United States Government Accountability Office

Report to Congressional Committees

November 2016

DOD COMMISSARIES AND EXCHANGES

Plan and Additional Information Needed on Cost Savings and Metrics for DOD Efforts to Achieve Budget Neutrality

Accessible Version

Revised November 14, 2016 to correct pages 17-18 (Recommendations for Executive Action). The corrected section should read: 'As DOD assesses potential cost savings under the Defense Resale Business Optimization Board or through other cost savings initiatives identified, we recommend that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and the Marine Corps Exchange, take the following three actions'.

GAO-17-38

GAO Highlights

Highlights of GAO-17-38, a report to congressional committees

November 2016

DOD COMMISSARIES AND EXCHANGES

Plan and Additional Information Needed on Cost Savings and Metrics for DOD Efforts to Achieve Budget Neutrality

Why GAO Did This Study

Given budget constraints, DOD is reviewing opportunities for efficiencies in its commissaries and exchanges, which provide reduced- price groceries and services for the military community. In fiscal year 2015, $1.3 billion in appropriated funds were used for DOD commissaries and exchanges. The National Defense Authorization Act for Fiscal Year 2016 mandated that DOD report on its plan for budget neutrality, and included a provision for GAO to assess DOD's report.

GAO evaluated the extent to which DOD's report (1) includes a plan to achieve budget neutrality and (2) addresses seven mandated elements and three mandated benchmarks to ensure the maintenance of customer satisfaction, quality of products, and savings that commissary and exchange patrons are to realize.

GAO compared DOD's report with the mandated elements and benchmarks, generally accepted research standards, and federal internal control standards, and interviewed DOD officials.

What GAO Recommends

GAO recommends that DOD provide information to Congress to support its conclusion about budget neutrality; develop a plan for achieving alternative reductions to appropriations; and identify specific metrics for customer satisfaction, product quality, and savings. DOD concurred with GAO's recommendations.

View GAO-17-38. For more information, contact Brian J. Lepore at (202) 512-4523 or leporeb@gao.gov.

What GAO Found

The Department of Defense's (DOD) May 2016 report on commissaries and exchanges does not provide a plan for achieving budget neutrality, which DOD interprets as ending the use of appropriated funding for commissaries and exchanges by October 2018. The report states that DOD will not be able to achieve budget neutrality, but does not provide detailed information on why budget neutrality is not possible. According to the report, DOD cannot achieve budget neutrality without reducing patron benefits; however, the report does not include cost estimates, assumptions, or specific details about trade-offs or limitations that would clarify DOD's conclusion that budget neutrality is not possible. Instead, DOD's report states that DOD expects to achieve an estimated $2 billion in reductions over a 5- year period from fiscal year 2017 through fiscal year 2021. However, the report does not include any assumptions, a methodology, or specific time frames related to cost savings initiatives that would lead to the $2 billion savings. According to DOD officials, the cost savings amount was an arbitrary estimate, and they did not develop details on the steps they would take to achieve $2 billion in savings. Without information to support DOD's conclusion related to achieving budget neutrality and a plan for achieving an alternative reduction in cost savings, the department lacks the assurance that its cost savings target is an accurate and achievable cost savings estimate, and decisionmakers cannot evaluate the effectiveness of DOD's efforts to achieve cost savings without reducing patron benefits.

GAO's analysis found that DOD's report fully addresses three of the seven mandated elements and partially addresses the remaining four. Although DOD's report discusses the seven mandated elements, GAO found that including additional information would have made the report more consistent with relevant generally accepted research standards and would have made the report more useful to decision makers. For example, the report did not fully include information about assumptions and anticipated cost savings associated with establishing common business processes at commissaries and the exchanges. According to DOD officials, DOD is in the early stages of developing efforts that could include an estimated cost savings target, and DOD did not have time to include additional information in the report.

In addition, GAO found that DOD's report discusses the three mandated benchmarks for customer satisfaction, quality of products, and patron savings but does not define specific metrics for each of the benchmarks. For example, DOD has not defined customer satisfaction relative to maintaining a "high level" of satisfaction or determined what results would qualify as meeting that benchmark. In another example, DOD has not determined whether the commissaries and exchanges are to use the last available savings rate or the average savings rate over the past 5 years as the metric for a sustained patron savings rate. Without specific metrics to assess the mandated requirements related to customer satisfaction, product quality, and patron savings, DOD cannot effectively assess its performance in meeting the benchmarks for success.

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Abbreviations

DeCA	Defense Commissary Agency
DOD	Department of Defense
MWR	Morale, Welfare, and Recreation

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November 9, 2016

The Honorable John McCain
Chairman
The Honorable Jack Reed
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Mac Thornberry
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

The Department of Defense (DOD) operates commissary and exchange systems for servicemembers, retirees and their families to provide reduced-priced groceries, household goods and services.[1] However, the long-term fiscal challenges facing the United States and recent budgetary constraints have created new incentives for DOD to assess its approach for managing the commissaries and exchanges. Congress identified $1.3 billion in fiscal year 2015 to help fund the operations of the commissaries[2] but has expressed interest in reducing the resources spent on them.[3] Congress also identified about $0.2 billion in fiscal year 2015 to help fund transportation costs of the military services' exchanges, although the exchanges rely primarily on revenue from sales to sustain their

[1] The commissaries provide reduced-priced groceries and household goods to military personnel, retirees, and their families. The exchanges also provide retail goods and services as well as some groceries similar to the commissaries.

[2] The Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, appropriated $1.7 billion for the Defense Working Capital Fund. The Joint Explanatory Statement accompanying the Consolidated Appropriations Act, 2016, indicated that $1.4 billion of that amount was for the Defense Commissary Agency (DeCA) in fiscal year 2016.

[3] 10 U.S.C. § 2483(b) requires that appropriated funds be used to cover the expenses of operating commissary stores and central product processing facilities of the defense commissary system. In fiscal year 2015, DeCA's total annual sales were about $5.5 billion.

operations.[4] In February 2016, in an effort to identify efficiencies at commissaries and exchanges, DOD established the Defense Resale Business Optimization Board to help implement reforms within and among the commissary and exchange systems.

There have been recent studies that recommended changes to the commissaries and exchanges through reform, consolidation, and the use of private sector practices, partly because private sector establishments provide similar retail services.[5] Section 651 of the National Defense Authorization Act for Fiscal Year 2016 mandated DOD to provide a comprehensive plan to achieve "budget neutrality," which DOD interpreted as ending the use of appropriated funding for commissaries and the military exchange system, by October 1, 2018.[6] The mandate required DOD to include seven specific elements in its plan and ensure that the plan met three benchmarks to maintain certain benefits provided by the commissaries and exchanges. Additionally, section 651 authorizes DOD to conduct pilot programs to evaluate the feasibility and advisability of processes and methods for achieving budget neutrality, and establish specific measurable benchmarks regarding the maintenance of certain benefits. Section 651 also includes a provision for us to assess DOD's report. We evaluated the extent to which DOD's report (1) includes a plan to achieve budget neutrality, and (2) addresses the mandated elements in achieving budget neutrality and benchmarks to ensure the maintenance of customer satisfaction, quality of products, and savings that commissary and exchange patrons are to realize.

To evaluate whether DOD's report included a plan to achieve budget neutrality, we reviewed information, including explanations related to budget neutrality and cost savings targets, provided in DOD's report.[7] We assessed the information and data against federal standards for internal control, which call among other things for an agency to have quality

[4] In fiscal year 2015, the exchanges' total annual sales were about $9 billion. See 10 U.S.C. § 2643(b).

[5] Boston Consulting Group, *Military Resale Study*, July 10, 2015 and Military Compensation and Retirement Modernization Commission (2015).

[6] Pub. L. No. 114-92, § 651 (2015).

[7] U.S. Department of Defense (DOD), *Report on Plan to Obtain Budget Neutrality for the Defense Commissary System and the Military Exchange System*, May 2016.

information to communicate with external parties and have relevant and reliable information to help management make informed decisions.[8] We also reviewed relevant information in the report compared with the best practices in project management related to the establishment of goals and time frames.[9] We obtained documentary and testimonial evidence from DOD officials to determine the scope and status of cost savings and efficiency-related efforts and what actions, if any, DOD has taken as a result of the efforts.

To evaluate the extent to which DOD's report addressed the mandated elements in its plan to achieve budget neutrality by October 2018 and the benchmarks to ensure the maintenance of customer satisfaction, quality of products, and savings that commissary and exchange patrons are to realize, we compared DOD's report with the elements and benchmarks listed in section 651 of the National Defense Authorization Act for Fiscal Year 2016. To determine the extent to which DOD's report addresses the elements in a plan required by the mandate, we developed a scorecard methodology based on the mandate's requirements which enabled us to compare DOD's report to those requirements. We considered an element to be "addressed" if DOD provided evidence that it addressed all aspects of the mandate in its report. We considered the element to be "partially addressed" if DOD provided evidence that it had addressed some aspects of the mandated element, and "not included" if DOD did not address any aspect of the element in its report. We also assessed the extent to which DOD's report is consistent with relevant generally accepted research standards for the development of a report, such as regarding the design of the report, including having baseline data, and a clear presentation of results that could be useful to decision makers.[10] In

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[8] GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C., September 2014).

[9] Project Management Institute, *The Standard for Program Management* © (Newtown Square, PA: 2006).

[10] Relevant generally accepted research standards are described in our 2006 report. See GAO, *Defense Transportation: Study Limitations Raise Questions about the Adequacy and Completeness of the Mobility Capabilities Study and Report*, GAO-06-938 (Washington, DC: Sept. 20, 2006). We developed these standards by identifying and reviewing frequently occurring research standards in the research literature and DOD guidance (relevant for defense reviews such as DOD's report on budget neutrality) that define a quality or complete report.

addition, to assess the extent to which DOD's report addresses mandated benchmarks to ensure the maintenance of customer satisfaction, quality of products, and savings that commissary and exchange patrons are to realize, we reviewed DOD's report for information on these benchmarks. We also reviewed documents and methodologies supporting the information provided in the report, such as surveys used by commissaries and exchanges to track customer satisfaction and the quality of products.[11] To guide our assessment of mandated benchmarks, we identified generally accepted research standards for developing and completely identifying metrics and baseline data. We interviewed DOD officials at commissaries and the exchanges to understand DOD's efforts to address mandated reporting elements and use surveys.

We conducted this performance audit from May 2016 to November 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Overview of Commissary and Exchange Systems

DOD's commissary and exchange systems are made up of the Defense Commissary Agency (DeCA) which manages DOD's commissaries, the Army and Air Force Exchange Service, the Navy Exchange, and the Marine Corps Exchange. The commissaries provide reduced-price groceries and household goods to military personnel, retirees, and their families at over 200 stores worldwide. The exchanges also provide retail goods and services as well as some groceries similar to the commissaries at over 2,500 locations worldwide. Exchanges manage stores that sell clothing, furniture, military uniforms, packaged food, household goods, and appliances, as well as manage barber and beauty shops, florists, and provision of financial services.

[11] An assessment of the quality of the data collected by the surveys was outside the scope of our review.

Although commissaries and exchanges provide some similar products as grocery and retail outlets in both the commercial and military setting, they operate under different business models. In addition, commissaries operate as entities funded through appropriations, while exchanges generally operate as non-appropriated fund entities. Specifically, commissary operating expenses are funded by appropriations.[12] DeCA received $1.3 billion in appropriated funds in fiscal year 2015. DeCA is required under law to establish the sales price at product cost,[13] plus a 5 percent surcharge worldwide at the point of sale.[14] In fiscal year 2015, DeCA's annual sales for its commissaries were approximately $5.5 billion.

As non-appropriated fund entities, the exchanges primarily rely on sales revenue to sustain operations and purchase products to be sold. The exchanges also received approximately $0.2 billion in congressional appropriations in fiscal year 2015 to help fund transportation costs to ship goods to overseas and remote locations as required by law.[15] In fiscal year 2015, the exchanges' annual sales totaled to about $11 billion. According to DOD's report, as non-appropriated fund entities, the exchanges have greater latitude regarding their workforce and have greater financial and management control than commissaries.

Benefits That Commissaries and Exchanges Provide

According to DeCA and exchange officials, in addition to the reduced price goods and services that are required by law, the commissaries and exchanges provide other benefits to servicemembers, retirees and their families. For example, these officials said that DeCA and the exchanges provide employment preference to veterans, military spouses, and military family members, providing additional income for families and career

[12] 10 U.S.C. § 2483(b).

[13] DOD is required to establish the prices at commissaries at a level that will recoup the actual product cost, and the price is to be adjusted to cover the cost of first destination commercial transportation within the United States, and the actual or estimated cost of shrinkage, spoilage and pilferage. 10 U.S.C. § 2484(e).

[14] Section 2484(d) of Title 10 of the United States Code requires the application of the 5 percent uniform sales price surcharge on all sales at commissaries. DeCA can only use surcharge funds for specific types of activities, such as commissary construction, equipment, repair, software and maintenance. See 10 U.S.C. § 2484(h). See also DOD Directive DODI 1330.17, DOD Commissary Program (June 18, 2014).

[15] See 10 U.S.C. § 2643(b).

opportunities during frequent military-mandated transfers. DOD's report, which was released in May 2016, listed multiple additional benefits provided by DeCA and the exchanges, including support for small businesses, environmental stewardship, scholarships, and school lunch programs. For example, in 2015, DeCA helped expand employment opportunities to Wounded Warriors.

In addition, according to DOD policy, the exchanges also make dividend contributions to the associated service's Morale, Welfare, and Recreation (MWR) activities, which provide quality-of-life benefits to military members and their families through a variety of recreation opportunities and community support programs. In fiscal year 2015, the exchanges generated about $259 million in dividends that supplemented MWR funds used to support the military community. The exchanges also support military communities in other ways. For example, Navy Exchange officials stated that, in July 2016, the Navy Exchange System provided goods and helped set up activities for the homecoming of the Truman Carrier Strike group after an extended deployment.

DOD's Report Does Not Include a Plan to Achieve Budget Neutrality

DOD's report states that DOD will not be able to achieve budget neutrality, or fully eliminate the use of appropriated funds for the commissaries and exchanges, but does not provide detailed information supporting its conclusion that budget neutrality is not possible. Instead, DOD's report states that it expects to achieve an estimated $2 billion in reductions over a 5-year period. This estimated reduction would be equal to an average of $400 million per year from fiscal year 2017 through fiscal year 2021, compared with about a $7 billion appropriation over the same period.[16] However, the report's $2 billion cost savings target is not supported by data and information. For example, the report does not include assumptions, a methodology or time frames related to the cost savings initiatives that would lead to the $2 billion in cost savings.

DOD did not provide a plan to achieve budget neutrality by October 2018 as mandated because according to the report, DOD cannot achieve budget neutrality without reducing savings to patrons or other benefits

[16] About $7 billion over a five-year period is based on the assumption that the Defense Commissary Agency (DeCA) continues receiving about $1.3 billion in appropriations annually.

provided by commissaries and exchanges. For example, the report stated that drastic changes, such as store closures and price increases, would have to be implemented if DOD were required to achieve budget neutrality. However, DOD did not provide additional information about potential steps to reach budget neutrality, such as cost estimates and assumptions, or include specific details about trade-offs, constraints and limitations to achieving budget neutrality such as reductions in benefits.

Instead of providing a plan, DOD estimated a $2 billion reduction over a 5-year period, which would fall short of achieving budget neutrality by about $5 billion. DOD officials told us the cost savings amount was an arbitrary estimate, and that therefore DOD did not develop details on steps it would take to achieve the $2 billion in savings. DOD officials could not explain the assumptions, methodology, data, specific time frames or DOD efforts that would lead to the $2 billion in savings. For example, DOD officials stated that the department could not provide precise cost savings estimates until DeCA had implemented the pricing pilot programs.[17] However, the report did not provide additional information that the pricing pilots would lead to cost savings. Additionally, DOD officials told us that as the Defense Resale Business Optimization Board reviews cost saving options and conducts pilot programs, it expects to identify an alternate estimate for cost savings and efficiencies, but has not yet developed these targets or time frames for achieving them.[18]

According to best practices in project management, the establishment of clear, achievable objectives and time frames can help ensure successful

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[17] Section 651(e) of the National Defense Authorization Act for 2016 authorizes DOD to conduct one or more pilot programs to evaluate the feasibility and advisability of processes and methods for achieving budget neutrality in the delivery of commissary and exchange benefits. The report describes piloting two different pricing options, such as private labeling and variable pricing that will help DeCA achieve efficiencies. Private label items are products generally intended to be comparable to and sometimes less expensive than name branded products and are commonly referred to as store brands. Variable pricing allows retailers to price goods to cover operating costs and capital expenditures and generate a profit.

[18] Under Section 651, DOD is authorized to establish pilot programs for commissaries and exchanges that may help DOD achieve budget neutrality.

project completion.[19] Additional information that clarifies reasons why DOD cannot achieve budget neutrality, and includes a plan with goals and time frames related to the cost savings target, could help provide DOD additional assurance that it is pursuing efforts to improve efficiency and reduce the amount of appropriated funds used without a reduction in benefits. In addition, federal standards for internal control emphasize the need for federal agencies to establish plans to help ensure that goals and objectives can be met, including compliance with applicable laws and regulations. Further, according to federal standards for internal control, management should have quality information to communicate with external parties to help achieve its objectives and management should have relevant data from reliable internal and external sources that are reasonably free from error and bias and faithfully represent what they purport to represent. Without additional information to support DOD's conclusion that DOD cannot achieve budget neutrality and a plan with targets and goals related to DOD's efforts to reach an alternative reduction in cost savings, the department lacks assurance that its cost savings target is a feasible and accurate cost saving estimate, and decisionmakers cannot evaluate the effectiveness of DOD's efforts in achieving cost savings without reducing patron benefits.

[19] Project Management Institute, *The Standard for Program Management* © (Newtown Square, PA: 2006).

DOD's Report Fully Addresses Some but Not All of the Mandated Elements, Does Not Include Some Information Consistent with Generally Accepted Research Standards, and Discusses the Three Benchmarks

Section 651 of the National Defense Authorization Act for Fiscal Year 2016 mandated DOD to provide a report on a plan to achieve budget neutrality that includes seven mandated elements while meeting three benchmarks for maintaining patron benefits.[20] Our analysis found that DOD's report meets the statutory requirement by addressing three of the seven mandated elements and partially addresses the remaining four. However, for four of the elements, we found that DOD did not include information on its planned steps to achieve estimated reductions that would make the report consistent with generally accepted research standards that define a quality or clear and complete study. In addition, we found that DOD's report discusses the three mandated benchmarks by stating that the commissaries and exchanges use surveys to track customer satisfaction and the quality of products, and have annual patron savings rates.[21]

DOD Report Partially Addressed Four of the Seven Mandated Elements

DOD's report fully addresses three of the seven mandated elements and partially addresses the remaining four. DOD's report includes descriptions of (1) how DOD engaged with major grocery retailers, (2) the impact of changes in the commissary and exchange operations on MWR, and (3) recommendations for legislative actions to support efforts to achieve budget neutrality. For example, regarding engaging with major grocery retailers, DOD's report stated that DOD contacted 10 major grocery retailers and found that three of them were interested in privatization. The report further stated that—for those three retailers—DOD requested further information regarding aspects of privatized commissaries the retailers would be willing to operate and under what conditions. Regarding recommendations for legislative action, the report noted that DOD requested permanent authority to implement variable pricing at

[20] National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92, § 651 (2015).

[21] While we reviewed the surveys for content, an assessment of the quality of the data collected by the surveys was outside the scope of this review.

commissaries. DOD also requested the conversion of commissaries to a non-appropriated fund entity.[22]

However, DOD's report partially addressed four mandated elements related to the description of changes to the commissary and exchange systems to obtain budget neutrality, including (1) the establishment of common business processes at DeCA and exchanges; (2) the privatization of commissaries and exchanges; (3) description of the impact of closure of commissaries; and (4) the analysis of different pricing options at commissaries. The report describes all of the four mandated elements but does not include information on how each of these elements will allow DOD to obtain budget neutrality.

In addition to assessing whether DOD's report met the statutory requirements, we evaluated whether DOD's report was consistent with generally accepted research standards that outline key attributes associated with the design, execution, and presentation of research that produce sound and complete reports in a clear manner, that are useful to decision makers. Although DOD included information about each of the mandated elements, we found that DOD did not include information on its planned steps to achieve estimated reductions in four of the seven mandated elements. Based on relevant generally accepted research standards, DOD did not fully provide information on assumptions and baseline information, and the results were incomplete or unclear, making it difficult to convey how the mandated elements would help DOD reduce appropriations. According to DOD officials, the department is in the early stages of developing efforts to achieve cost savings and efficiencies through the Defense Resale Business Optimization Board but has not yet fully developed or completed these efforts. Table 1 describes our assessment of the extent to which DOD's report addresses the mandated elements and includes information consistent with relevant generally accepted research standards.

[22] According to DOD's report, DOD requested a legislative proposal to convert commissaries to a non-appropriated fund entity if the pricing pilots prove to be successful. Variable pricing allows retailers to price goods to cover operating costs and capital expenditures and generate a profit.

Table 1: Our Assessment of the Extent to Which DOD's Report on Achieving Budget Neutrality Addresses the Mandate Elements and Includes Information About Generally Accepted Research Standards

Required element	Our assessment of DOD's Report
Description of the engagement of major commercial grocery retailers to determine their willingness to provide eligible beneficiaries with discount savings on groceries and certain household goods.	• Describes DOD's outreach to ten major private sector grocery retailers to determine their willingness to discuss their interest in operating privatized commissaries. • Relevant generally accepted research standards require findings and results to be presented in a clear manner. DOD's report provided a clear description of findings related to the engagement of major grocery retailers. For example, DOD's report stated that, once DOD receives a request of information from commercial grocery retailer, it might consider developing a privatization plan. DOD, however, did not commit to developing such a plan absent expressions of interest from such retailers, nor did it provide any goals for time frames for pursing this effort.
Description of the impact of any modifications described in the report on Morale, Welfare, and Recreation (MWR) quality-of-life programs.	• Describes changes at commissaries and the exchanges that can impact the MWR programs. For example, the report explains that privatization or closure of commissaries could create risks for MWR programs by reducing foot traffic at exchange stores. • Relevant generally accepted research standards require findings and results to be presented in a clear manner. DOD's report provided a clear and relevant description of findings, including the identification of various DOD initiatives that are currently proposed, such as the expanded online shopping benefit for veterans, which can benefit the MWR programs.
Recommendations for legislative action that DOD considers appropriate to achieve budget neutrality by October 1, 2018.	• Relevant generally accepted research standards require findings and conclusions to be presented in a clear, comprehensive manner. DOD's report fully explains the different legislative proposals. For example, the report identifies several legislative proposals that would help reduce appropriations at commissaries and the exchanges, including request for permanent authority to implement variable pricing at commissaries and conversion of commissaries to a non-appropriated fund entity.[a]
Description of any changes to the establishment of common business processes at the Defense Commissary Agency's (DeCA) commissaries and at the exchanges that DOD considers appropriate to obtain budget neutrality.	• Describes challenges related to the consolidation between DeCA's commissaries and the exchanges and discusses the benefits of consolidating some processes, such as back office systems, without the merger of DeCA's commissaries and the exchanges. DOD's report concludes that the consolidation of DeCA's commissaries and the exchanges and exchanges would not enhance benefits or improve cost-effectiveness without the disruption of current command structures. • Relevant generally accepted research standards note that assumptions should be explicitly identified to understand the context of the report's results. However, DOD's report does not provide additional information about assumptions or the anticipated savings associated with changes to the establishment of common business processes. For example, the report did not include additional information from the Boston Consulting Group and Military Compensation and Retirement Modernization Commission that recommended the consolidation of back office systems that would provide savings totaling between $215 million and $325 million, which could help reduce appropriations and address the mandate.

Required element	Our assessment of DOD's Report
Description of any changes to the privatization of commissaries and exchanges, in whole or in part, that DOD considers appropriate to obtain budget neutrality.	• Describes the risks and challenges with privatization of commissaries in whole or in part. For example, DOD's report estimates that privatization of larger commissaries would increase the price of goods by 20 percent and could reduce patron benefits. • Relevant generally accepted research standards note that assumptions should be explicitly identified to understand the context of the report's results and a methodology should be consistent with the report's objective. However, DOD's report does not include information about the assumptions, or provide documentation and methodology related to changes that may lead to privatization of commissaries and exchanges. For example, the report does not clarify whether the 20 percent price increase is associated with privatizing all commissaries in the United States or privatizing only larger stateside stores. The report also does not include information about potential cost savings associated with privatization.
Description of the impact of closure of commissaries in locations in close proximity to other commissaries or in locations where commercial alternatives may be available as DOD considers appropriate to obtain budget neutrality.	• Describes the risks associated with closing commissaries in the United States and keeping overseas stores open, including negatively impacting traffic at exchanges co-located with commissaries. • Relevant generally accepted research standards note that assumptions should be explicitly identified to understand the context of the report's results and a methodology should be consistent with the report's objective. However, the report concludes that fully eliminating appropriated funding cannot be achieved through store closures but it does not describe the risks, assumptions, documentation, and methodology used to support claims that prices would increase with closures.
Analysis of different pricing options to improve or enhance the delivery of commissary and exchange benefits to obtain budget neutrality.	• Describes two pricing pilot programs that DOD plans to implement at the commissaries, which the report explains will allow DeCA to achieve the long- term goals of reducing appropriations while maintaining the benefit. • Relevant generally accepted research standards note that baseline data and information used to support a report should be included to understand the context of the report's objective. Relevant research standards also require that results be presented in a complete and accurate manner. However, DOD's report did not provide time frames or cost saving estimates related to variable pricing pilots that could help DOD obtain budget neutrality or reduce appropriations.

Source: GAO analysis of Department of Defense (DOD) information. | GAO-17-38

[a]Variable pricing allows retailers to price goods to cover operating costs and capital expenditures and to generate a profit.

According to DOD officials, for some efforts that are already being considered, DOD officials told us that they did not include some information in the report to support their conclusions because they have not had time to verify the information. We found that additional information on these seven elements in a comprehensive plan would assist DOD to assess the potential impact on reducing appropriations. Because DOD's report was prepared in response to a one-time, nonrecurring mandate, we are not making any recommendations to amend the report or provide additional detail on the mandated elements.

DOD Report Discusses the Three Benchmarks for Customer Satisfaction, Quality of Products, and Patron Savings, but Does Not Define Metrics to Measure its Success

In addition to requiring that DOD to submit a report setting forth a comprehensive plan to achieve by October 1, 2018, budget neutrality in the delivery of commissary and exchange benefits, section 651 required DOD's report to ensure the (1) maintenance of high levels of customer satisfaction in the delivery of commissary and exchange benefits; (2) provision of high-quality products; and (3) sustainment of discount savings to eligible beneficiaries. In addition, section 651 authorizes DOD to conduct pilot programs to evaluate the feasibility and advisability of processes and methods for achieving budget neutrality, and requires that DOD measure success with regards to specific metrics.[23] Although the report discusses the three benchmarks for customer satisfaction, quality of products, and patron savings, the report does not define specific metrics to measure each of the benchmarks.

Customer Satisfaction Surveys. According to DOD's report, DOD conducts several surveys to determine customer satisfaction:

- For both commissaries and exchanges, DOD contracts with an outside research firm to conduct the American Customer Satisfaction Index survey annually. The American Customer Satisfaction Index survey produces one overall score for the retailer, which provides a high-level score for customer satisfaction and can be compared across the exchange system and with commercial counterparts in grocery, department and discount stores. The index also includes scores in eight areas, such as customer expectations, perceived overall quality and customer satisfaction.
- The commissaries conduct the Commissary Customer Service Survey annually. The Commissary Customer Service Survey includes a question directing customers to rate their level of satisfaction, and also includes questions on commissary performance related to shelf stock levels, the convenience of store hours, store cleanliness, the quality of fresh meat and produce, and other performance elements.
- Each exchange conducts a separate Customer Satisfaction Index survey, which is intended to gather actionable information specific to

[23] Under section 651, DOD is authorized to establish pilot programs for commissaries and exchanges that may help DOD achieve budget neutrality. Specifically, the Secretary is to establish specific, measurable benchmarks for success related to customer satisfaction, quality of products and patron savings, while achieving budget neutrality under the pilot program.

each exchange. The Navy Exchange and the Army and Air Force Exchange Service both also use web-based surveys, which provide continuous feedback throughout the year.[24] The surveys used by the exchanges ask direct questions on customer satisfaction, as well as questions on various elements of the shopping experience that might enhance satisfaction. For example, the Navy Exchange Customer Satisfaction Index survey includes several questions on the level of a customer's satisfaction, as well as questions about other aspects of the exchange that could contribute to overall satisfaction, including store environment, store signs, and associate knowledge. In addition, the survey asks customers about their satisfaction with other services they utilize on the installation, such as the barber shop and flower shop. The Army and Air Force Exchange survey asks for the customer's level of overall satisfaction, as well as several other questions, such as store cleanliness, associate friendliness, and product availability in-store and on the exchange's website.

Although DOD has information from surveys on customer satisfaction, DOD's report does not contain a specific metric regarding customer satisfaction in part because commissary and exchange officials told us that they had not been previously required to establish specific metrics for customer satisfaction and therefore had not yet determined what metric would indicate high levels of customer satisfaction. DOD officials stated that commissaries and exchanges are working on developing specific metrics, but according to DOD officials it is unclear how "high level" is defined or what results would qualify as meeting that metric. For example, exchange officials stated that they considered the metric for success to be the maintenance or improvement of current levels of customer satisfaction as a baseline. The Army and Air Force Exchange received Customer Satisfaction Index scores of 76, 77, 78, 79, 80, and 90 out of 100 for fiscal years 2010 through 2015, respectively. However, it is unclear whether the baseline of customer satisfaction would be the last collected result, a score of 90 in fiscal year 2015, or as an average of prior years, such as the average score of 80 over fiscal years 2010 through 2015.

Product Quality Surveys. The exchanges' Customer Satisfaction Index surveys and the Commissary Customer Service Survey provide customer

[24] The Marine Corps Exchange did not provide separate web-based surveys.

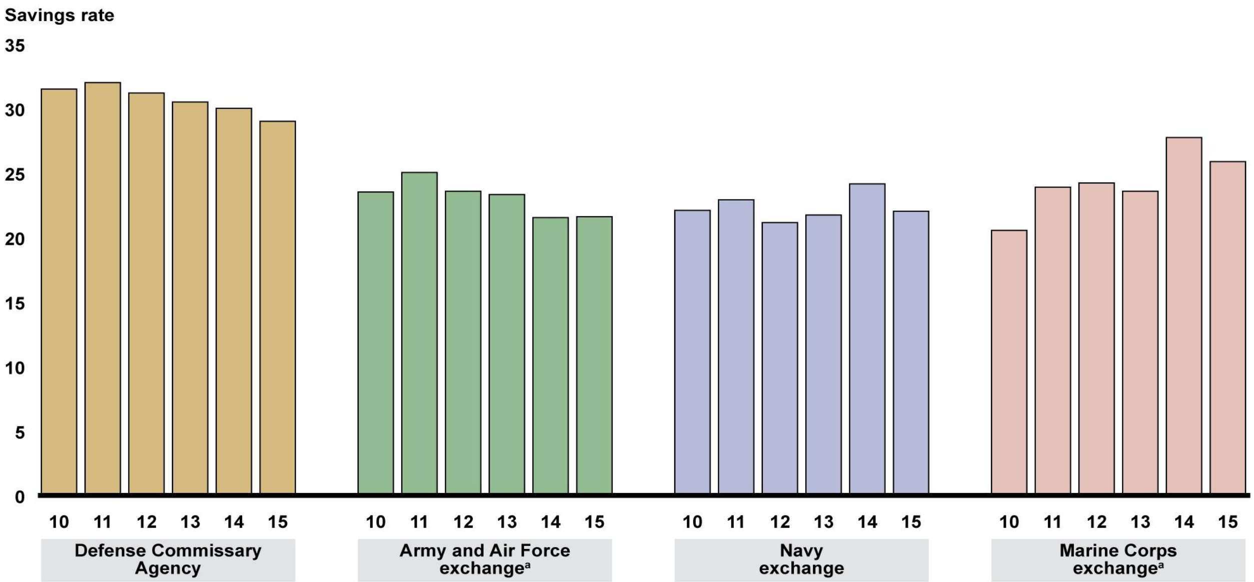
ratings on product quality. For example, Customer Satisfaction Index surveys used by the exchanges include questions on merchandise quality. The Army and Air Force Exchange Service conduct quality assurance testing on its merchandise for key features, such as the durability and strength of the products. Additionally, the commissaries ask patrons to rate the quality and selection of produce, meat, delicatessen items, and bakery items.

However, while the commissaries and exchanges have these measures to gauge product quality, it is unclear what metrics or baseline data will be used to ensure the provision of high-quality products. For example, DOD has not determined whether it will measure the maintenance of high-quality products based on survey responses on product quality or quality assurance testing results. In addition, DOD's report acknowledges the difficulty of measuring the quality of products and suggests using results from customer satisfaction surveys utilized by the commissaries and exchanges as an indirect measure. According to DOD officials, the commissaries and exchanges did not develop specific metrics for high-quality products because the commissaries and exchanges had not been previously required to establish specific metrics for product quality, and therefore had not yet determined what metric would indicate high levels of high-quality products.

Patron Savings Rates. For fiscal year 2015, the savings rate for patrons shopping at exchanges compared with the savings rate for patrons shopping at retail stores was an average of 23.17 percent across all the three exchanges. DeCA reported a savings rate of 29 percent for fiscal year 2015, and we have ongoing work that is assessing the savings methodologies used by DeCA.[25] Figure 1 shows the overall savings rates reported by commissaries and exchanges for the fiscal year 2010-15 time frame.

[25] Additionally, the Boston Consulting Group issued a report that found commissary savings rates ranged between 5 percent and 25 percent for a sample of 51 commissaries. Boston Consulting Group, *Military Resale Study*, July 10, 2015.

Figure 1: Overall Savings Rates as Reported by the Commissaries and Exchanges During Fiscal Year 2010-15



Source: GAO analysis of Defense Commissary Agency and exchanges data. | GAO-17-38

[a]Results from Army and Air Force Exchange and from the fiscal year 2010 Marine Corps savings rate are from fall surveys.

While commissaries and exchanges have annual patron savings rates, DOD's report did not define the savings metric that will be used to set a specific metric and ensure the savings rate is sustained. For example, it is unclear whether the Army and Air Force Exchange Service will choose to use the last available savings rate, 21.61 percent in fall 2015, or the average savings rate over the past 5 years, 23.09 percent, as the metric for maintaining a savings rate.[26]

Generally accepted research standards include guidelines related to developing and completely identifying metrics and baseline data as well as relevant data limitations. For example, the analytical baseline should be fully identified and used consistently throughout the study, and baseline data and other data used to support the analysis should be verified and validated. According to DOD officials, the Defense Resale Business Optimization Board is working to develop metrics but they have

[26] We have ongoing work that is assessing the savings methodologies used by DeCA.

not yet been established. However, DOD's report did not include time frames or additional information about the steps the department is taking to develop metrics. Without identifying specific metrics to determine whether the requirement has been fulfilled, DeCA and the exchanges cannot effectively assess their performance in maintaining customer satisfaction, product quality, and patron savings.

Conclusions

Given the challenging fiscal environment, identifying potential opportunities for efficiencies and cost savings in commissaries and exchanges can help DOD manage programs in the face of potential budget reductions. Although DOD's report states that DOD will not be able to achieve budget neutrality, the report lacks additional detailed information about potential trade-offs, constraints and limitations to achieving budget neutrality. In addition, DOD stated in its May 2016 report to Congress that it can achieve an estimated $2 billion in cost savings over a 5-year period, but the department did not provide information on its steps to achieve the cost savings. In addition, DOD's report does not fully address all of the mandated reporting elements, instead only partially addressing four of the seven elements. DOD does not outline specific metrics, as required for pilot programs authorized under section 651, to maintain high levels of customer satisfaction, quality of products, and patron savings within the commissaries and exchanges. As DOD moves forward with pilot programs, DOD will need specific metrics to meet the requirements of section 651. However, the report does not provide additional information for decision makers in Congress to evaluate how DOD will achieve its estimated reductions in 5 years. In the absence of detailed information to support its conclusion that it cannot achieve budget neutrality, the department lacks assurance that its cost savings target is an accurate and achievable estimate, as well as a plan with a methodology, cost estimates and specific time frames, decisionmakers cannot evaluate whether the implementation of DOD's efforts are effective in achieving its estimated cost savings without impacting patrons.

Recommendations for Executive Action

As DOD assesses potential cost savings under the Defense Resale Business Optimization Board or through other cost savings initiatives identified, we recommend that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and the Marine Corps Exchange, take the following three actions:

- Provide information to Congress that includes data, assumptions, and methodology supporting DOD's conclusion for not achieving budget neutrality;
- Develop a plan with assumptions, a methodology, cost estimates, and specific time frames for achieving alternative reductions to appropriations, to support DOD's efforts to ensure that DOD's cost savings target is feasible and accurate; and
- As DOD conducts pilot programs, identify specific metrics to determine whether DOD has fulfilled the mandated requirement to maintain high levels of customer satisfaction, the provision of high-quality products, and the sustainment of patron savings.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD concurred with our three recommendations. DOD's comments are summarized below and reprinted in their entirety in appendix I.

In its response to our first recommendation to provide information to Congress that includes data, assumptions, and methodology to support its conclusion for not achieving budget neutrality, DOD provided the recommended information. For example, DOD states that elimination of appropriations for secondary transportation costs would require the exchanges to recoup their costs by either adding transportation costs into the price of goods, removing some or all American goods from overseas inventories in favor of local products, or absorbing the transportation costs as operating costs among other information.

DOD also concurred with our second recommendation to develop a plan with assumptions, methodology, cost estimates and specific timeframes for achieving alternative reductions to appropriations, to support efforts to ensure that the cost savings target is feasible and accurate. In its letter, DOD provided information about how the estimated $2 billion cost savings target was developed, although it states that the basis of the savings estimate and associated recommended actions have not been piloted. DOD states that the Defense Resale Business Optimization Board was chartered to develop a plan, and as the Board approves initiatives for piloting the plan DOD expects to provide more specific information to Congress.

Finally, DOD concurred with our third recommendation to identify certain performance metrics as it conducts pilot programs. In its comments, DOD outlined its process for measuring customer satisfaction, maintaining high-quality products, and provided more information about forthcoming changes in its savings methodology. DOD further stated that it will provide more detailed information about specific metrics for its pilot programs in its report to the Armed Services Committees.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Defense, the Under Secretary of Defense for Personnel and Readiness, the Deputy Chief Management Officer, the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and Marine Corps Exchange. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-4523 or leporeb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.

Brian J. Lepore, Director
Defense Capabilities and Management

Appendix I: Comments from the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE
4000 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-4000

PERSONNEL AND READINESS

NOV 7 2016

Mr. Brian Lepore
Director, Defense Capabilities Management
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Lepore:

This is the Department of Defense (DoD) response to the Government Accountability Office (GAO) Draft Report, GAO-17-38, "DOD COMMISSARIES AND EXCHANGES: Plan and Additional Information Needed on Cost Savings and Metrics for DOD Efforts to Achieve Budget Neutrality," dated September 21, 2016 (GAO Code 100903).

We appreciate the GAO's review and analysis of the Secretary of Defense's May 24, 2016, "Report on Plan to Obtain Budget Neutrality for the Defense Commissary System and the Military Exchange System," which was required by section 651(a) of the National Defense Authorization Act for Fiscal Year 2016, P.L. 114-92.

We also appreciate the GAO report's explicit recognition of the impact of the constraints under which these reports were prepared. The DoD report represented an early stage in the evolution of a complex excursion into "unchartered territory," a complete restructuring of the highly-legislated defense commissary system. In addition, the compressed time schedule, not only for the completion of the Department's report but also for GAO's own review, prevented the Department from being very detailed at that time about the initiatives, assumptions, or anticipated savings associated with potential changes that may be proposed in years to come.

The Department established the Defense Resale Business Optimization Board to develop and evaluate potential reforms and proposed pilot projects to determine the extent to which they might reduce the Department's use of appropriated funding for the defense resale ecosystem. Our efforts in this direction will be guided by the Congressional mandate to sustain the current level of commissary and exchange customer satisfaction, product quality, and patron savings.

The Department is providing the enclosed official written comments for inclusion in the report.

Sincerely,

Peter Levine
Performing the Duties of the Under Secretary of
Defense for Personnel and Readiness

Enclosure:
As stated

GAO DRAFT REPORT DATED SEPTEMBER 21, 2016
GAO-17-38 (GAO CODE 100903)

"DOD COMMISSARIES AND EXCHANGES: PLAN AND ADDITIONAL INFORMATION NEEDED ON COST SAVINGS AND METRICS FOR DOD EFFORTS TO ACHIEVE BUDGET NEUTRALITY"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and Marine Corps Exchange, provide information to Congress that includes data, assumptions, and methodology supporting its conclusion for not achieving budget neutrality.

DoD RESPONSE: Concur. The following information expands upon the material presented in the DoD report and should satisfy this recommendation.

Section 651 of the National Defense Authorization Act for Fiscal Year (FY) 2016 (P.L. 114-92) does not define "budget neutrality." The Department has interpreted the term to mean that, while Congress viewed the defense resale system as an important non-pay benefit for military members and their families, it simultaneously desired to provide that same benefit at no cost to the taxpayers beginning in FY 2018. The Department's assumption that Congress views the commissary benefit as an important non-pay benefit is based on several factors: demonstrated Congressional level of interest in the defense resale system; the repeated restoration by Congress of appropriations reduced by the Department in the President's budgets for FY 2013, FY 2014, and FY 2015; and Congressional support for maintaining the same levels of savings and service provided by the Defense Resale Enterprise as subsidized by appropriations.

As cited in the Military Compensation and Retirement Modernization Commission's report, "in 2013, the commissaries received $1.4 billion in appropriated funding (APF), of which $152 million was spent on second destination transportation costs for transporting U.S. goods overseas. That same year, the exchanges received approximately $397 million in APF. This amount included $170 million for contingency support, covering expenses associated with the transportation of merchandise from warehouses to remote exchange sites, incremental inventory variances above the noncontingency average, danger pay, deployment bonuses, overtime, and foreign post differentials for deployed associates. Also included were $179 million for second destination transportation, and $47 million for direct and indirect exchange operating costs, including a limited number of active-duty military personnel, military travel, and utilities for authorized overseas locations and a limited number of [Continental United States] CONUS remote and isolated locations." The purposes, amounts, and legislative constraints have not substantively changed since the Department provided this information to the Commission.

Concerning appropriations for the defense exchange system ($397 million in FY 2013), it should be noted that the exchange system consists of several separate nonappropriated fund entities. Consequently, the exchange system funds the majority of operations through the sales of goods and services at a profit and without imposing a sales tax. A portion ($170 million) of their minimal appropriated funding directly supports military members performing military missions in contingency operations and therefore is not likely to be eliminated completely. The second destination transportation (SDT) funding ($179 million) enables the defense exchange system to provide goods familiar to the military members and their families at locations outside of the CONUS at no additional cost to them. The exchange system already works to minimize its SDT requirements so that these centrally-managed appropriations may be applied to other SDT needs within the respective military services. If the SDT appropriation to the defense exchange system were eliminated, the exchanges (as profit/loss-based retail businesses) would have three options for recouping the costs:

- Add the transportation costs into the price of the goods, thereby reducing the savings benefit to the military members and families outside CONUS;
- Remove some or all of the American goods from overseas inventories in favor of local products that might not be equivalent to the American goods, thereby affecting the quality as perceived by the military members and families overseas; or
- Absorb the transportation costs as an operating expense, thereby reducing net earnings.

The first two options would likely reduce sales based on price inelasticity and/or lower comparable pricing for like products on the local economy or through eCommerce sites (such as Amazon). For all of the options, any reductions to the exchange's net earnings (i.e., profits) directly reduce contributions to the military services' morale, welfare, and recreation (MWR) programs as well as funding for the exchanges' recapitalization programs.

The elimination of appropriated funding to the Defense Resale Enterprise would therefore diminish vital support for military missions and result in higher prices, lower quality or reduced availability of American products, and reduced support for MWR programs.

The Department has requested legislative authority to reduce the appropriated fund subsidy for second destination travel as efficiencies are identified and implemented to achieve savings in the Exchanges without reducing the MWR benefit. As these savings initiatives are fleshed out, the Department will provide additional information to Congress with regard to data, assumptions, and methodology.

Pursuant to 10 U.S.C. 2481(a), the defense commissary system operates separately from the defense exchange system. Whereas the exchange system operates predominantly with nonappropriated funds and generates its own revenue, 10 U.S.C. 2483 requires, with limited exceptions, the use of APFs appropriated each fiscal year to cover commissary system operating expenses. 10 U.S.C. 2484 establishes the merchandise categories that commissary stores may sell and provides that, with certain exceptions, the sales price of each item sold in the commissary shall recoup the actual product cost of the item. Additionally, a 5 percent surcharge is applied to the established sales price of commissary items sold.

Within the Defense Commissary Agency (DeCA) working capital fund (WCF), there are two activity groups: commissary resale stocks, which is a revolving fund consisting of revenues from the sale of the products by the commissary stores; and commissary operations, which funds the operating costs of commissaries, areas, and headquarters activities. The second WCF activity group's primary revenue source is the annual direct appropriation for the Defense WCFs, which

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in turn is apportioned to the DeCA WCF. DeCA's Surcharge Collections Trust Fund, which is a Treasury General Fund and not a Defense WCF, funds certain capital requirements and is primarily funded from the above-referenced five percent surcharge applied to commissary items sold. The uses of the Surcharge Trust Fund are established in 10 U.S.C. 2484(h). [Source: DeCA FY 2015 Annual Financial Report]

Breaking down the $1.4 billion in direct annual appropriations for the defense commissary system, approximately $152 million is for SDT of American grocery products to locations outside of the United States. Eliminating this support for the commissaries would have many of the same impacts as noted above for the exchange system, although here the focus is clearly more on pricing and product quality as perceived by the commissary patron, rather than on profit and MWR contribution. The remainder of the $1.4 billion funds the operating expenses of the commissary stores.

No other grocery or retail operation is financed in this manner. The Department's assessment that budget neutrality is not possible is based on comparative analysis. Profit and loss entities (such as the defense exchange systems and commercial grocers) fund their operating costs out of gross profits (i.e., net sales minus cost of goods sold). The defense commissary system does not generate any gross profits, due to the mandated pricing model.

Budget neutrality for the commissaries can only be achieved by adjusting two levers: net sales and/or operating expenses.

- For DeCA to cover the $1.4 billion in operating costs through variable pricing, prices across the board would need to be increased by about 25.5% to generate the gross profit necessary. This would not meet the requirement to provide the same levels of savings. Increased pricing would also drive higher out-of-pocket expenses for patrons through the surcharge. This percentage increase is based on $6.9 billion in net sales minus $5.5 billion in cost of goods sold with the result of $1.4 billion in gross profits.

- For DeCA to cover the $1.4 billion subsidy loss, it would have to eliminate all costs for operating commissary stores, areas, and headquarters. As stated earlier, 10 U.S.C. 2483 requires that, with certain exceptions, APFs shall fund the operations of DeCA and the Defense commissary system. Consequently, the budgetary resources in the DeCA WCF that pay commissary system employees are entirely dependent on the annual direct appropriations for Defense WCFs. Practically speaking, it would be impossible to eliminate the labor costs (approximately $700 million per year) and still operate the commissary system. The elimination of all operating costs would require the closure of the commissary system, which would not meet the requirement to provide the same levels of customer satisfaction, product quality, and patron savings.

The Department is committed to pursuing additional revenue sources and efficiencies in its operation of the commissary system, in order to reduce the reliance on APF support. However, there does not appear to be a viable way to eliminate all $1.4 billion in APF support to the defense commissary system (and $0.4 billion of APF support to the exchanges) while still maintaining customer satisfaction, product quality, and patron savings to the military members and families. The Department's preliminary estimate of potential savings is based on a report by the Boston Consulting Group, dated July 2015. The Department is committed to developing

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business case analyses to support specific reform proposals. As these business case analyses are developed, the Department will provide additional information to Congress with regard to data, assumptions, and methodology.

RECOMMENDATION 2: The GAO recommends that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and Marine Corps Exchange, develop a plan with assumptions, a methodology, cost estimates, and specific timeframes for achieving alternative reductions to appropriations, to support DOD's efforts to ensure that its cost savings target is feasible and accurate.

DoD RESPONSE: Concur. The following information expands upon the material presented in the Department of Defense (DoD) report and provides an outline of the Department's approach for the way ahead. Specific proposals for initiatives, pilot programs, and other program enhancements will be accompanied by the required information in sufficient detail to permit the Department's analysis and informed decisions.

The chief executives of the defense commissary and exchange systems and the Department of Defense Deputy Chief Management Officer worked collaboratively throughout 2015 to develop a budget proposal that would achieve savings in the Defense Resale Enterprise while maintaining customer savings and service. The result was a budget reduction over FY 2017-FY 2021 of $2.13 billion. The plan that formed this proposal was based almost exclusively on recommendations and estimates provided by the Boston Consulting Group (BCG) in a study it conducted for the Department. The Department has not implemented the recommendations contained in the BCG report, but those recommendations represented the best basis for developing a potentially achievable budget reduction.

In 2016, the Defense Resale Business Optimization Board was chartered to develop an executable plan, which may or may not include all of the initiatives identified for the budget proposal. The Board's current pipeline of executable initiatives reflects achievable savings based on assumptions, requirements, cost estimates, mission impacts, and timeframes. This pipeline is updated as the Board identifies, analyzes, and approves business cases for each optimization, and as the individual resale systems can absorb and execute change without overly disrupting business operations and patrons.

As it proposes specific program adjustments, pilot programs, and similar initiatives, the Department will include the required information in sufficient detail to assist in its analysis and decision processes.

RECOMMENDATION 3: The GAO recommends that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and Marine Corps Exchange, as DOD conducts pilot programs, identify specific metrics to determine whether the organization has fulfilled the mandated requirement to maintain high levels of customer satisfaction, the provision of high-quality products, and sustainment of patron savings.

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DoD RESPONSE: Concur. The following information expands upon the material presented in the Department of Defense (DoD) report and should satisfy this recommendation. Initial metrics and their related processes have already been identified, and baselines have been established. Savings, dividends, and capital expenditure metrics will be based on the 5-year trailing average of the most recent reports and audited financial statements; customer satisfaction will be based on the most recent year survey. Target ranges for each metric will be specified for each pilot program as it is developed.

Pursuant to section 651(e)(5)(A) of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2016 (P.L. 114-92), if the Department conducts a pilot program pursuant to section 651, the Secretary of Defense shall, not later than 30 days before commencing the pilot program, submit a report to the Committees on Armed Services of the Senate and the House of Representatives that includes a description of the pilot program and the provisions, if any, of chapter 147 of title 10, U.S. Code, that will be waived in the conduct of the pilot program. At this time the Department anticipates only conducting pilot programs for the commissary system. The Department will comply with the requirements of section 651 prior to commencing any pilot program and provide a report to Congress that describes at a minimum: parameters of the pilot program, operational criteria, assumptions, savings expectations, and measurement metrics. Those metrics will maintain high levels of customer satisfaction, provide high-quality products, and sustain patron savings, as defined below:

Customer Satisfaction: The Defense Commissary Agency (DeCA) will continue to measure customer satisfaction through the combination of their internal instrument, the Commissary Customer Service Survey (CCSS), and their external instrument, the American Customer Satisfaction Index (ACSI).

The CCSS is a comprehensive internal survey conducted annually by DeCA at all commissaries. Planning for the CCSS starts in May of each year. Survey administration is conducted in July/August. The initial report is complete by the end of the fiscal year to coincide with end of fiscal year reporting. All reports are complete by December of each year. The effort includes approximately 20,000 completed surveys each year. The response rate is typically near 90%. Its primary purpose is to identify potential improvement opportunities and gain information about our customers and their shopping behavior. The CCSS uses a rating scale from "1" to "5", with "1" being "poor" and "5" being "excellent." These numerical scores are converted to letter grades. The overall CCSS score is the average of these ratings, weighted by commissary sales. Using the green, yellow, red balanced scorecard approach, an "A" (4.5 or better) is green, "B" (4.20 – 4.49) is yellow, and "C" (below 4.20) is red.

The ACSI is an independent scientific effort—an outside source of customer satisfaction data for commissaries, exchanges, and private sector industry. The index is an economic indicator that measures customer satisfaction based on customer surveys and the application of sophisticated econometric modeling. DoD survey participants are selected randomly from a list of commissary eligible personnel provided by the Defense Manpower Data Center. Selected personnel are then screened so that only those who qualify as "customers" are surveyed about their expectations and satisfaction with store merchandise, products, services, and prices. ACSI uses econometric modeling to analyze customer satisfaction and produce a customer satisfaction index referred to as the ACSI. The ACSI is designed so that DeCA results can be compared to major commercial supermarket chains as well as other industries that report ACSI results.

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DeCA's goal is to meet or exceed the industry average. Using the green, yellow, red balanced scorecard approach, a green is achieved when DeCA's score equals or exceeds the industry average; a yellow when the score is within two points below that average; and a red when the score is more than two points below the industry average.

Maintaining High-Quality Products

With the advent of a broad range of branded products in the United States, measuring "high-quality" products is extremely difficult. Essentially those branded products which do not measure up to customer expectations, don't survive in the American marketplace. That is true for the commissary as well, with non-performing products quickly being deleted from the commissary assortment. Except for random weight products (meat, produce, dairy, and deli) the commissary sells and plans to continue selling brand name products, but will add a line of private label products. Today, private label products are controlled within the marketplace and fall into three categories—value brand, brand name equivalent, and premium brand. While the commissary assortment will be expanded to include a private label or store brand offering, that acquisition will be for brand name equivalent private label products. DeCA will continue to use the CCSS survey, some of whose 14 questions deal with quality of non-branded random weight products using the same green, yellow, red balanced scorecard measurement described under "customer satisfaction" above.

Sustainment of Patron Savings:

Pursuant to section 651(e)(3) of the NDAA for FY 2016, the Department is establishing a new baseline for commissary patron savings. The new baseline will identify:

- A savings level for each U.S. commissary
- A savings level at least monthly
- A savings level that measures a representative market list of items
- A savings level that incorporates pricing of local competitors

To meet these objectives, DeCA has developed a methodology with three parts:

1. A manual market basket shop component of up to 1,400 Stock Keeping Units (SKUs) that reflect products patrons normally purchase. This comparison will be conducted at the commissary as well as selected commercial stores in the vicinity of the commissary. The market basket data obtained will be used to calculate a commissary savings level as compared to commercial stores around each commissary. Each U.S. Commissary will be manually shopped once a year, at a rate of approximately 45 stores per quarter. The commissary savings levels collected each quarter will be combined via a sales weighted average to derive an overall manual approach savings metric.

2. A data-driven component with the largest possible range of items and competitors to ensure comprehensiveness by comparing the prices of all scannable products that DeCA

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carries (about 38,000 SKUs) to a database of average national prices. The data component, calculated on a monthly basis, will be used to monitor trends in savings.

3. An adjustment outside of the Continental United States (CONUS) to account for overseas cost of living differences by applying the Defense Travel Management Office Cost of Living Index to the CONUS savings calculation. The primary inputs to the overseas approach are the U.S. savings levels for the East and West coasts, and the cost of living allowance index for each overseas location.

The overall U.S. savings level is a combination of the data-driven calculation, which only measures scannable items in the near term, and the manual approach calculation, which measures both scannable items and fresh products. Conducted monthly, but reported quarterly, measurements will compute an average patron savings for the U.S. and for each of seven regional areas within the U.S. Using the green, yellow, red balanced scorecard approach, a green is achieved when DeCA's average U.S. score equals the baseline established as a prerequisite to conducting any pilot program; a yellow when the score is within one percent below that baseline; and a red when the score exceeds two percent below the baseline average.

As previously noted, therefore, the metrics and their related processes have already been identified, and baselines have been established. Savings, dividends, and capital expenditure metrics will be based on the 5-year trailing average of the most recent reports and audited financial statements; customer satisfaction will be based on the most recent year survey. Target ranges for each metric will be specified for each pilot program as it is developed and included in the required report to the Armed Services Committees. The additional information provided here should be sufficient to satisfy the Department's obligation under this recommendation and allow this item to be closed.

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Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

Brian J. Lepore, (202) 512-4523 or leporeb@gao.gov

Staff Acknowledgments

In addition to the individual named above, key contributors to this report were Gina Hoffman (Assistant Director), Pedro Almoguera, Mae Jones, Amie Lesser, Camille Pease, Ophelia Robinson, Sabrina C. Streagle, Yee Wong, and Elizabeth Wood.

Appendix III: Accessible Data

Agency Comment Letter

Comments from the Department of Defense

Page 1

Mr. Brian Lepore

Director, Defense Capabilities Management

U.S. Government Accountability Office 441 G Street, NW

Washington, DC 20548

NOV. 7 2016

Dear Mr. Lepore:

This is the Department of Defense (DoD) response to the Government Accountability Office (GAO) Draft Report, GA0-17-38, "DOD COMMISSARIES AND EXCHANGES: Plan and Additional Information Needed on Cost Savings and Metrics for DOD Efforts to Achieve Budget Neutrality," dated September 21, 2016 (GAO Code 100903).

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We also appreciate the GAO report's explicit recognition of the impact of the constraints under which these reports were prepared. The DoD report represented an early stage in the evolution of a complex excursion into "unchartered territory," a complete restructuring of the highly-legislated defense commissary system. In addition, the compressed time schedule, not only for the completion of the Department's report but also for GAO's own review, prevented the Department from being very detailed at that time about the initiatives, assumptions, or anticipated savings associated with potential changes that may be proposed in years to come.

The Department established the Defense Resale Business Optimization Board to develop and evaluate potential reforms and proposed pilot projects to determine the extent to which they might reduce the Department's use of appropriated funding for the defense resale ecosystem.

Our efforts in this direction will be guided by the Congressional mandate to sustain the current level of commissary and exchange customer satisfaction, product quality, and patron savings.

The Department is providing the enclosed official written comments for inclusion in the report.

Peter Levine

Performing the Duties of the Under Secretary of Defense for Personnel and Readiness

Enclosure: As stated

Page 2

GAO DRAFT REPORT DATED SEPTEMBER 21, 2016 GA0-17-38 (GAO CODE 100903)

"DOD COMMISSARIES AND EXCHANGES: PLAN AND ADDITIONAL INFORMATION NEEDED ON COST SAVINGS AND METRICS FOR DOD EFFORTS TO ACHIEVE BUDGET NEUTRALITY"

DEPARTMENT OF DEFENSE COMMENTS TO THE GAO RECOMMENDATION

RECOMMENDATION 1:

The GAO recommends that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and Marine Corps Exchange, provide information to Congress that includes data, assumptions, and methodology supporting its conclusion for not achieving budget neutrality.

DoD RESPONSE: Concur.

The following information expands upon the material presented in the DoD report and should satisfy this recommendation.

Section 651 of the National Defense Authorization Act for Fiscal Year (FY) 2016 (P.L. 114-92) does not define "budget neutrality." The Department has interpreted the term to mean that, while Congress viewed the defense resale system as an important non-pay benefit for military members and their families, it simultaneously desired to provide that same benefit at no cost to the taxpayers beginning in FY 2018. The Department's assumption that Congress views the commissary benefit as an important non-pay benefit is based on several factors: demonstrated Congressional level of interest in the defense resale system; the repeated restoration by Congress of appropriations reduced by the Department in the President's budgets for FY 2013, FY 2014, and FY 2015; and Congressional support for maintaining the same levels of savings and service provided by the Defense Resale Enterprise as subsidized by appropriations.

As cited in the Military Compensation and Retirement Modernization Commission's report, "in 2013, the commissaries received $1.4 billion in appropriated funding (APF), of which $152 million was spent on second destination transportation costs for transporting U.S. goods overseas. That same year, the exchanges received approximately $397 million in APF. This amount included $170 million for contingency support, covering expenses associated with the transportation of merchandise from warehouses to remote exchange sites, incremental inventory variances above the noncontingency average, danger pay, deployment bonuses, overtime, and foreign post differentials for deployed associates. Also included were $179 million for second destination transportation, and $47 million for direct and indirect exchange operating costs, including a limited number of active-duty military personnel, military travel, and utilities for authorized overseas locations and a limited number of [Continental United States] CONUS remote and isolated locations." The purposes, amounts, and legislative constraints have not substantively changed since the Department provided this information to the Commission.

Concerning appropriations for the defense exchange system ($397 million in FY 2013), it should be noted that the exchange system consists of several separate nonappropriated fund entities. Consequently, the exchange system funds the majority of operations through the sales of goods

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and services at a profit and without imposing a sales tax. A portion ($170 million) of their minimal appropriated funding directly supports military members performing military missions in contingency operations and therefore is not likely to be eliminated completely. The second destination transportation (SDT) funding ($179 million) enables the defense exchange system to provide goods familiar to the military members and their families at locations outside of the CONUS at no additional cost to them. The exchange system already works to minimize its SDT requirements so that these centrally-managed appropriations may be applied to other SDT needs within the respective military services. Ifthe SDT appropriation to the defense exchange system were eliminated, the exchanges (as profit/loss -based retail businesses) would have three options for recouping the costs:

- Add the transportation costs into the price of the goods, thereby reducing the savings benefit to the military members and families outside CONUS;
- Remove some or all of the American goods from overseas inventories in favor of local products that might not be equivalent to the American goods, thereby affecting the quality as perceived by the military members and families overseas; or
- Absorb the transportation costs as an operating expense, thereby reducing net earnings.

The first two options would likely reduce sales based on price inelasticity and/or lower comparable pricing for like products on the local economy or through eCommerce sites (such as Amazon). For all of the options, any reductions to the exchange's net earnings (i.e., profits) directly reduce contributions to the military services' morale, welfare, and recreation (MWR) programs as well as funding for the exchanges' recapitalization programs.

The elimination of appropriated funding to the Defense Resale Enterprise would therefore diminish vital support for military missions and result in higher prices, lower quality or reduced availability of American products, and reduced support for MWR programs.

The Department has requested legislative authority to reduce the appropriated fund subsidy for second destination travel as efficiencies are identified and implemented to achieve savings in the Exchanges without reducing the MWR benefit. As these savings initiatives are fleshed out, the Department will provide additional information to Congress with regard to data, assumptions, and methodology .

Pursuant to 10 U.S.C. 2481(a), the defense commissary system operates separately from the defense exchange system. Whereas the exchange system operates predominantly with nonappropriated funds and generates its own revenue, 10 U.S.C. 2483 requires, with limited exceptions, the use of APFs appropriated each fiscal year to cover commissary system operating expenses. 10 U.S.C. 2484 establishes the merchandise categories that commissary stores may sell and provides that, with certain exceptions, the sales price of each item sold in the commissary shall recoup the actual product cost of the item. Additionally, a 5 percent surcharge is applied to the established sales price of commissary items sold.

Within the Defense Commissary Agency (DeCA) working capital fund (WCF), there are two activity groups: commissary resale stocks, which is a revolving fund consisting of revenues from the sale of the products by the commissary stores; and commissary operations, which funds the operating costs of commissaries, areas, and headquarters activities. The second WCF activity group's primary revenue source is the annual direct appropriation for the Defense WCFs, which

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in turn is apportioned to the DeCA WCF. DeCA's Surcharge Collections Trust Fund, which is a Treasury General Fund and not a Defense WCF, funds certain capital requirements and is primarily funded from the above-referenced five percent surcharge applied to commissary items sold. The uses of the Surcharge Trust Fund are established in 10 U.S.C. 2484(h). [Source: DeCA FY 2015 Annual Financial Report]

Breaking down the $1.4 billion in direct annual appropriations for the defense commissary system, approximately $152 million is for SDT of American grocery products to locations outside of the United States. Eliminating this support for the commissaries would have many of the same impacts as noted above for the exchange system, although here the focus is clearly more on pricing and product quality as perceived by the commissary patron, rather than on profit and MWR contribution. The remainder of the $1.4 billion funds the operating expenses of the commissary stores.

No other grocery or retail operation is financed in this manner. The Department's assessment that budget neutrality is not possible is based on comparative analysis. Profit and loss entities (such as the defense exchange systems and commercial grocers) fund their operating costs out of gross profits (i.e., net sales minus cost of goods sold). The defense commissary system does not generate any gross profits, due to the mandated pricing model.

Budget neutrality for the commissaries can only be achieved by adjusting two levers: net sales and/or operating expenses.

- For DeCA to cover the $1.4 billion in operating costs through variable pricing, prices across the board would need to be increased by about 25.5% to generate the gross profit necessary. This would not meet the requirement to provide the same levels of savings. Increased pricing would also drive higher out-of-pocket expenses for patrons through the surcharge. This percentage increase is based on $6.9 billion in net sales minus $5.5 billion in cost of goods sold with the result of $1.4 billion in gross profits.
- For DeCA to cover the $1.4 billion subsidy loss, it would have to eliminate all costs for operating commissary stores, areas, and headquarters. As stated earlier, 10 U.S.C. 2483 requires that, with certain exceptions, APFs shall fund the operations of DeCA and the Defense commissary system. Consequently, the budgetary resources in the DeCA WCF that pay commissary system employees are entirely dependent on the annual direct appropriations for Defense WCFs. Practically speaking, it would be impossible to eliminate the labor costs (approximately $700 million per year) and still operate the commissary system. The elimination of all operating costs would require the closure of the commissary system, which would not meet the requirement to provide the same levels of customer satisfaction, product quality, and patron savings.

The Department is committed to pursuing additional revenue sources and efficiencies in its operation of the commissary system, in order to reduce the reliance on APF support. However, there does not appear to be a viable way to eliminate all $1.4 billion in APF support to the defense commissary system (and $0.4 billion of APF support to the exchanges) while still maintaining customer satisfaction, product quality, and patron savings to the military members and families. The Department's preliminary estimate of potential savings is based on a report by the Boston Consulting Group, dated July 2015. The Department is committed to developing

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business case analyses to support specific reform proposals. As these business case analyses are developed, the Department will provide additional information to Congress with regard to data, assumptions, and methodology.

RECOMMENDATION 2:

The GAO recommends that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and Marine Corps Exchange, develop a plan with assumptions, a methodology, cost estimates, and specific timeframes for achieving alternative reductions to appropriations, to support DOD's efforts to ensure that its cost savings target is feasible and accurate.

DoD RESPONSE: Concur.

The following information expands upon the material presented in the Department of Defense (DoD) report and provides an outline of the Department's approach for the way ahead. Specific proposals for initiatives, pilot programs, and other program enhancements will be accompanied by the required information in sufficient detail to permit the Department's analysis and informed decisions.

The chief executives of the defense commissary and exchange systems and the Department of Defense Deputy Chief Management Officer worked collaboratively throughout 2015 to develop a budget proposal that would achieve savings in the Defense Resale Enterprise while maintaining customer savings and service. The result was a budget reduction over FY 2017-FY 2021 of $2.13 billion. The plan that formed this proposal was based almost exclusively on recommendations and estimates provided by the Boston Consulting Group (BCG) in a study it conducted for the Department. The Department has not implemented the recommendations contained in the BCG report, but those recommendations represented the best basis for developing a potentially achievable budget reduction .

In 2016, the Defense Resale Business Optimization Board was chartered to develop an executable plan, which may or may not include all of the initiatives identified for the budget proposal. The Board's current pipeline of executable initiatives reflects achievable savings based on assumptions, requirements, cost estimates, mission impacts, and timeframes. This pipeline is updated as the Board identifies, analyzes, and approves business cases for each optimization, and as the individual resale systems can absorb and execute change without overly disrupting business operations and patrons.

As it proposes specific program adjustments, pilot programs, and similar initiatives, the Department will include the required information in sufficient detail to assist in its analysis and decision processes.

RECOMMENDATION 3:

The GAO recommends that the Secretary of Defense, with assistance as necessary from the Director and Chief Executive Officer of the Defense Commissary Agency, the Director and Chief Executive Officer of the Army and Air Force Exchange Service, the Chief Executive Officer of the Navy Exchange Service Command, and Marine Corps Exchange, as DOD conducts pilot programs, identify specific metrics to determine whether the organization has fulfilled the mandated requirement to maintain high levels of customer satisfaction, the provision of high-quality products, and sustainment of patron savings.

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DoD RESPONSE: Concur.

The following information expands upon the material presented in the Department of Defense (DoD) report and should satisfy this recommendation. Initial metrics and their related processes have already been identified, and baselines have been established.

Savings, dividends, and capital expenditure metrics will be based on the 5-year trailing average of the most recent reports and audited financial statements; customer satisfaction will be based on the most recent year survey. Target ranges for each metric will be specified for each pilot program as it is developed.

Pursuant to section 651(e)(5)(A) of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2016 (P.L. 114-92), if the Department conducts a pilot program pursuant to section 651, the Secretary of Defense shall, not later than 30 days before commencing the pilot program, submit a report to the Committees on Armed Services of the Senate and the House of Representatives that includes a description of the pilot program and the provisions, if any, of chapter 147 of title 10, U.S. Code, that will be waived in the conduct of the pilot program. At this time the Department anticipates only conducting pilot programs for the commissary system. The Department will comply with the requirements of section 651 prior to commencing any pilot program and provide a report to Congress that describes at a minimum: parameters of the pilot program, operational criteria, assumptions, savings expectations, and measurement metrics.

Those metrics will maintain high levels of customer satisfaction, provide high-quality products, and sustain patron savings, as defined below:

Customer Satisfaction:

The Defense Commissary Agency (DeCA) will continue to measure customer satisfaction through the combination of their internal instrument, the Commissary Customer Service Survey (CCSS), and their external instrument, the American Customer Satisfaction Index (ACSI).

The CCSS is a comprehensive internal survey conducted annually by DeCA at all commissaries. Planning for the CCSS starts in May of each year. Survey administration is conducted in July/August. The initial report is complete by the end of the fiscal year to coincide with end of fiscal year reporting. All reports are complete by December of each year. The effort includes approximately 20,000 completed surveys each year. The response rate is typically near 90%. Its primary purpose is to identify potential improvement opportunities and gain information about our customers and their shopping behavior. The CCSS uses a rating scale from "1" to "5", with "1" being "poor" and "5" being "excellent." These numerical scores are converted to letter grades. The overall CCSS score is the average of these ratings, weighted by commissary sales. Using the green, yellow, red balanced scorecard approach, an "A" (4.5 or better) is green, "B" (4.20 - 4.49) is yellow, and "C" (below 4.20) is red.

The ACSI is an independent scientific effort-an outside source of customer satisfaction data for commissaries, exchanges, and private sector industry. The index is an economic indicator that measures customer satisfaction based on customer surveys and the application of sophisticated econometric modeling. DoD survey participants are selected randomly from a list of commissary eligible personnel provided by the Defense Manpower Data Center. Selected personnel are then screened so that only those who qualify as "customers" are surveyed about their expectations and satisfaction with store merchandise, products, services, and prices. ACSI uses econometric modeling to analyze customer satisfaction and produce a customer satisfaction index referred to as the ACSI. The ACSI is designed so that DeCA results can be compared to major commercial supermarket chains as well as other industries that report ACSI results.

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DeCA's goal is to meet or exceed the industry average. Using the green, yellow, red balanced scorecard approach, a green is achieved when DeCA's score equals or exceeds the industry average; a yellow when the score is within two points below that average; and a red when the score is more than two points below the industry average.

Maintaining High-Quality Products

With the advent of a broad range of branded products in the United States, measuring "high- quality" products is extremely difficult. Essentially those branded products which do not measure up to customer expectations, don't survive in the American marketplace. That is true for the commissary as well, with non-performing products quickly being deleted from the commissary assortment. Except for random weight products (meat, produce, dairy, and deli) the commissary sells and plans to continue selling brand name products, but will add a line of private label products. Today, private label products are controlled within the marketplace and fall into three categories-value brand, brand name equivalent, and premium brand . While the commissary assortment will be expanded to include a private label or store brand offering, that acquisition will be for brand name equivalent private label products. DeCA will continue to use the CCSS survey, some of whose 14 questions deal with quality of non-branded random weight products using the same green, yellow, red balanced scorecard measurement described under "customer satisfaction" above.

Sustainment of Patron Savings:

Pursuant to section 651(e)(3) of the NDAA for FY 2016, the Department is establishing a new baseline for commissary patron savings. The new baseline will identify:

- A savings level for each U.S. commissary
- A savings level at least monthly
- A savings level that measures a representative market list of items
- A savings level that incorporates pricing of local competitors

To meet these objectives, DeCA has developed a methodology with three parts:

1. A manual market basket shop component of up to 1,400 Stock Keeping Units (SKUs) that reflect products patrons normally purchase. This comparison will be conducted at the commissary as well as selected commercial stores in the vicinity of the commissary. The market basket data obtained will be used to calculate a commissary savings level as compared to commercial stores around each commissary. Each U.S. Commissary will be manually shopped once a year, at a rate of approximately 45 stores per quarter. The commissary savings levels collected each quarter will be combined via a sales weighted average to derive an overall manual approach savings metric.
2. A data-driven component with the largest possible range of items and competitors to ensure comprehensiveness by comparing the prices of all scannable products that DeCA

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carries (about 38,000 SKUs) to a database of average national prices. The data component, calculated on a monthly basis, will be used to monitor trends in savings.

3. An adjustment outside of the Continental United States (CONUS) to account for overseas cost of living differences by applying the Defense Travel Management Office Cost of Living Index to the CONUS savings calculation. The primary inputs to the overseas approach are the U.S. savings levels for the East and West coasts, and the cost ofliving allowance index for each overseas location.

The overall U.S. savings level is a combination of the data-driven calculation, which only measures scannable items in the near term, and the manual approach calculation, which measures both scannable items and fresh products. Conducted monthly, but reported quarterly, measurements will compute an average patron savings for the U.S. and for each of seven regional areas within the U.S. Using the green, yellow, red balanced scorecard approach, a green is achieved when DeCA's average U.S. score equals the baseline established as a prerequisite to conducting any pilot program; a yellow when the score is within one percent below that baseline; and a red when the score exceeds two percent below the baseline average.

As previously noted, therefore, the metrics and their related processes have already been identified, and baselines have been established. Savings, dividends, and capital expenditure metrics will be based on the 5-year trailing average of the most recent reports and audited financial statements; customer satisfaction will be based on the most recent year survey. Target ranges for each metric will be specified for each pilot program as it is developed and included in the required report to the Armed Services Committees. The additional information provided here should be sufficient to satisfy the Department's obligation under this recommendation and allow this item to be closed.

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