

DOCUMENT RESUME

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[Armed Services Procedures for Handling Foreign Military Sales Need Improvement]. LCD-77-222; E-165731. May 27, 1977. 5 pp.

Report to Secretary, Department of Defense; by Robert G. Rothwell (for Fred J. Shafer, Director, Logistics and Communications Div.).

Issue Area: International Economic and Military Programs: Foreign Military Sales (605); Facilities and Material Management (700); Military Preparedness Plans: Logistic Support Planning for Major Equipment (801).

Contact: Logistics and Communications Div.

Budget Function: National Defense: Department of Defense - Military (except procurement & contracts) (051).

Organization Concerned: Defense Logistics Agency.

Congressional Relevance: House Committee on Armed Services; Senate Committee on Armed Services.

Authority: Foreign Military Sales Act, sec. 22 (22 U.S.C. 2762).

Certain procedures and practices for handling direct foreign military sales at the Defense Logistics Agency and its subsidiary centers have resulted in unnecessary and illegal expenditures of appropriated funds, and may have adversely affected the Agency's ability to respond to the needs of U.S. military customers. Findings/Conclusions: Defense policy provides that cooperative sales arrangements be considered in forecasting stock levels but that direct sales not be considered. However, direct sales of low value replenishment demand and numeric stockage objective type items to foreign customers are required to be included in forecasting demand by Agency policy. U.S. funds are used illegally according to law governing foreign military sales. This departure from established policy has increased stock levels significantly. Direct foreign sales requisitions should be placed on backorder if existing stocks are at reorder level; however, the requisitions are often considered to be "exceptions" and on-hand stocks are used, thus depleting stocks needed for U.S. military protection. Certain nonmaintained inventory items are automatically reviewed each quarter for possible reclassification to maintained items. Many items have been changed without meeting the maintained criteria, which is against Defense policy. Recommendations: The Department of Defense should insure that the changes in the foreign sales policy proposed by the Agency are implemented on a timely basis and that they comply with legal provisions and with Defense and Agency policy. (Author/SMS)



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

MAY 27 1977

02156

LOGISTICS AND COMMUNICATIONS
DIVISION

B-165731

The Honorable
The Secretary of Defense

Dear Mr. Secretary:

Because foreign military sales have grown rapidly during recent years, we surveyed their impact on supply operations within the Department of Defense. Our survey covered selected field activities in each of the military services and the Defense Logistics Agency. We found that certain procedures and practices for handling direct foreign military sales at the Agency and its Defense Electronics Supply Center have resulted in unnecessary and illegal expenditures of appropriated funds and may have adversely affected the Agency's ability to respond to the needs of U.S. military customers.

The Department of Defense has established specific policies covering sales to foreign countries and the Agency has incorporated these policies into its material management manual. We found, however, that not all operating procedures included in the Agency's supply operating manual are consistent with established policy.

Contrary to Defense policy, direct foreign military sales issue experience is being used in establishing stock levels for some categories of supply items, and direct sales requisitions are being filled without appropriate regard for stock balances. In addition, supply items are moved from the numeric stockage objective type of management to the replenishment demand type of management without meeting established criteria. Numeric stockage objective items are not expected to incur sufficient demands to be managed as replenishment demand items, but are stocked in limited quantities as a precautionary measure.

INVENTORY INVESTMENT INCREASED IN
SUPPORT OF DIRECT FOREIGN SALES

Sales of secondary items to foreign customers are generally either covered by cooperative logistics support

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arrangements or are classified as direct foreign military sales. Cooperative arrangements normally involve the investment of the foreign customer's funds in the U.S. inventory. Direct sales involve no such investment in inventory.

Defense policy as stated in Department of Defense memorandums and Defense Logistics Agency's Material Management Manual, DSAM 4140.3, provides that demand for items sold under cooperative arrangements be accorded the same treatment as U.S. customer demands in establishing stock levels. Other foreign demands (direct sales) are not to be considered in setting stock levels.

Contrary to this policy, operating procedures included in the Agency's Supply Operating Procedures Manual, DSAM 4140.2, provide that direct sales of low value replenishment demand and numeric stockage objective type items to foreign customers be used in forecasting demands. U.S. funds are used to procure the stock. We believe, and Defense officials have agreed, that in the absence of authorizing legislation such expenditures of U.S. funds are illegal.

The expenditures are illegal because section 22 of the Foreign Military Sales Act, 22 U.S.C. 2702, the authority for procurement of defense articles or services for foreign sale, conditions such procurement upon the receipt of a dependable undertaking from the foreign government to pay the full amount of the procurement contract price which will assure the U.S. Government against any loss on the contract. Without such an undertaking, which does not exist in this case, there is no authority to procure specifically for foreign sale, hence no authority to take projected foreign sales into account in setting inventory levels.

According to June 30, 1976, stratification reports, 90 percent of the 518,700 items stocked by the Supply Center, and 67 percent of the procurement actions involved low value replenishment demand or numeric stockage objective items. Our analysis of a random sample of foreign military sales requisitions revealed that 49 percent of the direct sales were for such items. For some of the stocked items included in our sample, the only issue activity over the 14-month period ending August 31, 1976, was direct foreign sales. This indicates that the items may have been retained in stock solely to support direct sales customers.

Supply Center officials informed us that their operations conformed to the Agency's operating procedures manual.

They were aware of the conflict with Defense policy but said they were required to follow the manual.

Inasmuch as the Agency's direct foreign military sales totaled over \$78 million during fiscal year 1975, we believe its departure from established policy has increased stock levels significantly and constitutes unnecessary and illegal expenditures of U.S. funds.

DIRECT FOREIGN SALES REQUISITIONS FILLED
WHEN ASSETS ARE BELOW THE REORDER POINT

Consistent with the policy of not establishing supply levels in support of direct foreign military sales, Material Management Manual 4140.3 prohibits filling direct sales requisitions from stock when assets are at or below the reorder point. However, our analysis of 94 direct sales requisitions filled during July 1976 disclosed that 25 were filled when the stocks were either below the reorder point or were drawn below the reorder point by the requisition.

Direct foreign sales requisitions, under the Agency's Standard Automated Material Management System, were to be automatically placed on backorder if the filling of the requisitions would cause issuable stock to fall below the reorder point. Such orders should not be filled until the stock levels are again above the reorder point. However, the system was not functioning as intended. Stock type items were not automatically backordered, but were referred to the item managers for consideration as exceptions. We found that in many cases the item managers filled the requisitions from stock on hand.

Defense Logistic Agency auditors have reported this breakdown in the system on two different occasions--Audit Report 75-113, dated February 4, 1975, and Audit Report 77-18, dated August 16, 1976. In the earlier report the auditors estimated it was costing the Agency \$221,200 a year in labor and material to process the exceptions at four Supply Centers operating under the Standard Automated Material Management System.

Although headquarters officials had approved two automated system changes--one in June 1974 and the other in February 1975--which would correct the problem, the changes had not been implemented at the time of our survey.

Furthermore, irrespective of the breakdown in the automated system, item managers should not fill direct sales

requisitions when assets go below the reorder point. Such a practice complicates inventory management and may jeopardize support of U.S. forces.

NUMERIC STOCKAGE OBJECTIVE ITEMS
IMPROPERLY RECLASSIFIED

Under the Standard Automated Material Management System, certain numeric stockage objective items are automatically reviewed each quarter for reclassification to replenishment demand stock. The Agency's established criteria for reclassifying a numeric item is that the item have had three or more demands during the previous four quarters. In addition, these demands must total 12 or more units and have an extended value of more than \$20.

We found that many items had been reclassified to replenishment demand stock without meeting this criteria. We tested 110 of the 2,494 items reclassified during the September 30, 1976, quarterly review. In all cases, two of the three reclassification criteria--three demands totaling 12 or more units--were met. However, in 15 cases items were reclassified even though the extended demand value was less than \$20.

Furthermore, in 13 cases items were reclassified to replenishment demand stock based exclusively, or in part, on direct foreign military sales. As pointed out earlier, this is contrary to Defense policy which states that stock levels will not be established for such sales.

Supply Center officials agreed that the automated system was reclassifying numeric stockage objective items without meeting the reclassification criteria. The Supply Center forwarded this information to Defense Logistic Agency headquarters and recommended that the system be reprogramed to assure that all classifications meet the program criteria.

Since the replenishment demand method of management usually requires a greater investment in stock than the numeric stockage method, its use should be limited to the conditions specified by Agency policy.

CONCLUSIONS AND RECOMMENDATIONS

Department of Defense policy on the establishment of stock levels and the handling of direct foreign military sales requisitions was designed to comply with the legal provisions governing foreign military sales and protect

the interests of U.S. customers. The Defense Logistic Agency's failure to follow this policy has resulted in the unnecessary and illegal expenditure of supply funds and has jeopardized its ability to respond to the needs of U.S. military customers.

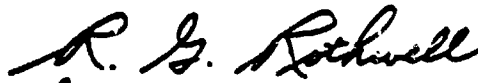
At the completion of our survey, we met with Agency headquarters officials who agreed with our findings and conclusions. They told us of a number of changes which had been made or were being made to correct the weaknesses we have cited. These changes, when implemented, should assure that direct foreign military sales are not considered in establishing stock levels, that direct sales requisitions are not filled when stock levels are so low that responsiveness to U.S. customers is impaired, and that numeric stockage objective items are reclassified according to established criteria.

We recommend that the Secretary of Defense follow up to insure that the changes proposed by the Agency are implemented on a timely basis and that they comply with legal provisions and with Defense and Agency policy.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and to the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget, and the Director, Defense Logistics Agency.

Sincerely yours,


for Fred J. Shafer
Director