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UNITED STATES GENERAL ACCOUNTING OFFICE  
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STATEMENT OF  
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BEFORE THE  
SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY  
OF THE HOUSE GOVERNMENT OPERATIONS COMMITTEE

ON

THE ~~GENERAL ACCOUNTING OFFICE~~ REPORT  
"COST WAIVERS UNDER THE FOREIGN MILITARY SALES  
PROGRAM: MORE ATTENTION AND CONTROL NEEDED"]

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss with you one of the (continuing problems in cost recovery under the foreign military sales program.) As you are aware, Defense has had continuing accounting and financial management problems in its foreign military sales program. These problems have resulted in the failure to recover hundreds of millions of dollars from other governments under the foreign military sales program.) In the past decade, GAO has issued over 30 reports covering a wide range of these problems. One of these reports, which was issued in September 1978, discussed the need for more attention and control of cost waivers under the foreign military sales program. We will also provide background information and discuss certain actions taken since September 1978 when the report was issued.

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(The Congress, in passing the International Security Assistance and Arms Export Control Act of June 30, 1976, for the first time specified the circumstances in which the Department of Defense could waive certain costs under the foreign military sales program. This act provides that nonrecurring research, development, and production costs and charges for the use of Government-owned plant and production equipment can be reduced or waived, if the foreign sales would significantly advance

--U.S. interests in North Atlantic Treaty Organization standardization or

--foreign procurement in the United States under coproduction arrangements.

The Arms Export Control Act and its legislative history, however, do not indicate what the Congress meant by the term "significantly advance," leaving this determination, which by its nature is largely subjective, to the Defense Department.)

In preparing our report, we addressed actions taken by Defense to authorize, account for, and report significant costs waived for foreign military sales and the pricing of these sales. We found that the Congress had not been informed of the amounts being waived and the specific reasons for granting waivers although this information would have improved its oversight and control of the program.

DEFENSE HAS NOT KEPT CONGRESS  
INFORMED OF COST WAIVERS

Since 1976, (Defense has authorized cost waivers of over \$800 million without being required to report to the Congress.

on how the United States benefits from the waivers. Because of the amount of money involved, Congressional oversight and control is needed over cost waivers to insure compliance with congressional intent that foreign governments not be subsidized through the foreign military sales program.)

Congressional approval is not required for cost waivers, nor is Defense required to report to the Congress on the reasons for and amounts of waivers. We found that it is difficult to determine whether a sale would significantly advance standardization or coproduction. For example, without demonstrating that the sale significantly advanced U.S. interests in North Atlantic Treaty Organization standardization, Defense officials used the cost waiver provision to justify waiving millions in nonrecurring research and development costs on the proposed sale of a missile to a North Atlantic Treaty Organization country. The waiver was authorized after the foreign country balked at paying the charge. Defense authorized the waiver of additional millions in similar costs on a second proposed sale to the same country because of the precedent established in granting the first waiver.

The Arms Export Control Act and its legislative history, do not indicate what the Congress meant by the term "significantly advance", thereby leaving to the Defense Department this determination which by its nature is largely subjective. However, the Congress has made it clear that the foreign military sales program should not be used to subsidize foreign governments and that waivers are to be used to gain advantage

for the United States. It is, therefore, important that costs be waived only when Defense can demonstrate that an advantage was gained because of the waiver.

(Defense has not developed specific criteria for granting cost waivers because it believes this would place the Secretary of Defense at a disadvantage in negotiating with officials of other countries who would be aware of, but not bound by, such criteria. We agree that publication of criteria for cost waivers would be disadvantageous to the United States. However, because of the large sums involved in waivers granted, authorized, and under consideration, GAO believes that the Congress should be informed of the amounts being waived and the specific reasons for granting the waivers. This would afford the Congress a means to measure whether Defense is acting within the intent of the law and would strengthen congressional oversight.

GAO RECOMMENDATIONS TO  
THE CONGRESS IN 1978

To assist the Congress in obtaining information necessary for oversight and control of cost waivers under the foreign military sales program, our report recommended that the Congress amend the law to require that Defense include the value of and the explanation for cost waivers in the required notification reports on foreign military sales.

Our report also recommended that, until the Congress had an opportunity to consider legislative changes, the Secretary of Defense include the value of and explanations for cost

waivers when he submits to the Congress those notification reports on foreign military sales required by the Arms Export Control Act.

NEED FOR ACTION  
ON GAO'S REPORT

Defense did not concur with the recommendations in our 1978 report and has waived several hundred million dollars in costs since our report was issued without reporting to Congress on the amounts of and justifications for these waivers of costs. As a result, (the Congress is not being provided a complete picture of the costs excluded from proposed foreign military sales prices. These waived costs are often significant in relation to the total sales price and should be disclosed so that the Congress can carry out its oversight and control responsibility.)

The Congress has not taken action to amend the Arms Export Control Act based on our recommendations to require Defense to report the amount approved for waivers and the reasons for the waivers. Consequently, Defense has not and does not report to the Congress the full costs of a sale including the amount of costs waived or any other material concessions related to the sale. Unless the law is changed, we expect Defense to continue to negotiate waivers and not provide this information with the normal congressional notifications of proposed foreign military sales.

Although the Congress has not required and Defense has not taken action to report on the amount of and justification

for waivers, significant amounts have been waived. For instance, since October 1, 1978, Defense has waived over \$280 million in nonrecurring, research and development, and production costs on foreign military sales. These waivers were justified as furthering North Atlantic Treaty Organization standardization with the exception of \$3.6 million waived on a sale to Egypt. The waiver to Egypt was granted because Egypt absorbed a part of initial testing costs. Also, I might add that the amount waived includes a partial waiver of \$70 million on the sale of the CF-18 aircraft to Canada. Defense informed us that, in return for the waivers, Canada agreed to increase the number of aircraft purchased from 129 to 137.

Also, in this instance it is difficult to determine conclusively whether the sale will significantly advance standardization. It was not necessary for Defense to demonstrate the extent to which the waiver of about \$70 million on 137 aircraft or over one-half million dollars per aircraft would advance North Atlantic Treaty Organization standardization. In sales of this type which involve only one other country, the question of "Did the sale significantly advance standardization?" could be raised. Because the House Government Operations Committee did not have needed information on the justification for this waiver, GAO was requested to assist in gathering this data. We encountered difficulties in obtaining the desired information because (1) it took considerable time and effort to locate a copy of the contract

in Defense and (2) additional time elapsed before Defense agreed to provide the requested information.

Since our report in 1978, the Congress has amended the Arms Export Control Act to allow Defense to provide North Atlantic Treaty Organization countries with quality assurance, inspection, and contract audit service without charge. The law requires the submission of a report to the Congress which identifies any costs waived for North Atlantic Treaty Organization cooperative projects.

RECENT GAO AND DEFENSE ACTIVITY AUDIT  
REPORTS ON WAIVERS OF RECOUPMENTS

(GAO, the Defense Audit Service, and the Army Audit Agency all have recently issued audit reports on cost waivers. These reports emphasize the need for compliance with nonrecurring cost recovery requirements and recommend improvements to protect the interests of the United States.)

In July 1980, GAO issued a report entitled "Equitable Cost Sharing Questioned on NATO's Airborne Early Warning and Control Program." Essentially, the report discusses U.S. participation in this program and the reasonableness of cost sharing agreements. The airborne early warning and control program is a \$1.8 billion agreement between the United States and participating North Atlantic Treaty Organization countries, wherein the costs will be shared. The high cost of acquiring the necessary aircraft was a major barrier to North Atlantic Treaty Organization countries agreeing to participate in this program. The United States made financial concessions to

the other North Atlantic Treaty Organization nations, including waiving nonrecurring cost recoupments, in order to obtain broad participation in the program.

Because the North Atlantic Treaty Organization aircraft purchase was complex and did not follow normal sales and procurement procedures and because the possibility exists that Defense may have to go to the Congress for additional funds if potential program costs grow or funding shortfalls materialize, we suggested that the Congress may wish to consider requiring full reporting from Defense on the status of the program. To date, the Congress has not required any such reporting.

In September 1980, the Defense Audit Service reported that Defense procedures and controls for determining and collecting nonrecurring costs for foreign customers were inadequate. Appropriate costs were either not computed, not computed accurately, or computed but not billed. As a result of these deficiencies, Defense did not charge foreign military sales customers for about \$18 million of nonrecurring costs. For example, the price charged for aircraft engines sold to foreign countries was the estimated contract price and did not include nonrecurring costs. The Defense Audit Service recommended that the services take action to compute and recoup nonrecurring costs in accordance with established guidance. Action had not been completed on these recommendations.



The Army Audit Agency conducted several recent audits and issued a summary report in January 1981. The Agency concluded that the Army had not recouped several million dollars in nonrecurring research, development, and production costs as required. In addition, the Agency found the same passive attitude toward recoupment of nonrecurring costs that it had reported in June 1977. The Agency recommended various system improvements to increase recoupments. It also recommended that action be initiated to permit the Army to use recouped funds to offset the cost of the recoupment program or for approved unfunded requirements. Actions on the recommendations are still pending.

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Mr. Chairman, this concludes my prepared statement. We shall be happy to answer any questions that you or other members of the Committee may have.

