions without corresponding reductions to commissaries, the vendor plans to establish a quarterly review procedure and develop a price reduction strategy to achieve equivalent prices for the commissaries over an annual time period. At the third vendor, we identified seven products that at least one commercial customer purchased at a lower average price than the military during the first 11 months of 1981. The additional cost to the services was about \$277,000. Vendor officials stated that the services paying more than the commercial customer is not an indication of the vendor's noncompliance with the warranty provisions. The commissaries were offered better deals, but they did not take advantage of them.

Commercial customers, they continued, took advantage of the deals they were offered by buying in large quantities, and as a result, paying lower prices.

ALLOWANCES PROVIDED COMMISSARIES

Our audit also disclosed that allowances were made to commissaries. These allowances either reduced the price of the products being purchased or reduced commissary operating costs. The following are a few examples of the allowances provided commissaries.

One allowance that most vendors provided was billing commissaries in unit prices. Commercial customers are billed by the case. To accommodate commissaries, vendors must divide their case price by the number of units in a case and round to the nearest cent. Although we do not know how much this service is costing the vendors, one Army commissary official estimated it would cost from \$850,000 to \$900,000 annually for the Army's commissaries to convert case prices into unit prices.

Each commissary buys in quantities that are far below commercial customer orders. However, some of the vendors that had quantity discounts sold their products to commissaries at the same price paid by commercial customers getting these discounts.

Some vendors reduced prices for prompt payment discounts rather than requiring commissaries to pay within the time required to receive a discount. One vendor complained that commissaries take an average of 20 days longer than commercial customers to pay their bills. The potential savings to the commissaries from two vendors that provided this allowance was over \$1 million for 1 year.

Vendors also noted that commissaries benefited from merchandising services and lagging price increases. Merchandising services included stocking shelves and setting up promotional displays. Price lagging occurs because price increases can be passed on to commercial customers immediately, while commissaries require a 10-day notice before the effective date of an increase and the price must remain in effect for 30 days before the next increase.

ALLOWANCES UNAVAILABLE
TO COMMISSARIES

Some vendors offer discounts and allowances to commercial customers that commissaries do not qualify for. Commercial customers, with warehouses and trucks, get discounts for picking up

their orders from vendors and distributing the products throughout their chain. This service reduces the vendor's operational costs, which can then be passed on to its customers. Since commissaries do not have the distribution system that many commercial customers have, they cannot take advantage of these discounts.

Commercial customers can get promotional allowances for advertising a vendor's product as a sale item in local newspapers. Commissaries are prohibited from advertising outside the store. However, some vendors offer commissaries display allowances which advertise sale items in the store.

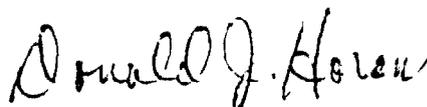
CONCLUSION

Because of its limited scope, our audit did not conclusively demonstrate compliance or noncompliance with the price warranty provisions in the brand name vendor contract. For much of what we reviewed, the commercial and commissary prices were comparable. Some of the price discrepancies we found were random errors in that they were not systematically generated by pricing policies or practices of vendors. Those discrepancies caused by pricing policies or practices of vendors were, for the most part, inconclusive because they may have been the result of commissary requirements. Although Army and Air Force commissary officials deny having certain requirements which may be contributing to higher prices, three vendors attribute some of the problem to unique commissary requirements. Another cause, which may be more significant, is the different buying patterns of commissary and commercial customers. Commissaries are buying only limited quantities while commercial customers are buying in large quantities to take advantage of discounts when they are offered by vendors.

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Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,



Donald J. Horan
Director