Audit Report

OFFICE OF THE INSPECTOR GENERAL

DOD MILK PLANTS IN THE PACIFIC - JAPAN

Report No. 96-224 September 18, 1996

Department of Defense

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

September 18, 1996

MEMORANDUM FOR COMMANDER, U.S. FORCES JAPAN
COMMANDER, ARMY AND AIR FORCE EXCHANGE SERVICE

SUBJECT: Audit Report on DoD Milk Plants in the Pacific - Japan (Report No. 96-224)

We are providing this audit report for review and comment. This report is the third and final in a series of reports on DoD milk plants in the Pacific. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. Army and Air Force Exchange Service comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. However, U.S. Forces Japan did not comment on a draft of this report. Therefore, we request that U.S. Forces Japan provide comments on the final report by October 18, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Terry L. McKinney, Audit Program Director, at (703) 604-9288 (DSN 664-9288) or Mr. Ronald W. Hodges, Audit Project Manager, at (703) 604-9291 (DSN 664-9291). See Appendix E for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-224 **September 18, 1996**
(Project No. 5CF-0060.02)

DoD Milk Plants in the Pacific - Japan

Executive Summary

Introduction. This report is the third and final in a series of reports on DoD milk plants in the Pacific and discusses the U.S. Army Kanagawa milk plant in Japan. Since 1947, the Army has maintained a Government-owned, contractor-operated milk plant in Yokohama, Japan, to provide milk and other dairy products to DoD personnel and their families. The milk plant operation was formerly necessary because fresh milk and other dairy products are highly perishable and could not be economically shipped from the United States without spoiling. In addition, DoD could not purchase milk and other dairy products from local dairy sources because Japanese dairies did not meet U.S. health standards.

Currently, Servrite International is operating the Kanagawa milk plant in the second option year of a contract that expires on September 30, 1996. The Kanagawa milk plant produces "filled milk" products that consist of a nonfat, dry milk powder mixed with water, vitamins, and coconut oil. The milk plant annually produces approximately 3.2 million quarts of milk, other dairy products, and flavored drinks at a cost of $6.1 million.

Recent technological advances and sanitary improvements by U.S. dairies have led to the development of fresh milk with a shelf life of more than 60 days. The development of extended-shelf-life milk has provided a viable alternative to the products produced at the milk plant.

Audit Objectives. The primary audit objective was to determine whether DoD milk plant operations in the Pacific are efficient, effective, and needed. We also planned to evaluate the management control program associated with milk plant operations. Based on the results of our audits of milk plants on Okinawa and in Korea, we decided to focus our review on determining whether the Kanagawa milk plant is needed. Therefore, we did not review the management control program for the Kanagawa milk plant.

Audit Results. The Kanagawa milk plant is no longer needed. By closing the milk plant and obtaining extended-shelf-life milk and other dairy products from U.S. manufacturers, DoD could put U.S. and Government of Japan funds of $2.6 million to better use over 6 years. Also, DoD could encourage the Government of Japan to reprogram funds of $34 million, which were planned for use in constructing a replacement milk plant, to fund other DoD construction requirements in Japan. In addition, discontinuing use of filled milk will improve the quality of life for DoD personnel and their families in Japan. For details of the audit results, see Part I.

Summary of Recommendations. We recommend that the Commander, U.S. Forces Japan, develop and implement procedures to obtain extended-shelf-life milk and related dairy products for all DoD organizations in Japan on a regular basis and establish a lead organization to develop contingency plans in case of possible shortages. We recommend that once extended-shelf-life milk and related dairy products are available throughout Japan, the Commander direct the U.S. Army in Japan to close the Kanagawa milk plant. Once the existing milk plant is closed, the Commander, U.S. Forces Japan, should reassign the 38 milk plant employees paid by the Government of Japan to satisfy other DoD workload requirements. We also recommend that the Commander terminate the plan to construct a replacement milk plant and negotiate with the Government of Japan to reprogram the estimated $34 million in construction costs to fulfill other unfunded requirements. In addition, we recommend that the Commander, Army and Air Force Exchange Service, establish procedures to supply extended-shelf-life milk and other dairy products to retail outlets and DoD dependent schools in Japan.

Management Comments and Audit Response. The Commander, U.S. Forces Japan, did not respond to a draft of this report. Therefore, we request the Commander, U.S. Forces Japan, to provide comments on the final report by October 18, 1996. The Army and Air Force Exchange Service established procedures to supply extended-shelf-life milk and other dairy products to retail outlets and DoD dependent schools in Japan. See Part I for a discussion of management comments and Part III for the complete text of the Army and Air Force Exchange Service comments.

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Part I - Audit Results

Introduction

This report is the third and final in a series of reports on DoD milk plants in the Pacific and discusses the U.S. Army Kanagawa milk plant in Yokohama, Japan. DoD has maintained three Government-owned, contractor-operated milk plants in the Pacific to supply milk and other products to DoD personnel stationed there and their families. Inspector General, DoD, Report 96-197, "DoD Milk Plants in the Pacific - Korea," July 22, 1996, discusses the milk plant in Korea. Inspector General, DoD, Report No. 96-140, "DoD Milk Plants in the Pacific - Okinawa," June 3, 1996, discusses the milk plant on Okinawa, Japan. The findings in those reports are summarized in Appendix B.

Audit Background

Production of Milk by the Military Departments. In the past, fresh milk was highly perishable and subject to bacterial contamination, requiring that the milk be transported quickly to avoid spoilage. The Military Departments began producing milk and other dairy products at plants in the Pacific shortly after World War II because technology did not exist to preserve fresh milk and other dairy products for the long period required to transport the products from the United States. The Military Departments could not purchase fresh milk and other products from the local Japanese dairies because local dairies did not meet U.S. health standards.

The three Government-owned, contractor-operated milk plants in the Pacific have produced and distributed dairy products that consist of nonfat, dry milk powder mixed with water, vitamins, and coconut oil. The milk produced is commonly referred to as "filled milk." Currently, DoD produces filled milk only in the Pacific.

U.S.-Manufactured Fresh Milk. Fresh milk produced in the United States is designated as either Grade A or Grade B. Grade A fresh milk is produced under higher sanitary standards than Grade B and is the only type of milk available for fluid consumption within the United States. Grade A milk can also be used for the production of other dairy products such as ice cream, butter, and cottage cheese. In the United States, Grade B milk can only be used for the production of hard dairy products such as nonfat dry milk, cheese, and butter. Because of technological advances and sanitary improvements of U.S. production facilities, U.S. dairy manufacturers now offer fresh (Grade A) milk with a shelf life of more than 60 days. Commonly referred to as "extended-shelf-life milk," the milk is pasteurized at a higher temperature and packaged in a more sterile environment to extend the period before bacterial contamination occurs. The development of extended-shelf-life milk eliminated the problem of milk spoiling during shipment over long distances. Extended-

shelf-life milk is currently available in commissaries throughout Japan. Ultra-high-temperature milk, another type of extended-shelf-life milk, is pasteurized at higher temperatures and packaged in a sterile environment. The ultra-high-temperature milk has a shelf life of about 6 months and does not require refrigeration. The milk is used primarily on Navy ships and among deployed troops.

Audit Objectives

The overall audit objective was to determine whether DoD milk plant operations in the Pacific are efficient, effective, and needed. We also planned to evaluate the management control program as it applied to milk plant operations.

Based on the results of our audits of the milk plants on Okinawa and in Korea, we decided to focus our review on determining whether the Kanagawa milk plant is needed. Therefore, we did not review the management control program for the Kanagawa milk plant. See Appendix A for a discussion of the scope and methodology. See Appendix B for a summary of reports on our prior audits of milk plants in the Pacific.

U.S. Army Milk Plant in Japan

The U.S. Army Kanagawa milk plant in Japan, which provides filled milk to DoD personnel and their families, is no longer needed and should be closed. The milk plant is unnecessary because:

o the primary justification for the milk plant existence, non-availability of extended-shelf-life milk (fresh milk), is no longer valid;

o the Army contention that a milk plant in Japan is necessary for contingency operations is not valid;

o customers prefer fresh milk to filled milk; and

o continuing to operate the milk plant is not cost-effective.

By closing the milk plant and obtaining fresh milk and other dairy products from U.S. manufacturers, DoD could put U.S. and Government of Japan funds of $2.6 million to better use over 6 years. DoD could encourage the Government of Japan to use funds of $34 million, which were to be used in constructing a replacement milk plant, to fund other DoD construction requirements in Japan. In addition, discontinuing use of filled milk will improve the quality of life for DoD personnel and their dependents in Japan.

Operation of the Kanagawa Milk Plant

Milk Plant Facility. The milk plant in Japan is one of three DoD milk plants in the Pacific. The facility that houses the milk plant was constructed by the Government of Japan in 1937 as a chemical weapons laboratory. The Army converted the chemical weapons laboratory into a milk plant in 1947. The milk plant is not located on a military installation, but is in the Kanagawa district of the downtown section of Yokohama, Japan.

Milk Plant Responsibility. The milk plant is a Government-owned, contractor-operated facility. U.S. Forces Japan is the unified command that oversees all DoD Components in Japan. Responsibility for the milk plant belongs to the U.S. Army Japan, 9th Theater Army Area Command. Within the 9th Theater Army Area Command, the 17th Area Support Group oversees the day-to-day milk plant operations. Because the Kanagawa milk plant is a contractor-operated facility, and the Army has limited contracting authority in Japan, the 374th Contracting Squadron at Yokota Air Base, Japan, is responsible for negotiating, awarding, and administering contracts to operate the plant.

To assist in the administration of the milk plant contract, the 17th Area Support Group assigns a full-time contracting officer representative and a veterinary food service inspector from the U.S. Army Veterinary Services. The contracting officer representative coordinates customer orders for filled milk products under the contract and ensures that the contractor complies with the terms of the contract. The veterinary food service inspector inspects and tests the milk plant for compliance with health and sanitation standards, while the Chief Food Analysis Laboratory, Tripler Army Medical Center, Hawaii, is responsible for testing the quality of milk plant products. In addition, the 17th Area Support Group provides several other indirect support personnel, such as accounting technicians to process customer bills and to pay milk plant bills.

Milk Plant Contract. Servrite International, a U.S.-invited contractor, operates the milk plant because local sources are not interested or qualified. An invited contractor is generally a business that does not possess the licenses, registrations, and permits required to conduct business in a foreign location, but that receives logistical support from the U.S. armed forces for the purpose of executing contracts with DoD. The 374th Contracting Squadron, Japan, competitively awarded the current contract (F62562-93-D-4012), estimated at $700,000 per year, to Servrite International on October 1, 1993, for a 1-year period with 4 option years. The contract is currently in the second option year, which expires September 30, 1996. The contractor produces 52 line items of milk and other products and is responsible for the general maintenance and management of the milk plant, including supplying coconut oil, flavorings, and other ingredients, except dry milk powder (which is supplied by DoD) that are necessary to produce filled milk.

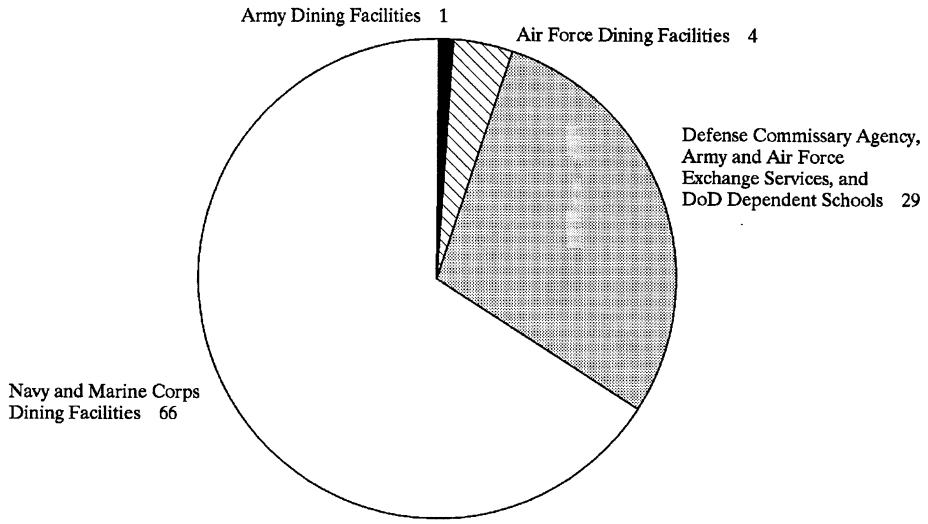
The Army is responsible for supplying the nonfat dry milk powder and the labor force of 38 Japanese employees. The employees are provided by the Government of Japan to the Army in accordance with a cost-sharing plan (Master Labor Contract) negotiated between the U.S. and the Government of Japan in 1991. The Government of Japan is responsible for the local national labor force required to support the U.S. mission in the Pacific. The employees are provided to the various Military Departments based on a predetermined requirement. If the milk plant closes, the employees would still be assigned to the Army; however, if the Army could not use the employees for other purposes, U.S. Forces Japan would be responsible for assigning the employees elsewhere. In accordance with the 1991 Master Labor Contract, the wages and benefits of the employees were shared between the U.S. and the Government of Japan. However, since April 1, 1995, the Government of Japan has assumed all labor costs under the Master Labor Contract.

Milk Plant Customers. The milk plant customers include military dining facilities, commissaries, and exchanges in Japan. The Commander, Army and Air Force Exchange Service, is responsible for supplying milk and other dairy products to retail exchange outlets and DoD dependent schools located on Army and Air Force installations in Japan. Similarly, the Navy Exchange is responsible for supplying milk and other dairy products to retail exchange

outlets and DoD dependent schools located on Navy installations in Japan. The Army and Air Force Exchange Service currently obtains 100 percent of the milk used in DoD dependent schools from the Kanagawa milk plant. The Navy Exchange obtains 100 percent of its milk for DoD dependent schools from U.S. manufacturers.

The Defense Commissary Agency is responsible for the operation of the commissaries in Japan. Of the milk and other dairy products obtained by the Japan commissaries for resale, 4 percent is from the Kanagawa milk plant. The largest milk plant customer is the military dining facilities, which include dining facilities on Navy ships assigned to the Yokosuka Naval Base.

The following figure, which represents sales of $1.8 million, shows the percent of sales to each milk plant customer during FY 1995.



FY 1995 Kanagawa Milk Plant Percent of Sales to Each Customer

Justification for Establishing the Milk Plant in Japan

The Army justification for establishing the milk plant in Japan is no longer valid. The milk plant was established to supply milk and other dairy products to U.S. forces in Japan when local and U.S. dairy manufacturers could not meet the requirement. The Army could not purchase milk locally because Japanese dairies do not meet U.S. dairy standards for quality. Also, before 1992, the Army could not economically ship U.S.-manufactured fresh milk and other dairy products to Japan without spoilage. However, U.S. manufacturers now extend the shelf life of fresh milk and other dairy products to at least 60 days by pasteurizing the milk at higher temperatures and under more strict sanitary conditions. The longer shelf life allows fresh milk products to be shipped by sea transportation without spoiling, which makes purchasing fresh milk and other dairy products a viable alternative to operating a milk plant.

The Defense Commissary Agency in Japan has procured fresh milk and other products from U.S. dairy manufacturers and sold the products in the commissaries since at least 1992. Based on a 60-day shelf life at the time of production, fresh milk and other products have an average remaining shelf life of 30 days by the time the products are available for sale in the commissaries. During the past 4 years, the commissaries experienced no shipping delays when shipping fresh milk and other dairy products purchased in the United States to Japan.

Justification for Continuing Milk Plant Operations

The Army justification for continuing to operate a milk plant in Japan is not valid. The Army maintains that a milk plant is essential to support the Pacific region during a war, or in response to natural disasters and other contingencies. However, the Army has never used the milk plant to provide support during such occurrences. Furthermore, when disasters and other regional contingencies did occur, filled milk was not needed or requested and, in some cases, fresh milk was obtained more readily through other sources. Examples follow.

o In February 1995, the Army did not use the milk plant to provide milk, bottled water, or fruit drinks in support of a major disaster relief effort. Following the earthquake in Kobe, Japan, the Commander In Chief, U.S. Pacific Command, organized various DoD organizations to provide support and disaster relief to the city of Kobe. Even though the milk plant's primary mission was to provide support during such disasters, the milk plant provided no

assistance. Army officials stated that the contracting officer (374th Contracting Squadron) was responsible for the milk plant contractor and should have initiated the action to provide filled milk.

o In December 1995, the Army did not use the milk plant to support a milk and dairy product shortage in Okinawa. Okinawa was out of milk because the milk plant workers staged a strike. Although the Army anticipated supplying milk to Okinawa, the Army could not overcome logistical problems to get milk from mainland Japan to Okinawa. Okinawa customers obtained fresh milk from established sources through existing pipelines.

o In January 1996, the commissaries did not obtain filled milk in response to a 3-day shortage of fresh milk. Commissary officials stated that fresh milk was available at the docks; however, because of a Japanese holiday, in-country transporters could not deliver the milk to the various commissaries. Although filled milk was available and not subject to the same delays, the commissaries opted to wait for the fresh milk. Commissary officials stated that most of their customers will not buy filled milk even when fresh milk is not available.

Consumer Preference

Product Taste and Consumer Perception. The taste of filled milk is generally considered inferior to the taste of fresh milk. The taste difference occurs because the fat in filled milk is coconut oil instead of butter fat. In addition, the use of milk powder results in a taste difference because of the milk powder processing. According to the Department of Agriculture Marketing Service, powdered milk is available in two U.S. grades. The higher U.S. grade, U.S. extra grade milk powder, has a slight chalky, cooked, and flat taste. Therefore, even if the milk plant uses the higher grade milk powder in its products, the products will not have a "fresh" taste. As a result, individuals may stop buying milk.

Fresh Milk Preferred Over Filled Milk. Current sales data show that once fresh milk became available, consumers preferred fresh milk over filled milk despite the higher cost of fresh milk. For example, during FY 1996, the commissary customers throughout Japan purchased fresh milk over filled milk at a rate of 21 to 1, even though fresh milk cost 61 percent more. Navy personnel stated that the higher price of fresh milk compared to filled milk made no difference. To them, the preference is a quality-of-life issue: fresh milk just tastes better than filled milk.

The following table shows a comparison of average fresh milk and filled milk sales at commissaries throughout Japan during FY 1996. Prices of each are also provided.

Comparison of FY 1996 Commissary Sales of Fresh and Filled Milk in Japan

Product	Monthly Sales Quantity in Quarts	Price of Milk Per Quart*	Percent of Milk Sales
U.S.-Manufactured Fresh Milk	181,666	$0.87	96
Kanagawa Plant Filled Milk	8,490	0.54	4

Fresh milk sales exceed filled milk sales by a ratio of 21 to 1.

*Prices were determined by converting unit prices to prices per quart and calculating the weighted average price by sales quantity.

In addition, as discussed in the example on page 8, commissary customers generally will not buy filled milk even when fresh milk is not available.

Decreased Demand For Filled Milk. After 1992, when fresh milk became available, the demand for filled milk decreased significantly. The milk plant operated at 75 percent capacity before 1992 compared with 18 percent capacity during 1995.

The demand for filled milk will continue to decrease based on the following recent customer decisions and ongoing actions to purchase other than filled milk products.

o The Air Wing Commander at Yokota Air Base recently directed the base commissary to provide fresh milk for his troops.

o Misawa Air Base is currently negotiating with U.S. vendors to obtain fresh milk in lieu of filled milk.

o The Navy Exchange at Yokosuka Naval Base decided to provide fresh milk exclusively to its retail outlets and to the DoD dependent schools it supports.

o Most Navy ships, when deployed, now use an ultra-high temperature milk because it offers more utility. The ultra-high-temperature milk has a 6-month shelf life and requires no refrigeration. The Navy ships use the extra chill space, which is no longer occupied by milk, to carry other perishable items.

o The U.S.S. *Independence*, which carries approximately 5000 military personnel, uses the ultra-high-temperature milk exclusively, when deployed as well as in port. Navy studies showed that Navy ship personnel prefer the ultra-high-temperature milk over filled milk.

Fresh Milk Not Available to Some Customers. Some of the milk plant's customers, such as the DoD dependent schools on Army and Air Force installations and the troop dining facilities, are not provided with a choice between fresh milk and filled milk.

DoD Dependent Schools. The Army and Air Force Exchange Service food service manager at Yokota Air Base indicated his preference for fresh milk at the DoD dependent schools, even though the schools did not offer fresh milk. He recognized that some children either did not drink the filled milk or would only drink flavored, filled milk. However, he was reluctant to offer both fresh and filled milk because he would have to charge for the fresh milk, whereas the filled milk is free to students. Children going through a line for milk would select either fresh milk or filled milk, dependent on what their parents could or could not afford, thereby creating a class structure within the school.

Comparatively, the Navy Exchange at Yokosuka Naval Base decided that fresh milk was important and elected to exclusively provide fresh milk to the DoD dependent schools it supports. Serving filled milk at some schools and fresh milk at other schools unfairly diminishes the quality of life for some students. At a minimum, life on U.S. bases overseas should at least meet the basic U.S. standards in regard to the availability of products and services. The basic U.S. standard for milk is Grade A fresh milk, not filled milk.

Dining Facilities. Troop dining facilities do not offer fresh milk. Continuing to supply U.S. troops in Japan with filled milk when fresh milk products are available in the commissaries could adversely affect troop morale. The well-being of troops overseas may be jeopardized because troops are not receiving the best quality products available.

Cost-Effectiveness of Continued Milk Plant Operations

Cost of Operations. The milk plant operation in Japan is not cost-effective and should be shut down. Our comparison of milk plant sales to total milk plant operating costs for FY 1995 showed that the U.S. Army and the Government of Japan spend about $6.1 million annually to operate a milk plant that generates annual sales of less than $1.8 million. Appendix C shows that, of the $6.1 million, $2.7 million was funded by the Government of Japan. In addition, customer demand for milk plant products continues to decline, with the milk plant currently operating at about 18 percent capacity. As a result, milk plant production does not meet even the minimum quantities needed to cover the contractor's fixed operating costs. The milk plant contract stipulates that the Army will reimburse the contractor for any shortfalls (based on a specified formula). The estimated shortfall, which does not include labor funded by the Government of Japan, is $13,000 per quarter, and will continue unless renegotiated by the contracting officer.

We performed a cost benefit analysis to determine whether procuring fresh milk and other dairy products from U.S. dairy manufacturers would be cost-effective. Using the actual cost of production, which includes costs funded by the Government of Japan, we concluded that procuring fresh milk and other dairy products from U.S. dairy manufacturers instead of keeping the milk plant open will save DoD and the Government of Japan about $432,000 per year. Over 6 years, that savings would total $2.6 million. In addition, by closing the milk plant, U.S. Forces Japan, could reassign the 38 milk plant employees, also funded by the Government of Japan, to satisfy other DoD workload requirements. Appendix C compares the cost to produce filled milk with the cost to import fresh milk.

Additional Resources Used in Attempt to Increase Sales. The Army continues to expend resources to increase sales for filled milk, even though filled milk is an inferior product that is no longer needed or preferred. Due to the erosion of the milk plant's customer base, and as a result of our audit, the Army has initiated plans to win back customers and continue producing filled milk.

The 17th Area Support Group is actively seeking to:

- develop new packaging to make the filled milk products more attractive to consumers,
- develop more product lines to compete with U.S. manufacturers, and
- use a milk expert to act as a consultant for the milk plant.

Given the strong consumer preference for fresh milk over filled milk, expending additional resources to increase sales of filled milk is a waste of DoD and Government of Japan funds.

Supply of Fresh Milk in Japan

Although the Navy and Air Force in Japan have adequate contracting facilities, in-country transportation, and cold storage to supply fresh milk, U.S. Forces Japan needs to establish procedures for obtaining fresh milk and other dairy products that will ensure proper management of dairy product support in Japan.

Supply Source For Fresh Milk and Other Products. Using the Defense Personnel Support Center (the Support Center) as a source of supply for fresh milk and other milk products in Japan is a viable method for obtaining fresh milk products. The Support Center was established to provide support to the Military Departments and is capable of providing products at a lower cost because it can consolidate requirements and use multiple suppliers. The Military Departments on Okinawa began using the Support Center in February 1996 to supply fresh milk and other dairy products to DoD personnel.

By using the Support Center, U.S. Forces Japan will have the option to let the Military Departments in Japan, including the military dining facilities that currently offer only filled milk, submit orders for fresh milk directly to the Support Center or to establish a lead organization responsible for consolidating the orders before submission to the Center. A lead organization could provide more effective use of transportation facilities and of limited cold storage space when supplying milk and other dairy products.

The Army and Air Force Exchange Service needs to establish procedures to obtain fresh milk and other dairy products for its retail outlets and DoD dependent schools in Japan, similar to procedures used by the Navy Exchange to supply fresh milk and other dairy products to Navy retail outlets and Navy DoD dependent schools in Japan.

Contingency Plan for Fresh Milk and Other Products. Although the commissaries in Japan have not experienced shortages of fresh milk and other dairy products because of shipping delays from the United States to Japan, a 3-day shortage of fresh dairy products did occur. Therefore, U.S. Forces Japan should designate a lead organization to develop a contingency plan to address possible shortages that adversely impact the supply of fresh milk and other dairy products in Japan. One viable option that the lead organization should consider is to approve a Japanese dairy as a source to supply filled milk if shortages in fresh milk occur. That option is similar to an option being considered on Okinawa. The contingency plan should address military dining facilities, commissaries, and exchanges. Although those organizations may have separate contracts for fresh milk and other dairy products, establishing separate contingency plans may not be feasible or cost-effective, considering that limited alternate dairy sources exist.

We believe the Fleet Industrial Supply Center (Supply Center) at Yokosuka, Japan, is in the best position to develop and provide contingency plans. The Supply Center already provides some types of subsistence and medical support for all the military installations in Japan that we visited or contacted during the audit. In addition, the Supply Center operates and manages the primary cold storage facility in Japan. In response to milk shortages, the Supply Center has provided ultra-high-temperature milk and other emergency subsistence support on Okinawa.

Proposed Replacement Facility

The Government of Japan wants to use the Kanagawa milk plant property for commercial development and has offered to construct a replacement plant at no cost to the Army. The Army has accepted the Government of Japan offer of a new plant located at the Army North Dock Area of Yokohama, Japan. The new milk plant is expected to cost the Government of Japan about $34 million and take 5 years to build.

We question the Army's need for the new replacement facility, especially when customer demand for filled milk products continues to decline. Army officials stated that they saw no reason to stop or change the project if the Government of Japan was willing to pay for a new facility. Although the new facility would be constructed at no cost to DoD, based on consumer preference for fresh milk and a continued decline in filled milk sales, allowing the Government of Japan to construct a $34 million replacement milk plant is an inefficient use of host nation resources. Further, these resources could be used to fund other DoD construction projects in Japan.

Conclusion

A decision to supply fresh milk and other dairy products in place of filled milk will provide a better quality product and thereby will improve the quality of life for DoD personnel and their families in Japan. At a minimum, life on U.S. bases overseas should at least meet the basic U.S. standards in regard to the availability of products and services. The basic U.S. standard for milk is Grade A fresh milk, not filled milk. Furthermore, United States Code, title 21, section 62, "Filled milk; manufacture, shipment, or delivery for shipment in interstate or foreign commerce prohibited," declares filled milk illegal in the United States.

Recommendations for Corrective Action

1. We recommend that the Commander, U.S. Forces Japan:

a. Develop and implement procedures for military dining facilities in Japan, similar to those used by the Air Force and the Marine Corps on Okinawa, to obtain extended-shelf-life milk and other dairy products from the Defense Personnel Support Center in lieu of continuing to use filled milk products.

b. Establish a lead organization to develop contingency plans to provide milk to all DoD organizations in Japan in case of possible shortages.

c. Direct the U.S. Army in Japan to close the Kanagawa milk plant once extended-shelf-life milk and other dairy products have been obtained throughout Japan.

d. Reassign the 38 master labor contract employees that were assigned to the milk plant to satisfy other DoD workload requirements, after the existing milk plant in Japan is closed.

e. Terminate the Army plan to construct a $34 million replacement milk plant using funds from the Government of Japan.

f. Request, in negotiations with the Government of Japan, that the $34 million the Government of Japan planned to use to construct a replacement milk plant be reprogrammed to fund other DoD construction requirements in Japan.

2. We recommend that the Commander, Army and Air Force Exchange Service, develop and implement procedures to obtain extended-shelf-life milk and other dairy products for retail stores and DoD dependent schools in Japan. Those procedures should be similar to procedures used by the Navy Exchange at Yokosuka, Japan, to supply fresh milk and other dairy products to Navy retail stores and the DoD dependent schools it services in Japan.

Management Comments

U.S. Forces Japan Comments. U.S. Forces Japan did not comment on a draft of this report. Therefore, we request that U.S. Forces Japan provide comments in its response to the final report.

Army and Air Force Exchange Service Comments. The Army and Air Force Exchange Service concurred and stated that it has established procedures to supply extended-shelf-life milk and other dairy products to retail outlets and DoD dependent schools in Japan. Deliveries were scheduled to begin in August or September 1996.

Part II - Additional Information

Appendix A. Scope and Methodology

We reviewed contract documents for the Kanagawa milk plant and obtained related cost, consumption, and production data for FYs 1994 through 1995, during the audit of contract administration in the Pacific. We announced the DoD milk plant audit in June 1995. We interviewed representatives of the legal department, the contracting officer, and the contracting officer's representative for the milk plant and toured the plant to observe production of milk and other products. We also interviewed DoD personnel involved with milk procurement, including Defense Commissary Agency officials and food service managers of the Army and Air Force Exchange Service and of the Navy Exchange that are responsible for supporting the DoD dependent schools. We also contacted officials at several DoD schools throughout Japan. In addition, we interviewed various DoD transportation officials and subsistence officers in Japan and at the Defense Personnel Support Center to determine how subsistence items are currently provided to U.S. forces overseas.

We performed this economy and efficiency audit from June 1995 through January 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did not rely on computer-processed data or statistical sampling procedures to perform the audit. Appendix D lists the organizations visited or contacted.

Appendix B. Summary of Prior Audits

Inspector General, DoD

Report No. 96-197, "DoD Milk Plants in the Pacific - Korea," July 22, 1996, states that the Eighth U.S. Army milk plant in Korea is no longer necessary and was not cost-effective. The report recommended that the Eighth U.S. Army should close the Korea milk plant, develop contingency plans, and use the Defense Personnel Support Center as a source to provide extended-shelf-life milk and other products from the United States. The report also recommended that the Commander, Army and Air Force Exchange Service, establish procedures to obtain extended-shelf-life milk and other products for retail outlets in Korea. Management generally concurred with the report and agreed to implement the recommendations.

Report No. 96-140, "DoD Milk Plants in the Pacific - Okinawa," June 3, 1996, states that the Air Force recommendation to close the Okinawa milk plant and use extended-shelf-life fresh milk was proper. The audit determined that the Okinawa milk plant was not needed and responded to allegations stated in a complaint to the Defense Hotline. The report states that the Air Force and Marine Corps need to resolve key issues regarding the supply of fresh milk to troops on Okinawa. The audit recommended that the Commander, U.S. Forces Japan, designate either the Air Force or the Marine Corps as the lead organization responsible for providing dairy support for the troops on Okinawa. The Commander, U.S. Forces Japan, did not comment on the draft report.

Report No. 94-098, "Audit of the Eighth U.S. Army Milk Plant Contract," May 13, 1994, states that the U.S. Army Contracting Command Korea generally followed acquisition procedures for the renewal of the Eighth U.S. Army milk plant contract in the Republic of Korea. The audit responded to congressional concerns that stemmed from constituents' allegations that U.S. firms were excluded from competing and that Korean firms were given preferential treatment for the pending milk plant contract renewal. The report contains no recommendations.

Army Audit Agency

U.S. Army Audit Agency, Audit Report No. AA 96-103, "Milk Plant Operations, Eighth U.S. Army, Seoul, Korea," February 22, 1996, provides operating costs and sales data of the Eighth U.S. Army milk plant. The report states that because of scope limitations, the Army Audit Agency did not determine whether the milk plant was operating at maximum efficiency, nor whether it would be more economical to obtain dairy and juice products from other sources. The report contains no recommendations.

Appendix C. Comparison of Milk Plant and Purchased Extended-Shelf-Life-Product Costs

Table C-1. FY 1995 Milk Plant Operating Costs

	DoD Cost	Government of Japan Cost
Contract cost	$ 699,491	
Milk powder	801,316	
Milk powder waste	4,300	
In-Country Transportation	1,715,044	
Army civilian salaries	127,092	
Japan MLC salaries		$1,976,039
Utility costs		398,612
Utility costs (Army)	55,189	
Shipping milk powder from United States	20,370	
Annual depreciation of building/equipment		254,381*
Boiler Maintenance	54,360	
Subtotal	**$3,477,162**	**$2,629,032**
Total milk plant operating costs	**$6,106,194**	

*Estimated building and equipment depreciation and maintenance costs.

Table C-2. Estimated Costs to Purchase Products From U.S. Dairy Manufacturers

Product cost	$2,614,995[1]
Sea-lift costs from United States	1,343,493[2]
In-Country transportation costs	1,715,044
Total cost to purchase from U.S. manufacturers	**$5,673,532**

[1]Based on FY 1995 milk plant production and prices from two vendors who currently supply dairy products to Japan commissaries.

[2]Calculations based on data provided by the Military Traffic Management Command.

Table C-3. Monetary Benefits From Closing the Milk Plant and Purchasing Products From U.S. Dairy Manufacturers

Milk plant operating costs		$6,106,194
Estimated costs to purchase from U.S. manufacturers	(less)	5,673,532
Annual difference		$ 432,662
	(times)	6 years
Total costs avoided over 6 years		**$2,595,972**

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
Deputy Under Secretary of Defense (Logistics), Washington, DC
Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management), Washington, DC
Assistant Secretary of Defense (Force Management Policy), Washington, DC
Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education), Washington, DC

Department of the Army

U.S. Army Japan, 9th Theater Army Area Command, Camp Zama, Japan
17th Area Support Group, Camp Zama, Japan
Kanagawa Milk Plant, Yokohama, Japan
U.S. Army Pacific Command, Fort Shafter, HI
Headquarters Veterinary Service Support District, Japan
Army Directorate of Services, Washington, DC
Food Management Division, Washington, DC
U.S. Army Soldier Systems Command, Natick, MA
U.S. Army Natick Research, Development, and Education Center, Natick, MA
DoD Veterinary Laboratory, Fort Sam Houston, TX
Tripler Army Medical Center, Schofield Barracks, HI

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller), Washington, DC
Military Sealift Command, Washington, DC
Office of the Inspector General, Washington, DC
Dry Cargo Division, Washington, DC
Line Agreement Division, Washington, DC
Naval Supply Systems Command, Washington, DC
Navy Food Services Office, Washington, DC
Fleet Industrial Supply Center, Yokosuka Naval Base, Japan
Marine Corps Air Station, Iwakuni, Japan

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Air Force Directorate of Services, Washington, DC
  Food Management Division, Washington, DC
Headquarters, Pacific Air Forces, Hickam Air Force Base, HI
Yokota Air Base, Yokota, Japan
  374 Contracting Squadron, Yokota Air Base, Japan
Misawa Air Base, Japan

Unified Commands

Commander in Chief, U.S. Pacific Command, Honolulu, HI
U.S. Forces Japan, Yokota Air Base, Japan

Other Defense Organizations

Headquarters, Defense Commissary Agency, Fort Lee, VA
  Northwest/Pacific Region, Fort Lewis, WA
    Japan Zone, Sagami Depot, Japan
    Commissary, Yokota Air Base, Japan
    Commissary, Misawa Air Base, Japan
    Commissary, Atsugi Naval Air Facility, Japan
    Commissary, Iwakuni Marine Corps Air Station, Japan
    Commissary, Yokosuka Naval Base, Japan
Headquarters, Defense Logistics Agency, Fort Belvoir, VA
  Defense Personnel Support Center, Philadelphia, PA
Military Traffic Management Command, Alexandria, VA
  Ocean Cargo Clearance Authority, Yokohama, Japan
  Army and Air Force Exchange Service, Washington, DC
Navy Exchange Service, Norfolk, VA

Non-Government Organizations

International Dairy Foods Association, Washington, DC
United States Dairy Association, Washington, DC
California Sunshine, Ultrafresh Dairy Products, Fullerton, CA
Dairy Maid Dairy, Inc., Virginia Beach, VA
Hood Dairy, Alder Foods, ME
California Pacific Association, Oakland, CA

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Deputy Under Secretary of Defense (Logistics)
    Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management)
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Force Management Policy)
  Deputy Assistant Secretary of Defense (Personnel Support, Families, and Education)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army
Commander, U.S. Army Japan, 9th Theater Army Area Command
Commander, U.S. Army Pacific Command

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Commander in Chief, U.S. Pacific Fleet
Auditor General, Department of the Navy
Commander, Naval Supply Systems Command
  Commander, Fleet Industrial Supply Center, Yokosuka, Japan

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force
Commander, 374th Contracting Squadron, Yokota Air Base, Japan

Unified Commands

Commander in Chief, U.S. Pacific Command
Commander, U.S. Forces Japan, Yokota Air Base, Japan

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Director, Defense Personnel Support Center
Director, National Security Agency
  Inspector General, National Security Agency
Director, Defense Commissary Agency
Commander, Army and Air Force Exchange Service
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

  Senate Committee on Appropriations
  Senate Subcommittee on Defense, Committee on Appropriations
  Senate Committee on Armed Services
  Senate Committee on Governmental Affairs
  House Committee on Appropriations
  House Subcommittee on National Security, Committee on Appropriations
  House Committee on Government Reform and Oversight
  House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
  House Committee on National Security

Honorable Owen B. Pickett, U.S. House of Representatives

Part III - Management Comments

Army and Air Force Exchange Service Comments

Final Report
Reference

DEPARTMENTS OF THE ARMY & AIR FORCE
Headquarters Army & Air Force Exchange Service
Dallas, Texas 75266-0202

10 JUL 1996

SUBJECT: DoD Milk Products in the Pacific-Japan (IG Memo, 20 June 1996)

THRU: Lt Gen George T. Babbitt 2 AUG 1996
Chairman, Board of Directors
Army and Air Force Exchange Service
1290 Air Force Pentagon
Washington DC 20330-1290

TO: Inspector General, Department of Defense
ATTN: Mr. Ronald W. Hodges, Project Manager
400 Army Navy Drive, Room 415
Arlington, VA 22202-2884

1. Reference subject audit draft dated June 20, 1996.

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2. We concur with recommendation #2, page 15 of the IG Audit Report regarding DoD milk plants in the Pacific-Japan. Due to escalating prices of DoD milk plant products in Japan, AAFES has already established procedures to obtain fresh milk and dairy products from US sources. Initial deliveries are planned for the Aug/Sep time frame.

A. D. BUNGER
Major General, U.S. Air Force
Commander

Audit Team Members

This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Paul J. Granetto
Terry L. McKinney
Ronald W. Hodges
Robert W. Smith
Myra M. Frank
Brian C. Filer
Shawn L. James
Lorin T. Pfeil
Robyn N. Stanley
Ana M. Myrie