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



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ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

B-203001

APRIL 30, 1981

The Honorable Caspar W. Weinberger
The Secretary of Defense

Dear Mr. Secretary:

Subject: [Action Needed to Improve Timeliness of Army
Billings for Sales to Foreign Countries]
(AFMD-81-61)

This report discusses our review of the Army accounting system used to bill and collect for foreign military sales from foreign countries' trust fund accounts. Our review showed that:

- The Army has not promptly collected from trust fund accounts for goods and services delivered to foreign customers.
- Serious weaknesses exist in the Army billing system, and many deliveries were not billed at the time of shipment as required.
- When the Army's procedures provide for obtaining advance funds, the amounts requested do not always recover costs.

The following summarizes our audit coverage, discusses the problems we found, and recommends actions needed to correct accounting system weaknesses that delay billing and collection for foreign military sales.

OBJECTIVES, SCOPE, AND METHODOLOGY

The overall objective of our review was to assess the effectiveness of the Army's accounting system for collecting from foreign governments' trust funds. More specific objectives were to

- evaluate the efficiency and accuracy of the accounting systems the Departments of the Army and Defense use for prompt collection from trust funds, and
- determine the extent to which deliveries have been made to foreign countries without proper reimbursement to Army appropriated funds.

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This review included an examination of trust fund accounting records and related billing data at the Security Assistance Accounting Center, Denver, Colorado; the U.S. Army Security Assistance Center, New Cumberland, Pennsylvania; and two of the five Army materiel readiness commands--the Army Armament Materiel Readiness Command, Rock Island, Illinois, and the Army Tank-Automotive Readiness Command, Warren, Michigan.

We also discussed policies and procedures for processing billings and collections with senior officials of these activities as well as of the Defense Security Assistance Agency, Washington, D.C.; the Army Materiel Development and Readiness Command, Alexandria, Virginia; and Defense Audit Service, Arlington, Virginia.

We selected 102 of the largest customer orders that were reported by the Army to be shipped but not billed and determined the status of these orders and reasons for any billing delays. In addition to this coverage, we reviewed followup work performed by the two materiel readiness commands. We also determined if appropriate advances were received from the trust fund before shipments were made, and if these advances were promptly accounted for.

Our review was limited to the Army because, of all the military services, it makes the greatest use of its own funds rather than customers' funds to initially pay for items acquired for foreign customers. Of the \$456 million the services were reimbursed in the quarter ending December 30, 1979, the Army's share was \$283 million. The other activity using its own funds, the Air Force, began in October 1979 to convert to a system that directly charges the foreign military sales trust fund. The contracts for which the Air Force used its own funds and subsequently obtained reimbursement from the trust fund were awarded before this change in funding methods was implemented in October 1979.

We limited our review to assessing the effectiveness of the Army's accounting system for obtaining timely reimbursements from foreign customer's trust funds. We did not evaluate the accuracy of trust fund balances or the adequacy of foreign military sales pricing. Accordingly, this report should not be considered an assessment of the Army's overall management of the foreign military sales program.

FUNCTIONING OF ARMY BILLING SYSTEM

The Defense and Army regulations provide for ensuring that all costs are billed and collected and that Army appropriations are not used for interim financing of foreign military sales. These regulations, which were developed to comply with the International Security Assistance and Arms Export

Control Act of 1976, place reliance upon the adequacy and timeliness of billing actions by the Army materiel commands as the Army accounting system provides for charging costs to its appropriation and obtaining timely reimbursement from trust fund accounts maintained by the U.S. Treasury. The Army uses two collection procedures for foreign military sales: One provides for billing concurrent with shipment and the other provides for billing in advance of shipment.

If the goods or services sold under the foreign military sales program are obtained from inventory and not shipped directly from a contractor, reimbursement is to be obtained when delivery is made. This reimbursement is obtained when the Army materiel command notifies the Security Assistance Accounting Center of the delivery. The Security Assistance Accounting Center then processes the reimbursement to the Army.

Under the Army system, stock fund and secondary items, which are generally low cost and on hand in the Army inventory system, are to be billed concurrently with shipment. Also, if major items are shipped from Army inventory, the Army materiel commands are required to bill concurrently with shipment. The rationale for billing at this time rather than in advance, is this: When items are taken from inventory, no additional Army funds are required until after the shipment is made and the Army must use funds to purchase replacement items for its own inventory.

When appropriations are used to purchase items directly from contractors for foreign military sales, procedures exist for the Army to obtain advances from the trust fund account. Appropriated funds are generally used for purchases of major items such as tanks, howitzers, or trucks. Army procedures provide that such payments may not be made to contractors unless a cash advance, based on an initial price estimate, has been obtained from the foreign customer's trust fund. This advance billing, which is based on estimated costs, is necessary to make progress payments to the contractors. The amount collected in advance must be sufficient to cover all disbursements made to contractors.

SERIOUS WEAKNESSES IN ARMY BILLING SYSTEM

The Army's accounting system did not result in prompt collection from trust fund accounts maintained by the U.S. Treasury when goods and services were delivered under the foreign military sales program. As of October 3, 1980, Army records indicated it had not yet billed the trust fund for items amounting to \$498 million that had been shipped at least 60 days and in most cases over 180 days. Over \$67 million of these items were shipped more than 2 years ago. As a result of these delays, for long periods of time the Army used its own funds to finance sales to foreign countries.

This condition existed primarily for two reasons. First, when deliveries were made from existing inventories, the Army did not bill the foreign customers' trust funds promptly. Secondly, when the Army purchased items directly from contractors for delivery to foreign countries, it did not obtain sufficient advances from the trust fund account as required by Army regulations. Details follow on actions needed to remedy this condition.

Billings not promptly processed

The Army materiel commands did not always promptly process billings to obtain reimbursements when items were shipped to foreign customers. Records prepared by the Army Security Assistance Center identified deliveries of \$498 million as of October 1980 that were not billed. Of this total, about \$431 million was shipped between October 1, 1978, and July 31, 1980, and \$67 million was shipped before October 1978.

At two of the Army materiel commands, we reviewed data to determine if the specific items identified by the Army Security Assistance Center as shipped after October 1, 1978, were still unbilled. This review showed that in 70 percent of these cases, the billing and collection system had broken down and the items shipped had not been billed as of October 3, 1980. In most cases the items had been shipped at least 180 days earlier and in some cases more than a year earlier. For example, 189 trucks valued at \$2.5 million were shipped to Korea during 1979 and had not been billed. In another instance, four items valued at over \$14,000 were shipped from 49 to 551 days earlier.

In the other 30 percent of the cases, the Army listing was incorrect and the items had been billed. This condition resulted because billing documents were processed to withdraw funds from the foreign customer's account, but a copy of the billing document was not fully processed through the Army accounting system.

We also examined the 25 largest shipments prior to October 1978 which Army records showed no billings and found that in 24 cases the Army listing was incorrect and that the items had been billed.

These billing and collection deficiencies were not promptly detected because the Army had not sufficiently emphasized monitoring and followup efforts to ensure timely billings. In addition, the Army materiel commands did not promptly research all requisitions identified as shipped but unbilled.

Sufficient advances not collected

The Army's advance billing process for obtaining funds to pay contractors for major items delivered directly to foreign

countries also was not working well. Disbursements to contractors often exceeded collections from the foreign countries' trust fund accounts. However, these underbillings were not promptly detected because amounts collected were not compared with amounts disbursed periodically.

Our review at two of the five Army materiel commands showed that one materiel command did not bill for amounts sufficient to cover progress payments. For example, at this command, we reviewed the status of collections for 14 requisitions with total disbursements of \$44.1 million at September 30, 1980. The total collections on these cases totaled \$42.1 million and were not sufficient to cover disbursements because the Army was not able to accurately estimate the funds needed. In most of these cases, disbursements had exceeded collections for over 180 days.

As discussed earlier, the Army has established procedures for obtaining reimbursement in advance by withdrawing money which the foreign countries have deposited in their trust fund accounts when major items are delivered directly from contractors. However, the amounts requested were not always sufficient to recover costs and the Army had not developed a system for monitoring the adequacy of these amounts. This monitoring system could consist simply of comparing advances received with disbursements made, and determining the reasons for significant differences. The Army could then obtain the required advances.

ACTIONS NEEDED TO IMPROVE TIMELINESS OF COLLECTIONS

The Army was aware of shortcomings in its collection process and has initiated several actions to remedy these deficiencies. Although these actions are a step in the right direction, more remains to be done. Specifically, the Army needs to

- establish standard time frames for completing the billing cycle when items are delivered from inventory;
- periodically evaluate the reasonableness of its estimates which are used to request advance payments by comparing collections with disbursements; and
- revise its system to directly charge the foreign customer's fund when major items are purchased from contractors for delivery to the foreign customer.

Establishment of standard time frames for completing the billing cycle would result in more timely identification of billing delays. Also, unusual problems creating such delays would be more promptly identified. In the past, this has not always happened. For instance, at one materiel command,

billings were delayed 5 months by an electrical storm which interfered with transmission of delivery data on thousands of orders for stock fund items. An absence of internal controls over transmission of data to assure that all records transmitted were received, coupled with a need for establishing standard time frames for completing the billing cycle, allowed this problem to go undetected.

A major problem arises from the fact that the Army relies on estimates of future payments to contractors in obtaining advances from the trust fund. Although attempts to improve these estimates have been unsuccessful, the Army can reduce the impact of inaccurate estimates by periodically comparing collections with disbursements.

Because the Army has not been able to perfect its estimating system, it needs to phase out this method of financing and follow the Air Force and Navy practice of directly citing trust funds when payments are made. Defense policy encouraged use of a system of direct cite financing and this system would have eliminated the need to obtain advances based on estimated expenditures, but the Army has not adopted this method. Although this method would require changes to the standard accounting system used by the Army materiel commands, such changes are necessary and the Army needs to develop and implement such a plan.

The Army has delayed changing its accounting system to direct cite financing because of uncertainties involving the development of a centralized accounting system. Based on previous GAO reports, the House Armed Services Committee has recommended that Defense centralize accounting for foreign military sales contracts. Since this centralized accounting system would use direct cite financing and may be implemented in the near future, the Army has been reluctant to make system changes. However, Army officials recently advised us that because problems in the current system are recognized, they are considering converting the current system to direct cite financing.

CONCLUSIONS

Although the Army was aware of shortcomings in its collection process and had initiated improvements at the two materiel commands included in our review, more needs to be done. The Army's accounting system must improve controls to ensure that foreign customers are billed for all shipments and that appropriated funds are reimbursed promptly. These controls should include monitoring the timeliness of billing efforts.

Also, effective controls must be established to minimize U.S. financing of foreign military sales until a system

of direct cite financing is implemented. These controls must assure compliance with the Army system for collecting from foreign countries' trust fund accounts before contractors are paid.

Although uncertainties exist involving the centralization of the accounting system, action is needed to correct existing problems. Certain of these actions can be implemented on an interim basis without waiting until the accounting system changes are finalized. Also, in the near future, the Army needs to devise and implement a plan for direct cite financing.

RECOMMENDATIONS

In the interim, the Secretary of Defense should require the Commander, U.S. Army Materiel Development and Readiness Command to:

- Place increased management emphasis on monitoring and followup efforts to ensure that foreign customers are billed for all shipments. This emphasis would include establishing and enforcing standard time frames for completing billing actions.
- Establish procedures to compare amounts obtained from trust fund accounts with amounts disbursed. This procedure should ensure that adequate advances are collected by the Army when major items are procured for direct delivery to foreign military sales customers.

Also, the Secretary of Defense should ensure that the Army devises and implements a system which provides for directly charging the foreign government's trust fund account when foreign military sales items are obtained directly from contractors.

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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. You must send the statement to the House Committee on Government Operations and the Senate Committee on Governmental Affairs within 60 days of the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of the report.

We discussed our findings with Defense officials and considered their comments in preparing this report.

We are sending copies of this report to the Director, Office of Management and Budget; the Chairmen, House Committee on Government Operations and Senate Committee on Governmental Affairs; and the Chairman, House Appropriations Committee, Subcommittee on Defense.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D. L. Scantlebury". The signature is fluid and cursive, with a long, sweeping tail on the final letter.

D. L. Scantlebury
Division Director and
Chief Accountant of GAO