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REPORT BY THE  
**Comptroller General**

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RELEASED

**Centralization: Best Long-Range  
Solution To Financial Management  
Problems Of The Foreign  
Military Sales Program**

For years, Defense has had accounting and financial management problems in its foreign military sales program. Those problems have resulted in the failure to charge other governments hundreds of millions of dollars and in the inability to properly account for what has been done with billions of their dollars. In the past decade, GAO has issued over 30 reports covering a wide range of these problems.

Improvements have been made and others may result from current Defense initiatives, but the Department lacks an adequate programwide management plan. Policies have been implemented inconsistently and attempts to standardize have not worked.

As a long-term solution, the Congress should require the Secretary of Defense to present a plan for centralizing accounting and financial management of the foreign military sales program. As a short-term solution, Defense should strengthen its existing steering committee for identifying foreign military sales financial management problems. This report was prepared at the request of the Chairman, House Appropriations Committee.



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FGMSD-79-33  
MAY 17, 1979



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-174901

The Honorable Jamie L. Whitten  
Chairman, Committee on Appropriations  
House of Representatives

*HSE 00300*

Dear Mr. Chairman:

*46C00546 - Comptroller*

The letter of August 16, 1978, from Mr. Mahon, asked that we give the Committee an overview of problems identified in accounting, billing, and collecting for the foreign military sales program and determine what the Defense Department is doing to correct those problems. (See app. II.) Mr. Mahon's concern was prompted by an article appearing in the July 24, 1978, issue of Business Week which, quoting a high-ranking Defense official, alleged that Defense has lost accounting control over billions of dollars of foreign military sales orders and that it will be years before its accounting problems will be straightened out. *AGC*

On March 9, 1979, we briefed members of your office on the results of our work to date. At that time, we were asked to provide a report by May 1979. This report, which summarizes our work through March 31, 1979, includes alternatives for solving Defense's foreign military sales accounting and financial management problems. The scope of our review is in appendix I.

Although improvements have been made and may result from present Defense initiatives, progress has been slow and many longstanding problems remain uncorrected. Since the program's inception, Defense has not had an adequate programwide financial management plan. Each military department and the Security Assistance Accounting Center designed their own financial management and accounting systems. The systems have not provided accurate or timely data, and the Department is unable to provide foreign governments a proper accounting of how their money was spent.

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James, (C)*

Although other alternatives exist, we believe the best and most expeditious way for Defense to finally resolve its foreign military sales financial management and accounting problems is to establish a centralized accounting and disbursing organization; thereby separating, to the maximum extent practicable, accounting for foreign military sales from accounting for Defense's own operations.

BACKGROUND

Foreign military sales are authorized by the International Security Assistance and Arms Export Control Act of 1976 (22 U.S.C. 2751, et seq.), which amended and revised the Foreign Military Sales Act of 1968. In recent years, increased public and congressional awareness has focused on the dramatic increases in the dollar volume of U.S. foreign military sales. Defense sales of articles and services to foreign countries have grown from \$953 million in fiscal 1970 to \$13.5 billion in fiscal 1978. Defense is currently managing foreign sales agreements valued at \$70 billion.

Foreign military sales accounting and financial management involves more than 40 Defense organizations. The Security Assistance Accounting Center in Denver, Colorado, was established in November 1976 and is Defense's central foreign military sales billing and collecting organization. The Center is responsible for providing foreign customers an accounting of what has been done with their deposits into the foreign military sales trust fund.

The trust fund contains advance payments from foreign governments as required by the Arms Export Control Act. Each year between \$8 billion and \$9 billion is deposited into and disbursed from the trust fund. The average trust fund balance is about \$6 billion. The Center was created to (1) provide a single point in the Defense Department for foreign countries' inquiries concerning financial aspects of sales agreements and (2) assure uniformity in billing and collecting. The military departments previously were responsible for these functions, but they had done a poor job, and their efforts to standardize billing and collecting had failed.

The military departments are responsible for detailed obligation, expenditure, and cost accounting; for paying contractors; and for reporting these disbursements as well as other financial information to the Center. Each department developed its own system to account for and report sales transactions. The Center is dependent upon their input, which is nonstandard, to prepare foreign customer bills, reimburse the departments' appropriations, and account for trust fund expenditures.

OVERVIEW OF PROBLEMS IDENTIFIED IN  
ACCOUNTING FOR FOREIGN MILITARY  
SALES AND DEFENSE'S EFFORTS TO  
RESOLVE THESE PROBLEMS

For years, Defense has experienced serious accounting and financial management problems with regard to the foreign military sales program. In the past decade, we have issued over 30 reports covering a wide range of these problems. For instance, we reported on:

- Defense's failure to charge foreign customers for hundreds of millions of dollars of costs properly chargeable to them under the program ( FGMSD-77-20, Apr. 11, 1978; FGMSD-78-51, Aug. 25, 1978; and FGMSD-79-16, Mar. 22, 1979).
- A breakdown in the Army's accounting control for its customer orders; the breakdown contributed appreciably to a \$225 million violation of the Anti-Deficiency Act (31 U.S.C. 665) for the Army's procurement appropriations (FGMSD-76-74, Nov. 5, 1976, and FGMSD-78-28, Apr. 27, 1978).
- The Navy's inability to reconcile \$554 million in differences between foreign government cash balances on its records and balances shown in the foreign military sales trust fund (FGMSD-79-2, Nov. 15, 1978).
- The Defense Security Assistance Agency's and the Center's inability to accurately account for the value of foreign military sales. This inability resulted in over \$2 billion of accounting errors, inconsistencies, and differences which may have caused the President's arms sales ceiling to be set \$420 million higher than it would otherwise have been (FGMSD-78-30, Apr. 12, 1978, and FGMSD-79-21, Mar. 16, 1979).

In the July 24, 1978, issue of Business Week, a high-ranking Defense official charged that Defense has lost financial control of the program. He said that the Department lacks information on the financial status of arms sales and cannot tell foreign governments precisely what has been done with their money or whether they have been accurately billed.

On June 17, 1977, the Assistant Secretary of Defense (Comptroller) directed that a new foreign military sales financial reporting system be adopted. The system, when fully implemented, should give the Department visibility and control over the use of foreign military sales budget (obligational) authority and should improve management of the trust fund.

As you know, in fiscal 1977 Defense changed the methodology for recording foreign military sales budget authority after being criticized by the Congress for having large unobligated balances on its books that were created to a great extent by foreign military sales. Under the revised methodology, only the budget authority which is going to result in obligations in the current fiscal year is recorded. Previously, the budget authority for foreign military sales corresponded to the total value of new sales agreements that were entered into with foreign governments during the year, plus the amount of unobligated budget authority for foreign military sales from previous years.

The system promulgated in the June 17, 1977, memorandum was not intended to provide for detailed obligation, expenditure, and cost accounting or for disbursing foreign customer funds or for billing and collecting. These functions continue to be carried out by the military departments' and the Center's systems. The Assistant Secretary initially mandated that the new system be implemented by September 30, 1977. However, in an October 3, 1977, memorandum, that date was extended to October 1, 1978; as of March 31, 1979, implementation had not been completed.

In response to the Assistant Secretary's June 17, 1977, memorandum and because the Center's billing, collecting, and trust fund system did not provide the necessary financial accounting and control, the Center began developing the Defense Integrated Financial System in November 1977. This system, which is to cover various facets of foreign military sales financial management--particularly billing, collecting, and trust fund accounting--will still be dependent upon input from the military departments. The system is to be implemented by October 1, 1979.

In another action, the Director of the Defense Security Assistance Agency established a steering committee in May 1978 to identify and rank according to priority foreign military sales financial management problems. The steering committee

included representatives of the Office of the Secretary of Defense, the military departments, and the Center. However, it did not include high-level decisionmakers, such as the military department comptrollers, or representatives of organizations responsible for day-to-day operations.

In addition to the creation of the committee, the Assistant Secretary met with representatives of the military departments and the Center in January 1979 to address accounting and financial management problems and the actions underway to correct them.

Major unresolved problems identified by Defense and noted during our review include the following:

- Defense's foreign military sales policies have not been uniformly implemented because each of the military departments has a different accounting system.
- Disbursements made by the military departments on behalf of foreign customers are not always reported to the Center in sufficient detail to enable a proper accounting to foreign countries on how their funds were spent. The Navy, for example, disbursed foreign funds of over \$2 billion for which it has identified the country and sales agreement involved but has not identified the specific articles and services paid for by these funds.
- Many echelons are involved in developing expenditure projections. As a result, projections have been poor, and Defense's ability to ensure compliance with provisions of the Arms Export Control Act has been limited. The act requires that adequate foreign customer funds be on deposit in the trust fund in advance of an expenditure being made. Expenditure projections must also be precise because of the impact on the budgeting systems of the various foreign governments involved.
- Shipments of articles to foreign governments by Defense contractors are not promptly reported to the Center. The status of orders reported to foreign customers is, therefore, inaccurate and creates customer dissatisfaction. For example, the Army completed delivery of 111 wreckers valued at \$8.9 million to Iran in September 1977, but, as of March 1979, it had not reported this information to the Center.

--Defense does not have accounting systems which accurately assign to sales agreements those progress payments made to contractors for a foreign government. In lieu of making an accurate accounting, the systems arbitrarily allocate the payments to Defense appropriations' and foreign customers' accounts. Therefore, they are unable to assure that the correct country's trust fund has been charged for the items produced and delivered.

--In attempting to implement the Assistant Secretary's June 17, 1977, memorandum, an appreciable number of errors have been identified in the military departments' accounting records. For instance, on November 17, 1978, the Army Audit Agency reported that 18 percent of the nearly 8,500 active Army foreign military sales agreements were either not recorded on the Army system or contained errors. Also, the Army Audit Agency was unable to verify prior year obligations for all Army foreign sales. That verification was needed to fully comply with the June 17, 1977, memorandum because Army records did not show obligations or billing data at the country or sales agreement level.

--The military departments and the Center are severely restricted in their ability to respond to new foreign military sales policies because the number of experienced professional financial management personnel is limited.

DEFENSE HAS NOT BEEN ABLE TO CORRECT  
ITS FOREIGN MILITARY SALES FINANCIAL  
MANAGEMENT AND ACCOUNTING PROBLEMS

Although improvements have been made and further improvements may result from current Defense efforts, the Department has been unable to correct its longstanding foreign military sales financial management and accounting problems. The Department lacks an adequate programwide plan to solve these problems. Guidance and coordination <sup>to assure that adequate</sup> accounting systems are developed <sup>has</sup> been insufficient, and policies have been inconsistently implemented. } FC

Defense, the military departments, and the Center have a common goal to assure that all costs of arms sales are recovered and that the United States is able to meet its fiduciary responsibility to its foreign customers. To effectively

manage a \$70-billion program, all parties must operate under uniform rules that are consistently applied.

Financial management systems were not designed to accommodate the phenomenal growth of the foreign military sales program. To perform necessary accounting and financial management, the military departments and the Center had to use existing financial systems. Systems development was left to them. As a result, nonstandard systems have been developed.

In establishing the Center, Defense sought to centralize billing and collecting. Although the Center has provided a standardized bill and certain other financial management controls, it is dependent upon the military departments' accounting systems for its financial information and serves, for the most part, as a clearinghouse operation which reports to foreign customers only what it is told.

Although one of its primary fiduciary responsibilities is to advise foreign customers how their money was spent, the Center has had little, if any, input into the design of the military department systems for reporting financial information. These systems, which were developed independent of each other, have not provided accurate or timely financial data. Further, although the military departments must report to the Center, they have not provided input into the design of the Center's system.

Efforts to correct foreign military sales problems have been piecemeal; policy has been established by the Assistant Secretary of Defense (Comptroller) and implemented by the military departments and the Center as they saw fit. Long-range planning has been lacking and policies have been established without fully considering systems design requirements, leadtime, and the capability to implement the requirement. Further, because accounting and financial management are fragmented, any resistance to a new system or policy can seriously affect its implementation.

Now, nearly 2 years after its implementation was mandated by the Assistant Secretary, the June 17, 1977, memorandum, has not been fully implemented and actions to implement it have varied. To implement the memorandum, the Army developed a new obligational control system. However, as discussed on page 6, the Army Audit Agency found that an appreciable amount of the information in the system is incorrect. The Air Force attempted to adapt its existing system in order to implement the memorandum. This had not been satisfactory, however, and the Air Force is now considering developing a system similar



in design to the Army's. The Navy modified its existing system, and the Center is developing the Defense Integrated Financial System.

In March 1977, the Assistant Secretary of Defense (Comptroller) told the military departments to develop direct cite accounting systems. Direct cite is a method of financing foreign sales. It requires that obligations and expenditures be charged directly to the foreign trust fund, thereby precluding the mixing of foreign and U.S. funds. The requirement to develop the systems was established without an implementation plan. As of March 31, 1979, 95 percent of the Navy's and 50 percent of the Air Force's foreign military sales were direct cite. The Army has not implemented the requirement to any great extent.

Further, Defense has not provided sufficient resources to assure that good pricing and accounting practices are implemented. The Office of the Secretary has only two accountants responsible for preparing and updating pricing, billing, collecting, and accounting policies for the program.

#### ALTERNATIVES TO RESOLVE FOREIGN MILITARY SALES FINANCIAL MANAGEMENT PROBLEMS

Defense needs to develop a detailed programwide improvement plan to include specific short- and long-term solutions to its remaining financial management problems.

##### Short-term alternative

The formation of a steering group to identify and rank according to priority foreign military sales financial management problems was a positive step. The steering group, however, does not have authority to direct systems implementation nor the means to follow up on actions taken to correct identified problems. To improve its effectiveness, the steering group should be headed by the Assistant Secretary of Defense (Comptroller) since he is responsible for accounting and financial management policy in the Defense Department. The group should include the military department comptrollers as well as representatives of the organizations responsible for day-to-day foreign military sales financial management.

##### Long-term alternatives

Many long-term alternatives exist for getting the program under control. We believe the two best are (1) a central foreign military sales organization responsible for

obligation and expenditure accounting and disbursing of funds, and assuring that all costs properly chargeable to the program are recovered and (2) a standard accounting and financial management system implemented by the military departments and the Center. In view of the past problems in implementing Defense's policies and in standardizing procedures and systems, we believe that the best long-range alternative is for Defense to centralize foreign military sales accounting and financial management.

#### Need for centralization

Foreign military sales are unique in that funds of another country are involved. The United States has a fiduciary responsibility that goes beyond normal Government appropriation and expenditure accounting. By the terms of the Arms Export Control Act, the cost of the program must be assessed foreign governments, and, therefore, good accounting, costing, and financial management systems are required.

In the past decade, Defense has been criticized by the Congress and us for its inability to properly manage the finances of the foreign sales program. Defense has acted to improve accounting, costing, billing, and collecting. New systems, such as the one promulgated by the Assistant Secretary in his June 17, 1977, memorandum, have been developed and are under development. Nevertheless, as discussed previously, serious problems still exist. We believe they will continue until a comprehensive centralized accounting and financial management system is developed solely for foreign military sales.

The advantages of developing a comprehensive centralized accounting and financial management system include:

- Uniform accounting and financial reporting, thus eliminating the reporting of nonstandard accounting data and providing greater accounting control. As discussed on pages 5 and 7, each of the military departments has a different accounting system for foreign military sales.
- Timely and complete adoption of Defense Department accounting policies such as direct cite accounting.  
(See pp. 5-7.)
- Direct control over foreign military sales disbursements to preclude such problems as the Navy's inability to reconcile \$554 million in differences between foreign

government cash balances shown on its records and the balances shown in the foreign military sales trust fund. (See p. 3.)

--Improved accounting for the program, thus better enabling the Department to meet its fiduciary responsibility to its foreign customers. Problems could be avoided such as the Navy's not properly accounting to the Center for the use of over \$2 billion of foreign customer funds. (See p. 5.)

--Improved expenditure projections by eliminating some of the echelons involved in developing projections. (See p. 5.)

--Better programwide planning because accounting and financial management will not be fragmented. (See p. 7.)

Since the military departments will still be responsible for implementing foreign sales agreements, a comprehensive centralized system should provide for supporting systems to be used by the military departments to report certain needed financial data. The military departments, however, would no longer be responsible for accounting and disbursing for the program.

Improving the military departments' and the Center's systems would be another alternative for solving the program's financial management problems. However, in view of prior experience, this is not likely to work in the long term. Long-standing efforts to improve these systems have not resulted in adequate systems. Billions of dollars of accounting errors, reporting delays, and other serious financial management weaknesses still preclude the Department from meeting its fiduciary responsibility to its foreign customers and from providing for good financial management for the program. Also, Defense efforts to standardize the military departments' systems have not worked, as was the case of billing and collecting which Defense centralized by establishing the Center.

In his June 17, 1977, memorandum and in a draft Defense accounting instruction, the Assistant Secretary indicated that the Security Assistance Accounting Center would become a centralized accounting station responsible for direct cite accounting. Center officials, although fully agreeing with the principle of centralization, had said that the Center does not have adequate personnel or computer capabilities to design and operate the required system. As a result, the Assistant Secretary deferred action on centralization.

Foreign customer funds could be used  
to pay for centralization

Additional personnel and resources would probably be needed to develop and carry out a detailed implementation plan for centralization and to assure that any new system provided accurate and timely data before its adoption. The Arms Export Control Act requires foreign countries to reimburse Defense for the cost of administering the foreign sales program. The cost of any additional personnel or computer equipment needed to administer the program should be covered by reimbursements. However, military and civilian personnel ceilings imposed by the Congress restrict the hiring of additional personnel to administer the foreign sales program. Defense officials said that personnel ceilings and restraints on the purchase of computer equipment have affected their ability to improve their accounting and financial management systems for the program.

Once a centralized system has been developed and thoroughly tested, existing personnel positions in the military departments could be transferred to the central accounting organization, and duplicate accounting operations would be stopped. The new system should conform to the accounting principles and standards prescribed by the Comptroller General and should be submitted to him for approval as required by the Budget and Accounting Procedures Act of 1950.

Centralization of accounting  
consistent with our recommendation  
on pricing problems

Centralization of accounting and financial management is consistent with our recommendation to solve the Department's longstanding pricing problems. We discussed the need for improved administration of foreign military sales pricing policies and implementing systems in our August 25, 1978, report entitled "The Department of Defense Continues to Improperly Subsidize Foreign Military Sales" (FGMSD-78-51). In that report we recommended that the Secretary of Defense assign specific responsibility for administering the pricing policy and monitoring pricing systems to a new organization or to some existing organization which can be sufficiently freed from other work to provide careful surveillance over the pricing functions. In a November 6, 1978, letter commenting on the report, the Assistant Secretary of Defense (Comptroller) stated that the existing Defense organization provided adequate surveillance over the pricing function.

However, as shown in our March 22, 1979, report entitled "Improperly Subsidizing the Foreign Military Sales Program-- A Continuing Problem" (FGMSD-79-16), Defense's decentralized approach to pricing has not worked. We recommended in that report that the Congress require the Secretary of Defense to produce a plan for overcoming the foreign military sales pricing problems. That plan was to include organizational changes that will be made and was to specify the additional personnel to be assigned to these activities.

### CONCLUSIONS

Adoption of the recommendation in our March 22, 1979, report, together with centralization of foreign military sales accounting and disbursing should, in the long term, be the best alternative for solving the accounting and financial management problems now plaguing the foreign military sales program.

Centralization could take several years. It should be carefully planned, and any new system should be thoroughly tested and proven before implementation. In this regard, the steering group charged with identifying and ranking according to priority foreign military sales financial management problems should be strengthened so that it is able to monitor the implementation of any new or improved systems.

### RECOMMENDATION TO THE CONGRESS

We recommend that the Congress require the Secretary of Defense to produce a plan for centralizing accounting and financial management of the foreign military sales program. That plan should include obligation and expenditure accounting and disbursing of funds, and should assure that all costs properly chargeable to the program are fully recovered. The plan should (1) specify the responsibilities of the central accounting organization and the support required from all organizations involved with the program, (2) establish detailed policies and procedures for centralization and define systems requirements, (3) identify personnel needs, including a description of duties, (4) establish milestones for development, testing, and implementation to include the transfer of existing personnel positions to the centralized accounting organization, and (5) require that the new system be developed and designed in accordance with the Comptroller General's accounting principles and standards and submitted to him for formal approval.

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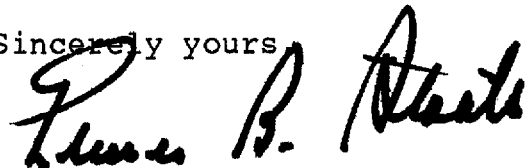
RECOMMENDATION TO THE  
SECRETARY OF DEFENSE

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We also recommend that the Secretary strengthen the existing Defense steering committee charged with identifying and ranking according to priority foreign military sales financial management problems. This can be done by designating the Assistant Secretary of Defense (Comptroller) to head the committee and by requiring that its membership include the military department comptrollers and representatives of those organizations responsible for day-to-day management of the program. Also, the group should have the capability to monitor the implementation of any new or improved systems.

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At the request of your office, we did not obtain written comments from the Department of Defense. However, the matters covered in the report were discussed with Defense officials and, where appropriate, their comments were considered.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from the date of this letter. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,



Comptroller General  
of the United States

SCOPE OF REVIEW

We reviewed the financial management problems identified for the foreign military sales program and the Defense Department's actions to correct them. Our review included an examination of legislation, policies, procedures, documents, and transactions dealing with accounting and financial management of the program.

We made our review at the following military departments and organizations:

- Departments of Defense, the Army, the Navy, and the Air Force; Washington, D.C.
- Defense Security Assistance Agency; Washington, D.C.
- Security Assistance Accounting Center; Denver, Colorado.
- Air Force Logistics Command, Wright-Patterson Air Force Base; Dayton, Ohio.
- Aeronautical System Division, Air Force Systems Command, Wright-Patterson Air Force Base; Dayton, Ohio.
- Naval Material Command; Washington, D.C.
- Naval Air Systems Command; Washington, D.C.
- Naval Sea Systems Command; Washington, D.C.
- Navy International Logistics Control Office; Philadelphia, Pennsylvania.
- U.S. Army Tank-Automotive Readiness Command; Warren, Michigan.
- U.S. Army International Logistics Command; New Cumberland, Pennsylvania.

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**Congress of the United States**  
**House of Representatives**  
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**Washington, D.C. 20515**

August 16, 1978

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Honorable Elmer B. Staats  
Comptroller General of the  
United States  
U.S. General Accounting Office  
Washington, DC 20548

Dear Mr. Staats:

The Committee is concerned about allegations contained in the July 24, 1978, issue of BUSINESS WEEK that there has been a serious breakdown in financial management of the foreign military sales program. The article quoting a high ranking Defense official said it would be five years before the accounting problems referred to would be straightened out.

The Committee would appreciate your office looking into allegations made in the article. Specifically, we would like for you to give this Committee (1) an overview of the problems that have been identified in accounting, billing, and collecting for the foreign military sales program, and (2) a determination as to what Defense is doing to correct its problems.

My staff has discussed this review with members of your Financial and General Management Studies Division. The Committee realizes because the issues and systems involved are diverse and complex the review may take a long time. We would appreciate your staff keeping us informed of your work plans and progress and would like a briefing on work completed as of February 1, 1979.

Sincerely,



Chairman

(903860)



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