

**DOCUMENT RESUME**

07237 - [B2427476]

[Army Underpricing of Machine Guns Sold to Foreign Governments].  
LCD-78-432; B-183318. August 28, 1978. 3 pp.

Report to Secretary, Department of Defense; by Richard W.  
Gutmann, Director, Logistics and Communications Div.

Issue Area: Procedures to Assure Sufficient, Not Excessive,  
Material Requisitioning. (719); International Economic and  
Military Programs: Foreign Military Sales (605).

Contact: Logistics and Communications Div.

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

Organization Concerned: Department of the Army.

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

Authority: Arms Export Control Act of 1976 (22 U.S.C. 2761).  
Army Regulation 795-14. DOD Instruction 2140.1.

An October 1977 report recommended that the Army rebill foreign military sales customers approximately \$60.7 million for the value of M-2 50-caliber machine guns sold at less than replacement prices. These contracts were made in 1973 and 1974, and deliveries to customers took place from September 1974 to May 1977. The Department of Defense (DOD) took the position that replacement prices should be charged only on machine guns sold since December 1974. This would preclude any repricing on the above sales since all offers and acceptances took place before December 1974. A review of pertinent laws and regulations indicated that: (1) under Army Regulation 795-14, issued June 3, 1974, the Army apparently had the option of determining the standard price either at the time the offer was prepared with a reasonable specified acceptance date or at the time the item was dropped from inventory; and (2) the ambiguity regarding the time of determination of price was not clarified by DOD until Jun 17, 1975. Therefore, charges for machine guns shipped after June 1975 should have reflected their replacement cost. The Secretary of Defense should attempt collection action and establish mechanisms to immediately notify foreign military sales customers of price changes when asset positions indicate future replacement procurement of U.S. stocks. (BRS)



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



LOGISTICS AND COMMUNICATIONS  
DIVISION

B-183318

AUGUST 28, 1978

The Honorable  
The Secretary of Defense

Dear Mr. Secretary:

This is in reply to the Department of Defense (DOD) response (DOD reference I-11571/77) to our report LCD-77-449, dated October 7, 1977, in which we recommended that you direct the Army to rebill foreign military sales customers approximately \$60.7 million for the value of M-2 50-caliber machine guns sold at less than replacement prices. As noted in our report, the subject contracts were made in 1973 and 1974; deliveries to customers took place from September 1974 to May 1977.

The DOD response, signed by Lieutenant General H. M. Fish, Director, Defense Security Assistance Agency and Deputy Assistant Secretary (ISA), Security Assistance, takes the position that replacement prices should be charged only on machine guns sold since December 1974. This position would preclude any repricing on the above sales since all offers and acceptances on the sales contracts, as shown on DD Form 1513, Offer and Acceptance, were made before December 1974.

The DOD position conflicts directly with our recommendation that replacement prices be collected on machine guns delivered after May 1974--the date when the Army initially identified a need to buy more machine guns to meet its own requirements. Our position was based, in part, on (1) the provisions of DD Form 1513 which stipulated that the price quoted is an estimate and that the purchaser shall reimburse the United States if final costs exceed the amounts estimated in the sales agreement and (2) DOD instructions which allowed prices to be determined when the Defense article was dropped from inventory.

LCD-78-432  
(990703)

After reviewing the DOD response, we made a careful review of the pertinent laws and regulations to see if section 21 of the Arms Export Control Act, 22 U.S.C. 2761 (1970), and the contractual language in DD Form 1513 provide the legal basis for the collection of undercharges in the M-2 machine gun contracts. We concluded that

- under AR 795-14, issued June 3, 1974, the Army apparently had the option of determining the standard price either at the time the letter of offer was prepared with a reasonable specified acceptance date or at the time the item was dropped from inventory and
- the ambiguity regarding the time of determining the standard price was not clarified by DOD until June 17, 1975, when it issued a revision to DOD Instruction 2140.1.

Therefore, we believe that charges for machine guns shipped after June 1975 should have reflected their replacement cost. In this context, we believe section 21 of the Arms Export Control Act, as it then read, and DD Form 1513 provide the legal basis for the retroactive adjustment of the estimated contract price of the machine guns and the attempt to recoup unbilled costs. As noted above, the conditions set forth in DD Form 1513 specifically provided for the adjustment of the quoted estimates to enable the Government to be reimbursed for the final cost. The failure to advise the purchaser of the increase does not affect the right of the Government to be reimbursed for such costs.

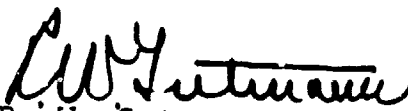
As noted in the enclosure to our report of October 7, 1977, rebilling of foreign military sales customers for underpriced machine guns delivered after June 1975 could amount to more than \$35 million in recovery of replacement prices. The decrease from \$60.7 million stated in our October 7, 1977 report, to the present \$35 million in potential recovery is due to the ambiguity in DOD regulations until June 1975. We recommend that you attempt collection action and establish mechanisms to immediately notify foreign military sales customers of price changes when asset positions indicate future replacement procurement of U.S. stocks to prevent recurrence of potentially embarrassing collection actions.

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 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 letter to the Chairmen of the Senate Committees on Appropriations, Armed Services, and Governmental Affairs; Chairmen of the House Committees on Appropriations, Armed Services, and Government Operations; and to the Director, Office of Management and Budget.

We would appreciate being advised of the collection action planned or taken with respect to the subject undercharges of M-2 machine guns noted above.

Sincerely yours,

  
R. W. Gutmann  
Director