



EXCHANGE
ARMY & AIR FORCE EXCHANGE SERVICE

CORE VALUES

Trust

Integrity

Teamwork

Empowerment

Accountability

Compassion

Risk Taking

Creativity



Report of Audit

**New Car Sales
No. 2011-09
December 2011**

Audit Division

EXECUTIVE SUMMARY

Report of Audit

New Car Sales

Audit No. 2011-09 December 2011 Project No. 2011-006

Introduction

The New Car Sales (NCS) program is operated by the Overseas Military Sales Corporation (OMSC), an independent contractor. This program includes the sale of Ford, Chrysler, and Honda vehicles, and Harley Davidson motorcycles, to Exchange customers at overseas locations. Within the Exchange, this program is managed by the Services Division, Sales Directorate, while the Services and Vending Business Contracting Branch provides contract administration support. During FY 2010, the NCS program generated sales of \$294.3 million; Exchange fees totaled \$2.60 million (0.88 percent). Year-to-date August 2011, the program generated sales of \$178.0 million; Exchange fees totaled \$1.68 million (0.94 percent).


Purpose and Scope

Our audit objectives were to determine if manufacturers and OMSC adhered to contract requirements regarding vehicle pricing, transportation, and other charges. We also evaluated vehicle pricing to determine if Exchange customers received competitive deals. In addition, we evaluated Exchange management oversight and control over the accuracy of sales reports and associated fee payments from OMSC. This audit was conducted between February 2011 and October 2011 and covered the period 1 January 2010 to 29 October 2011.

Conclusion

A review of vehicle pricing and invoices showed OMSC priced vehicles in accordance with contract requirements, and invoice price lists provided by OMSC were valid. However, contract requirements and management oversight procedures did not provide effective controls to verify OMSC accurately reported sales and fees. (b)(5) Deliberative Process Privilege

review of transportation charges showed 3,053 customers were overcharged \$384,491 for various transportation costs, and certain transportation charges were not always substantiated in accordance with contract requirements. In addition, a comparison of OMSC vehicle prices to Edmunds.com prices concluded all 81 vehicles reviewed for pricing were higher at OMSC than on Edmunds.com, by an average of \$913 (3.7 percent). (b)(5) Deliberative Process Privilege



Management Actions

Management actions taken or planned in response to audit recommendations should resolve the concerns discussed in this report.

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Report of Audit

New Car Sales

Audit No. 2011-09 December 2011 Project No. 2011-006

1. **INTRODUCTION.** The New Car Sales (NCS) program is operated by the Overseas Military Sales Corporation (OMSC), an independent contractor. This program includes the sale of Ford, Chrysler, and Honda vehicles, and Harley Davidson motorcycles, to Exchange customers at overseas locations. Within the Exchange, this program is managed by the Services Division, Sales Directorate (SD-V), while the Services and Vending Business Contracting Branch (SD-V/PZ) provides contract administration support. During FY 2010, the NCS program generated sales of \$294.3 million; Exchange fees totaled \$2.60 million (0.88 percent). Year-to-date August 2011, the program generated sales of \$178.0 million; Exchange fees totaled \$1.68 million (0.94 percent).
- a. **Program History.** The Exchange has maintained its contractual relationship with OMSC, as primary operator of the NCS program, since 1962. In recent years, OMSC has sold Ford, Chrysler, and Honda vehicles, and Harley-Davidson motorcycles. In 2005, General Motors withdrew from the overseas military resale business. The Exchange has direct contracts with Ford and Chrysler, and OMSC acts as their agent. The Exchange contracts with OMSC to sell Honda and Harley-Davidson products. NCS program sales results from 2006 to YTD August 2011 are shown in Table 1.

Table 1: NCS Program Sales - Calendar Years 2006 to YTD August 2011

Year	Units Sold	Gross Sales	Average Price Per Unit	Exchange Fees	Fee Percent
2006	11,805	\$290,816,387	\$24,635	\$2,479,015	0.85%
2007	11,967	\$295,828,190	\$24,720	\$2,545,050	0.86%
2008	11,835	\$295,749,474	\$24,989	\$2,537,595	0.86%
2009 ¹	9,919	\$248,152,901	\$25,018	\$2,267,915	0.91%
2010	11,076	\$294,346,377	\$26,575	\$2,596,664	0.88%
2011 ²	6,625	\$178,038,455	\$26,874	\$1,678,351	0.94%

¹Sales declined in 2009 due to the Chrysler Corporation bankruptcy.

²Through August 2011.

- b. **Operating Procedures.** Exchange Operating Procedures 30-1, Services, published in March 2009, established procedures for the NCS program. The program provides eligible customers an opportunity to purchase vehicles manufactured in the United States from recognized and reliable sources. Sales were authorized at overseas locations only, but deliveries could be made overseas or in the United States and its possessions. As of August 2011, there were 83 facilities selling new cars at overseas Exchanges.
- c. **Vehicle Order Process.** The vehicle order process was as follows:
- (1) OMSC employed Independent Sales Representatives (ISRs) to act as sales agents at each NCS location. Each ISR had access to the OMSC MilQuote system, which generates pricing information for the vehicles based on information received from manufacturers, and markup limitations established in the Exchange contracts. OMSC offered “no-haggle” prices, taken directly from the MilQuote system. For a given vehicle, the prices were the same for every customer, and were nonnegotiable.
 - (2) When considering a purchase, customers were presented with an Exchange Plaintiff pamphlet, intended to answer questions about the NCS program. The pamphlet included specific information about the various purchase and delivery options.
 - (3) After a vehicle was selected for purchase, the customer signed a Buyer’s Offer and a minimum deposit was collected. The Buyer’s Offer included vehicle price, option prices, and estimated transportation charges.
 - (4) OMSC acknowledged the Buyer’s Offer in writing, either 30 days after receipt of the offer, or 90 days before the delivery date, whichever was later, by completing and sending an Order Acceptance. At times, the Order Acceptance may vary from the Buyer’s Offer, due to changes in prices for transportation or options. If the order was accepted at a price that exceeds the Buyer’s Offer by more than \$100, the customer had 10 days to advise OMSC of any objections. If the issue cannot be resolved, the customer could cancel the order within 10 business days without liability, and receive a full refund of the deposit.
 - (5) After OMSC and the customer agreed on the Order Acceptance, OMSC must ensure the vehicle is ready by the delivery date on the Order Acceptance. Before delivery is made, the customer must make the final payment in full, to include taxes, registration, and licensing fees. If the vehicle was damaged in transit to the delivery point, and its safety or

reliability was impaired, it could not be turned over to the customer.

- d. **Fee Payments**. In accordance with the current contracts, OMSC was required to pay the Exchange (b)(4) Proprietary [REDACTED]
[REDACTED]
The contract did not provide for fees on extended service warranties or vehicle protection packages.
- e. **Contract Solicitations**. The contracts with Ford and Chrysler expire on 31 January 2012. The contract with OMSC for Harley-Davidson expires on 31 August 2012, while the contract with OMSC for Honda expires on 31 October 2012. (b)(5) Deliberative Process Privilege [REDACTED]
[REDACTED]
[REDACTED]

2. **PRIOR AUDIT COVERAGE.** There were no audits on this subject during the last 5 years.

3. **PURPOSE AND SCOPE**

- a. This audit was included in the 2011 Audit Plan. Our audit objectives were to determine if manufacturers and OMSC adhered to contract requirements regarding vehicle pricing, shipping, and other charges. We also evaluated vehicle pricing to determine if Exchange customers received competitive deals. Finally, we evaluated Exchange management oversight and control over the accuracy of sales reports and associated fee payments from OMSC. This audit was conducted between February and October 2011 and covered the period 1 January 2010 to 29 October 2011.
- b. We conducted our audit in accordance with generally accepted government auditing standards and directives and, accordingly, included an evaluation of policies and procedures and such tests of documents considered necessary under the circumstances. During the audit, we discussed all concerns with appropriate management officials.

4. **METHODOLOGY**

- a. During the audit, we reviewed NCS program contracts, policies, and procedures. We met with key management personnel at Exchange HQ, to include the SD-V business program manager and the SD-V/PZ contracting officer to obtain knowledge of the NCS program and operations. We also met with Exchange associates responsible for legal and investigative aspects of this contract.

Additionally, we met with key management personnel at the OMSC New York office, including the Vice President of Operations, the manager of the PCS/Pricing Group, and the representative for Government & Manufacturer Relations. In Germany, we met with Exchange and OMSC managers, and ISRs. We also analyzed sales information obtained from the Exchange intranet and OMSC, and reviewed vehicle pricing information collected from Exchange NCS locations and the Internet for comparative purposes.

- b. To ensure vehicles were sold in accordance with contract terms, we randomly selected a sample of 137 Order Acceptances for review from a population of 11,076 vehicles sold by OMSC in 2010. To accomplish this, we used a sample size generator from a statistical software package developed by the Army Audit Agency. The sample size was determined by using a 95 percent confidence level and an error rate of +/- 10 percent. Consequently, we are 95 percent confident our sample results represent the population within 10 percent. We believe this method provides a sound basis for projecting the sample results to the population.

- 5. **AUDIT RESULTS.** A review of vehicle pricing and invoices showed OMSC priced vehicles in accordance with contract requirements and invoice price lists provided by OMSC were valid. However, contract requirements and management oversight procedures did not provide effective controls to verify OMSC accurately reported sales and fees.

(b)(5) Deliberative Process Privilege

review of transportation charges showed 3,053 customers were overcharged \$384,491 for various transportation costs, and certain transportation charges were not always substantiated in accordance with contract requirements. In addition, a comparison of OMSC vehicle prices to Edmunds.com prices concluded all 81 vehicles reviewed for pricing were higher at OMSC than on Edmunds.com, by an average of \$913 (3.7 percent).

(b)(5) Deliberative Process Privilege

Observations follow:

- a. **Vehicle Pricing, Invoicing, Sales, and Fee Verification.** A review of vehicle pricing and invoices showed OMSC priced vehicles in accordance with contract requirements. However, effective controls

were not in place to verify OMSC accurately reported sales and fees: Observations follow:

- (1) A review of 137 deals showed all deals were in compliance with contract terms for applying mark ups and discounts on base price and vehicle options. Also, based on 54 survey letters sent to customers in the sample, the 11 replies received indicated the Order Acceptance (i.e., the deal paperwork provided to us by OMSC) was valid. In addition, communications with Ford and Chrysler concluded dealer invoice price lists provided by OMSC were valid as of the time the vehicle deals were made.
- (2) Contract requirements and management oversight procedures did not provide effective controls to verify OMSC accurately reported sales and fees. The contract did not include the requirement to provide detailed purchase information from the manufacturers or sales and inventory information from OMSC to facilitate sales and fee verification. An attempt was made to reconcile OMSC 2010 sales based on delivery information provided by Ford and Chrysler, and inventory information provided by OMSC; however, due to OMSC sales made outside the parameters of the Exchange NCS Program, sales could not be completely verified. Approximately 8,162 (84 percent) of 9,697 Ford and Chrysler vehicles presumed sold in 2010 were reported by OMSC. The remaining 1,535 (16 percent) vehicles could not be verified as sold outside the Exchange NCS program. (b)(5) Deliberative Process Privilege

b. **Transportation Charges.** A review of transportation charges showed 33 (24 percent) of 137 customers were overcharged for certain transportation costs. Upon notification, OMSC management concluded 3,053 customers were overcharged a total of \$384,491. Also, transportation charges were not always substantiated in accordance with contract requirements. Observations follow:

- (1) **Overcharges.** OMSC was authorized to pass on to customers all costs of transporting vehicles to their final delivery point. According to contract terms, OMSC must do this on a non-profit basis, and was required to maintain complete records of its transportation costs, and use these costs as the basis for transportation charges in the next year.
 - (a) A comparison of transportation costs described in the contract to OMSC charges noted a misapplication of

“delivery point processing service” for 33 (24 percent) of 137 vehicles in our sample. The contract allowed a charge of (b)(4) Proprietary for this service, but customers were charged \$525, based on an outdated amendment to the contract.

- (b) This observation was communicated to OMSC management who concluded 3,053 customers were impacted by this misapplication, and that Exchange customers were overcharged \$384,491 for overseas deliveries made between May 2010 and June 2011. The overcharges were for “delivery point processing service” and other related costs of vehicle preparation (i.e., importation and embarkation charges, and inland transportation charges).

Corrective Action Taken. OMSC initiated a refund program to reimburse customers for these overcharges during the audit; this refund program was completed in July 2011.

- (2) **Substantiation of Transportation Charges.** Exchange management did not always substantiate transportation charges in accordance with contract requirements. Examples follow:
 - (a) Invoices and other substantiation documentation were not provided by OMSC annually by May 30, nor were they approved annually by Exchange contracting officers by August 31, as required.
 - (b) For 2010 vehicle deals, OMSC charged for vehicle transportation based on its 2008 costs instead of 2009 costs as required; in essence, OMSC was 1 year in arrears on the substantiation requirement for vehicles sold in late 2010 (after August 31).
 - (c) OMSC did not show how the Freight Forwarder’s Administrative Fee of (b)(4) Proprietary fee was calculated beyond providing a summary of costs incurred. These costs related to direct and indirect costs incurred by OMSC for the transportation of vehicles to their final destination. The contract required this fee be substantiated by documentation of incurred costs derived from the books and records from the entities providing the services. Further, the fee amount should be calculated based on total direct and indirect service costs, divided by the number of vehicles shipped during the calendar year.

- (d) The German Transportation Service Provider (TSP) charge of (b)(4) Proprietary was applied to vehicles shipped through Bremerhaven for preparation, delivery, and inspection services; however, OSMC only provided one invoice to substantiate this charge for 2008. As a result, Exchange management could not determine if the (b)(4) Proprietary service cost was valid throughout the year.
- (e) OSMC did not provide substantiation for transportation charges on its web site as required by the contract. (b)(5) Deliberative Process Privilege

[Redacted]

c. **Vehicle Price Comparisons.** OSMC vehicle pricing was in accordance with contract terms; however, OSMC vehicle pricing did not provide the best value for Exchange customers. A comparison of OSMC vehicle prices to Edmunds.com prices concluded all 81 vehicle prices reviewed were priced higher at OSMC than on Edmunds.com, with price differences ranging from \$40 (0.1 percent) to \$4,211 (13.5 percent). On average, prices were \$913 (3.7 percent) more at OSMC. These price comparisons strongly suggest Exchange customers may not always be getting the best deal on vehicle sales.

(1) **Price Testing.** OSMC prices for the 81 model-year 2011 vehicles reviewed (42 Ford, 36 Chrysler, and 3 Honda vehicles) were obtained from its proprietary MilQuote system. The 81 vehicles were judgmentally selected at six NCS locations in Germany. Vehicle base plus accessory prices were compared to Edmunds.com prices.

(2) **Price Benchmark.** NCS contracts require OSMC to price vehicles by applying a mark up to dealer's invoice; this practice was followed as required. (b)(5) Deliberative Process Privilege

[Redacted]

d. **Management Oversight.** Improved oversight by the responsible business program manager was needed to assure reviews over Order Acceptances were documented, and documentation provided by OMSC to support transportation charges met contract requirements for proper substantiation of costs. Observations follow:

- (1) **Contract Compliance.** Order Acceptances and supporting documents were provided by OMSC to the responsible business program manager for the period May to October 2010; however, there was no documentation to support completed reviews. The business program manager stated he randomly selected and reviewed five vehicle Order Acceptances monthly (approximately 0.5 percent of monthly sales) to ensure the vehicles were sold according to contract terms.
- (2) **Transportation Charges Validation.** The responsible business program manager and contracting officer, tasked with annual validation of OMSC vehicle transportation charges, stated they validated 2009 and 2010 transportation charges. However, documentation provided by OMSC for substantiation did not meet contract requirements or allow for proper substantiation of costs. Transportation charges were required to be based on OMSC costs, and passed on to customers without added profit to OMSC.

e. **Fee Structure.** The Exchange only received fees for each vehicle sold, but did not receive fees for any additional services sold.

(b)(5) Deliberative Process Privilege

Our observations concerning the fee structure follow:

- (1) **Established Fees.** The Exchange currently receives a fixed commission fee of (b)(4) Proprietary

- (2) **Additional Fee Opportunities.** The Exchange did not receive fees from sales of extended service warranties, vehicle protection packages, and vehicle add-ons (such as entertainment packages, navigation systems, and floor mats). (b)(5) Deliberative Process Privilege

(b)(5) Deliberative Process Privilege
[Redacted]

(b)(5) Deliberative Process Privilege
[Redacted]

(b)(5) Deliberative Process Privilege
[Redacted]

f. (b)(5) Deliberative Process Privilege [Redacted] The Exchange's relationship with OMSC as the operator of the NCS program has been in place since 1962. Based on discussions with responsible Exchange associates, the contract for these services has been sole sourced for the prior two contracts. (b)(5) Deliberative Process Privilege [Redacted]

6. **RECOMMENDATION 1.** (b)(5) Deliberative Process Privilege [Redacted]
[Redacted]
[Redacted]
[Redacted]

(b)(5) Deliberative Process Privilege [Redacted]

7. **MANAGEMENT ACTIONS.** (b)(5) Deliberative Process Privilege [Redacted]

[Redacted]

[Redacted]

b. (b)(5) Deliberative Process Privilege [Redacted]

[Redacted]

8. **RECOMMENDATION 2.** (b)(5) Deliberative Process Privilege [Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

9. **MANAGEMENT ACTIONS.** (b)(5) Deliberative Process Privilege [Redacted]

[Redacted]

[Redacted]

(b)(5) Deliberative Process Privilege
[Redacted]

[Redacted]

b. (b)(5) Deliberative Process Privilege
[Redacted]

[Redacted]

c. (b)(5) Deliberative Process Privilege
[Redacted]

[Redacted]

d. (b)(5) Deliberative Process Privilege
[Redacted]

(b)(5) Deliberative Process Privilege

[Redacted]

[Redacted]

10. EVALUATION OF MANAGEMENT ACTIONS

Management actions taken or planned in response to audit recommendations should resolve the concerns discussed in this report.

(b)(6) Privacy

Director, Audit Division

APPENDIXES A-B

cf:
Exchange Elements
BoD, Audit Committee Members
Ernst & Young LLP, Certified
Public Accountants

APPENDIX A – LOCATIONS VISITED DURING THE AUDIT
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<u>LOCATION</u>	<u>COVERAGE</u>	<u>REPORT PROVIDED</u>
Corporate Procurement Directorate	S/A	Yes
Sales Directorate	S/A	Yes
Baumholder	S	No
Grafenwoehr	S	No
Heidelberg	S	No
Ramstein AB	S	No
Spangdahlem	S	No
Vilseck	S	No

S – Survey
A – Audit



Report Provided – A draft report was issued to obtain management comments. Findings and Recommendations are recorded in the Follow-up and Tracking System and will be selectively followed up on as management completes corrective action.

APPENDIX B – POTENTIAL DOLLAR SAVINGS AND BENEFITS

<u>PARAGRAPH</u>	<u>BENEFITS</u>	<u>EXPLANATION OF BENEFITS</u>
5b(1)b	\$384,491	Refund program for customer overcharges totaling \$384,491 was completed in July 2011.
6a	*	(b)(5) Deliberative Process Privilege
6b	*	(b)(5) Deliberative Process Privilege
7a	*	(b)(5) Deliberative Process Privilege
7b		(b)(5) Deliberative Process Privilege

*Note: *Indicates dollar amounts were not quantifiable.*

APPENDIX B – POTENTIAL DOLLAR SAVINGS AND BENEFITS, cont.

<u>PARAGRAPH</u>	<u>BENEFITS</u>	<u>EXPLANATION OF BENEFITS</u>
7c	*	(b)(5) Deliberative Process Privilege 
7d	*	(b)(5) Deliberative Process Privilege 

*Note: *Indicates dollar amounts were not quantifiable.*



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