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BY THE U.S. GENERAL ACCOUNTING OFFICE

**Report To The Chairman,
Committee on Appropriations
House Of Representatives**

**Design And Operation Of Special Defense
Acquisition Fund Can Be Improved**

The Special Defense Acquisition Fund finances the acquisition of defense articles for sale to foreign buyers. The purpose of the fund is to reduce delivery times associated with these sales and to reduce the need to withdraw equipment from U.S. military service inventories when delivery to a foreign recipient needs to be expedited.

This report discusses the problems which have been encountered in implementing the fund's operations. GAO identifies three changes the Congress could make in the authorizing legislation which should improve the fund's ability to operate effectively.



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

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-214236

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

Dear Mr. Chairman:

In a letter dated July 14, 1983, the Chairman, Subcommittee on Foreign Operations, House Committee on Appropriations, asked us to look at the management of the Special Defense Acquisition Fund (SDAF) resources and determine whether the fund has been meeting its objective of decreasing the delivery time needed to provide defense articles to foreign recipients under the Foreign Military Sales (FMS) program. Also, he asked us to identify any management and legislative policy issues that need to be addressed. This report, which responds to the Subcommittee's inquiry, is being provided to you at the request of the Subcommittee.

We believe that it is too early to conclude whether SDAF will accomplish its objectives. SDAF's ultimate success will depend on Department of Defense's (DOD) ability to forecast future sales requirements. In our analysis of SDAF's first 2 years of operation and its enabling legislation, we did find that the fund has reduced delivery time on FMS sales. We also have identified three legislative changes for your consideration which should improve its ability to function effectively:

1. Grant a 3-year obligation authority rather than the current 1-year authority. This would allow SDAF to be better coordinated with the services' weapons procurement process.
2. Allow SDAF to obligate the proceeds of a sale in the year in which the sale is made rather than waiting until authority is approved in the following year. This would provide greater latitude for meeting foreign needs.
3. Allow SDAF to purchase equipment not approved for release to foreign countries. This would allow foreign needs to be met by withdrawing releasable equipment from military service stocks and replenishing these stocks with the advanced nonreleasable versions procured by SDAF.

The following sections describe the history of the fund, its purchase and sales record, and potential changes in detail.

HISTORY OF SDAF

Prior to 1982, various collections associated with sales of defense equipment by the military services were deposited in a Treasury miscellaneous receipt account. In 1982, the Arms Export Control Act was amended to authorize the accumulation of up to \$900 million of these receipts in a new account, the Special Defense Acquisition Fund. The Act requires that money be made available pursuant to annual appropriation acts. The fund was established to address the dilemma posed to the U.S. government when a foreign government needed defense items, often in the face of a serious threat, and required delivery in less than the normal manufacturing time. The United States could turn down such requests, thus possibly damaging U.S. national security and foreign policy interests, or it could fulfill the requirements by diverting equipment from U.S. Forces, thus possibly degrading military readiness.

With SDAF, DOD can now procure defense items in anticipation of foreign demand. If DOD successfully forecasts foreign demand, SDAF allows DOD to fill the emergency foreign requirements from SDAF's inventory rather than withdrawing these requirements from service stocks. For non-emergency requirements, SDAF allows DOD to expedite delivery to the foreign buyer because DOD can be on contract for the equipment before an actual sales agreement is concluded.

SDAF, with its \$900 million authorization ceiling, is only a small part of the FMS program, which has had sales ranging from \$7.2 billion to \$17.5 billion annually between 1979 and 1983. The Defense Security Assistance Agency (DSAA) administers the fund. It relies on the military services to purchase the defense articles and on the Security Assistance Accounting Center in Denver, Colorado, to do the bookkeeping and accounting.

LIMITED PURCHASE EXPERIENCE

During fiscal years 1982 through 1984, Congress made available through appropriation acts \$475 million (\$125 million the first 2 years and \$225 million in the 3rd year) to finance SDAF purchases. For fiscal year 1985, Congress appropriated \$325 million.

In fiscal years 1982 and 1983, some of the major items purchased with SDAF included M-60 tanks, T.V. Maverick missiles, I-TOW antitank weapons, MARK 15 Phalanx close-in weapon systems, Stinger hand-held ground-to-air missiles, and various types of ammunition. In selecting the items, DSAA considered past

foreign military sales demands, previous withdrawals from U.S. inventories, diversions of contractor deliveries from U.S. Forces to foreign customers, and potential need for an item in an emergency. Appendix I provides the status of deliveries, diversions, and withdrawals for items purchased with SDAF in fiscal years 1982 and 1983.

LIMITED SDAF SALES EXPERIENCE

In fiscal years 1983 and 1984, SDAF's first 2 full years of operation, the fund's sales experience was quite limited. During fiscal year 1983, SDAF made one sale, involving 20 AN/VRC-12 radios. In fiscal year 1984, SDAF equipment filled eight foreign military sales valued at \$25.5 million. This equipment was purchased by SDAF in fiscal years 1982 and 1983 and will be provided to recipient countries from the contractor. By placing SDAF purchase orders 1 to 2 years before signing sales agreements, SDAF reduced the delivery time for these sales. Appendix II provides a detailed listing of SDAF fiscal year 1984 sales activity.

In addition, SDAF will be used to replenish service stocks with 400 Basic Stinger missiles valued at \$28.9 million. These missiles were sold in fiscal year 1984 to foreign countries but were supplied from U.S. service stocks. Because SDAF ordered these Stinger missiles in fiscal year 1983, U.S. service inventory will be replenished approximately a year sooner than if SDAF had not been used.

CHANGES NEEDED TO ENHANCE PROGRAM EFFECTIVENESS

The effectiveness of SDAF depends on DSAA's ability to predict foreign demand. The following discusses several ways Congress can enhance SDAF's effectiveness and reduce the risk that DSAA will purchase out-of-date equipment.

One-year obligation authority

SDAF appropriations are contained in the foreign aid appropriation act. The funds are made available for obligation on a 1-year basis, which is normally the case in foreign aid appropriations. This means that funds can only be obligated in the year appropriated. One-year obligation authority creates a number of problems for DSAA in selecting and acquiring military articles for SDAF.

For example, in fiscal year 1984, because of the 1-year obligation, a number of high priority defense articles could not be purchased due to legal and contract negotiation difficulties during the contracting award process. Two of these problem cases resulted in not using \$10 million in SDAF obligation

authority because the fiscal year ended before contracts could be awarded. In the third case, after 3 months of trying to buy the Multiple Launch Rocket System, DSAA learned that the contract for this weapon could not be negotiated before the close of the fiscal year. This resulted in DSAA reprogramming \$23 million to purchase lower priority ammunition.

One-year obligation authority problems could largely be eliminated by making appropriations available for 3 years, as weapons procurements appropriations are. The military services would be better able to integrate short lead-time items into the normal procurement cycles, and congressional review and oversight would not be affected.

Authority to use sale proceeds

When SDAF sales are made, its equity (inventory) declines. The proceeds from the sale are deposited in the SDAF account. However, where DSAA has already used all of its appropriations for a year, DSAA must wait until a subsequent appropriation act is passed for authorization to use these sales proceeds. If sales do develop, the authority to immediately use sales proceeds would allow DSAA to turn over SDAF assets more rapidly and avoid losing opportunities to exercise open contract options that would expire before the end of the sales year. This approach would allow SDAF to operate similarly to the military departments, which can immediately use sales proceeds to replenish their weapon stocks.

Currently, if the \$900 million authorization ceiling is not exceeded by an appropriation act, the size of SDAF's annual appropriation--which determines how much new equipment SDAF can order--is limited to the difference between SDAF equity (on-hand inventory plus open SDAF contracts) and the authorization ceiling. If SDAF's equity approaches its authorization level, which appears possible by fiscal year 1986, Congress may be asked to increase the level above \$900 million to allow SDAF to buy new equipment. Rather than raising the ceiling, the Congress could consider allowing DSAA to obligate SDAF sales proceeds in the year of sale to purchase new equipment.

In setting the amount of SDAF's obligation authority, Congress would state in the appropriations act that SDAF can spend up to a specified amount of sales proceeds. If sales are not made, the proceeds would not be available for new procurements. By making new purchases contingent on sales, Congress would be requiring DSAA to demonstrate that it has chosen items which are being sold to eligible foreign customers.

Authority to purchase nonreleasable systems

Currently, when an item is withdrawn from U.S. service inventory, military readiness is often degraded while the

services wait months or even years before inventories are replenished. However, in the end, U.S. readiness may be improved when an upgraded or improved version of the item is purchased with sales proceeds from these transfers. This type of transaction is known as replacement-in-kind procurement.

The Arms Export Control Act limits SDAF procurements to items anticipated to be sold to a foreign ally or international organization. In our view this means that SDAF can only purchase equipment that is releasable to foreign countries at the time the contract is awarded. However, DSAA has suggested that the act allows SDAF to procure items which it expects will be releasable under National Defense Policy (NDP) guidelines at the time of sale. We believe that such releasability predictions are speculative for the following reasons. The NDP decision on releasability, which requires a change to or exception from NDP guidelines, (1) will take place subsequent to the SDAF procurement; i.e., at the time of sale, which for advanced weapons systems could be 18 to 24 months, and (2) requires the approval of several different departments and agencies with potentially different views. Thus, SDAF's participation in replacement-in-kind procurements is restricted to weapon systems that are presently releasable to foreign countries. This can cause several problems.

For example, all FMS requirements for air-to-air missiles must be filled from service stocks of the older releasable AIM-9L missiles, because the current production line is only producing the AIM-9M air-to-air missile, which is not releasable to foreign countries. Although withdrawal of the older AIM-9L missile could seriously affect U.S. readiness, the Arms Export Control Act precludes SDAF from buying the more sophisticated AIM-9M missiles and selling these to the military services to replenish their inventories when they sell AIM-9L's to meet pressing foreign needs.

There are also risks involved in using SDAF to purchase older generations of equipment. If foreign buyers do not materialize, SDAF may have to sell the equipment to U.S. services, even though this equipment is essentially out-of-date for U.S. use.

If SDAF could purchase advanced systems not yet releasable to foreign governments, SDAF could simultaneously improve U.S. force readiness and make equipment available for transfer to foreign countries in support of U.S. foreign policy. The process could work as follows: SDAF would contract for the purchase of the nonreleasable system. If a sales order for the releasable version is subsequently received, the system would be supplied from service stock. The military services would use the sales proceeds to purchase the nonreleasable versions from SDAF.

If a sales order for the nonreleasable version is subsequently approved for sale, the system would be supplied from

SDAF stocks. If a sales order did not materialize, the system would be sold by SDAF to the services to meet established service requirements.

We believe authorization to procure nonreleasable systems would reduce the risk of less advanced equipment being transferred to the military services if foreign demand is below expectations. SDAF should, however, not become a general purpose fund for procuring a variety of military goods for U.S. Forces or a source of funds for unbudgeted procurements. To allow SDAF to procure nonreleasable systems would not be a departure from the present military service practice of using proceeds from the sale of older equipment to purchase more advanced equipment. The military services notify House and Senate Armed Services Appropriations Committees of such reprogramming actions.

Because all SDAF procurement funding, including replacement-in-kind procurements, would continue to require appropriation act action, SDAF replacement-in-kind procurements would be subject to more congressional oversight than present in military service replacement-in-kind procurements, which are accomplished through reprogramming actions. To ensure that the appropriate congressional committees are aware of all SDAF replacement-in-kind procurements, the Senate and House Armed Services and Appropriations Committees should be notified of the SDAF's annual procurement plans. Presently, only the Senate Armed Services Committee receives SDAF's annual procurement plan. This plan provides detailed information on all SDAF anticipated procurements.

If the Congress decides to allow SDAF to purchase non-releasable systems, the test of whether SDAF is meeting its legislative objectives would continue to be whether sales are made to eligible foreign countries. If no sales are made and the nonreleasable systems are transferred to the military services, then the Congress should consider if SDAF, even with authority to purchase nonreleasable systems, is a workable concept.

MATTERS FOR CONGRESSIONAL CONSIDERATION

We believe that the Congress should consider:

- allowing 3-year obligation authority for amounts made available to SDAF through appropriation acts;
- allowing SDAF to obligate the proceeds of a sale in the year in which the sale is made, stipulating the amount to be made available in an annual appropriation act;

--amending the Arms Export Control Act to allow DSAA to purchase advanced systems not releasable to foreign countries.

If Congress decides that these actions would enhance SDAF effectiveness, appendixes III and IV offer draft legislation which incorporates these changes.

AGENCY COMMENTS AND OUR EVALUATION

We sent a draft of this report to the Departments of State and Defense for comments. In a letter dated January 30, 1984, the Department of State stated it had no comment on the draft report. In a letter dated February 8, 1984, DOD commented on the draft which contained a significantly more detailed presentation of the issues. Because DOD's comments covered examples and other material which were deleted to simplify the report, we have not included their written comments in this report.

With regard to matters presented for congressional consideration, DOD generally endorsed them. However, the draft report did not specify that the use of sales proceeds in the year of sale would remain subject to appropriation act limitations. Also, the need for congressional action to authorize purchase of advanced systems did not surface until DOD attempted to include replacement-in-kind procurements in the fiscal year 1984 procurement plan. Subsequently, DOD officials confirmed that they continue to support the need for 3-year obligation authority, the need to use sales proceeds in the year of the sale, and the need to purchase advanced systems not releasable to foreign countries.

OBJECTIVES, SCOPE, AND METHODOLOGY

We examined all SDAF procurements for fiscal years 1982 and 1983. We also examined whether the legislation establishing SDAF and DSAA management practices provides a basis for SDAF to operate effectively. We conducted the review at the Departments of Defense, Army, Navy, Air Force, and State in Washington, D.C.

Fieldwork was conducted at the Security Assistance Accounting Center, Denver, Colorado; Tank and Automotive Command, Warren, Michigan; Communications and Electronics Command, Fort Monmouth, New Jersey; Armaments, Munitions, and Chemical Command, Rock Island, Illinois; Missile Command, Redstone Arsenal, Alabama; and Systems Contracting Division, Eglin Air Force Base, Florida, where we examined actions taken to procure military equipment for SDAF, annual reports to the Congress, and DSAA annual procurement plans. Our review was performed in accordance with generally accepted government audit standards.

We are sending copies of this report to the Chairman, Senate Committee on Appropriations; Senate Committee on Foreign Affairs; House Committee on Government Operations; Senate Committee on Governmental Affairs; the Director, Office of Management and Budget; the Secretaries of State and Defense; the Director, Defense Security Assistance Agency; and other interested parties.

Sincerely yours,

A handwritten signature in cursive script that reads "Frank C. Conahan". The signature is written in dark ink and is positioned above the printed name and title.

Frank C. Conahan
Director

STATUS OF DELIVERIES, DIVERSIONS, AND WITHDRAWALS
FOR ITEMS INCLUDED IN SDAF PROCUREMENTS^a

Item	Category	Fiscal Year					Deliveries scheduled for 1984 and beyond
		1977-79	1980	1981	1982	1983	
M60A3 Tanks	Customer:						
	FMS	-	-	173	413	100	402
	U.S. Services	469	799	130	124	163	
	SDAF	-	-	-	-	-	54
	Withdrawals/ Diversions:						
	Withdrawals	-	-	-	-	-	-
	Diversion	-	5	128	20	-	-
I-TOW Missile	Customer:						
	FMS	-	-	1634	115	3349	7000
	U.S. Services	-	-	3000	8000	6471	-
	SDAF	-	-	-	-	-	1200
	Withdrawals/ Diversions:						
	Withdrawals	-	-	-	-	-	-
	Diversions	-	-	-	115	595	-
M198 Howitzer	Customer:						
	FMS				12	46	229
	U.S. Services	18	4	23	165	166	48
	SDAF	-	-	-	-	-	54
	Withdrawals/ Diversions:						
	Withdrawals	-	-	-	-	-	-
	Diversions	-	-	-	-	32	-
Stinger Missile	Customers:						
	FMS	-	-	5	86	10	5247
	U.S. Services	-	33	615	2123	2648	
	SDAF	-	-	-	-	-	600
	Withdrawals/ Diversions:						
	Withdrawals	-	-	-	18	-	-
	Diversions	-	-	-	86	10	32

^aWithdrawals are the quantities sold to foreign countries from U.S. service stocks. Diversions are quantities scheduled for delivery to the U.S. military services but sold instead to foreign customers. Quantities shown were furnished by the military departments.

<u>Item</u>	<u>Category</u>	<u>Fiscal Year</u>					<u>Deliveries scheduled for 1984 and beyond</u>
		<u>1977-79</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	
AN/VRC-	<u>Customer:</u>						
12 Radio	FMS	4093	460	266	429	888	2733
	U.S. Services	396	-	-	2200	693	-
	SDAF	-	-	-	-	-	1744
	<u>Withdrawals/ Diversions:</u>						
	Withdrawals	-	-	-	-	82	-
	Diversions	772	160	10	100	119	-
PRC-77	<u>Customer:</u>						
	FMS	5095	357	450	201	670	5244
	U.S. Services	-	-	-	614	750	-
	SDAF	-	-	-	-	-	2210
	<u>Withdrawals/ Diversions:</u>						
	Withdrawals	-	-	-	-	350	-
	Diversions	458	867	236	135	834	-
SRBOC CHAFF	<u>Customer:</u>						
	FMS	-	-	-	384	1201	7368
	U.S. Services	1275	800	792	6114	5278	-
	SDAF	-	-	-	-	-	3000
	<u>Withdrawals/ Diversions:</u>						
	Withdrawals	-	-	-	1200	-	-
	Diversions	-	-	-	800	-	-
MK-15 Phalanx	<u>Customer:</u>						
	FMS	-	7	9	6	12	46
	U.S. Services	-	18	43	61	63	425
	SDAF	-	-	-	-	-	4
	<u>Withdrawals/ Diversions:</u>						
	Withdrawals	-	-	-	-	-	-
	Diversions	-	-	-	5	-	-
GPU-5A Gun Pods	<u>Customers:</u>						
	FMS	-	-	-	-	1	8
	U.S. Services	-	-	-	-	45	255
	SDAF	-	-	-	-	-	20

Item	Category	Fiscal Year					Deliveries scheduled for 1984 and beyond
		1977-79	1980	1981	1982	1983	
	<u>Withdrawals/ Diversion:</u>						
	Withdrawals	-	-	-	-	-	-
	Diversion	-	-	-	-	1	-
AGM-65A	<u>Customer:</u>						
Maverick	FMS	5650	-	11	1047	2521	1015
Missile	U.S. Services	4002	-	-	-	-	-
	SDAF	-	-	-	-	-	120
	<u>Withdrawals/ Diversion:</u>						
	Withdrawals	-	-	-	-	-	-
	Diversion	12	-	-	-	-	-
AN/TPS-70	<u>Customer:</u>						
Radar ^b	FMS	-	-	-	-	-	-
	U.S. Services	59	-	-	-	6	-
	SDAF	-	-	-	-	-	2
	<u>Withdrawals/ Diversion:</u>						
	Withdrawals	-	-	-	-	-	-
	Diversion	-	-	-	1	-	-

^bRadar model AN/TPS-43 is the version used by the U.S. military services.

SDAF FISCAL YEAR 1984
SALES AND PAYBACKS

<u>Type of activity</u>	<u>Defense article</u>	<u>Number of sales cases</u>	<u>Quantity</u>	<u>Amount</u>
Sale	M-198 Howitzer	1	6	\$ 2,209,230
Sale	An/PRC 77 Radios	2	825	799,977
Sale	CIWS Mark 15 PHALANX	1	4	13,226,956
Sale	I-TOW Missiles	1	1,200	6,493,979
Sale	Stinger training sets	1	2	70,434
Sale	Ammunition 155MM			
	Mix with components	2	20,800	2,726,195
Payback ^a	Ammunition 5.56 MM	N/A	9.5 million	600,000
Payback	Stinger missile systems	N/A	400	<u>28,900,000</u>
				<u>\$55,026,771</u>

^aPayback occurs when an item is supplied from U.S. service stocks to a foreign customer and SDAF items are sent from the contractor to U.S. services to replenish their inventories.

Draft Legislation To Amend the Arms Export
Control Act and To Allow for 3-Year Obligation Authority
and Authority To Use SDAF Sales Proceeds in Year of Sale

To allow SDAF to use sales proceeds in the year of the sale and to allow Fund monies generally to be available for obligation for 3 years, section 51(c) of the Arms Export Control Act, as amended, 22 U.S.C. 2795(c), would have to be amended by striking out paragraph (2) and inserting in lieu thereof the following:

Amounts in the Fund shall be available for obligation for a period of three years in such amounts as are provided in advance in appropriation Acts.

The annual appropriations act would have to contain the following language:

There are authorized to be made available for the Special Defense Acquisition Fund \$_____ in addition to \$_____ derived from sales of Defense Articles and Defense Services in fiscal year____, to remain available for obligation during fiscal year____ and two succeeding fiscal years.

Legislative Amendment to Arms Export
Control Act to Allow SDAF to
Purchase Advanced Systems Not
Releasable to Foreign Countries

To allow SDAF to purchase advance systems not releasable to foreign countries, section 51(a)(1) of the Arms Export Control Act, 22 U.S.C. 2795(a), would be amended to read as follows:

"Sec. 51. Special Defense Acquisition Fund.
(a)(1) Under the direction of the President and in consultation with the Secretary of State, the Secretary of Defense shall establish a Special Defense Acquisition Fund (hereafter in this chapter referred to as the "Fund"), to be used as a revolving fund separate from other accounts under the control of the Department of Defense, to finance the acquisition of defense articles and defense services in anticipation of (A) their transfer, or (B) the replacement of defense articles that are anticipated to be transferred, pursuant to this Act, the Foreign Assistance Act of 1961, or as otherwise authorized by law, to eligible foreign countries and international organizations, and may acquire such articles and services with the funds in the Fund as he may determine. Acquisition under this chapter of items for which the initial issue quantity requirements for United States Armed Forces have not been fulfilled and are not under current procurement contract shall be emphasized when compatible with security assistance requirements for the transfer of such items."

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