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Status of DOD Efforts To Improve  
Accounting for Foreign Military Sales

Statement of  
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Before the  
Legislation and National Security Subcommittee  
Committee on Government Operations  
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to once again comment on the Department of Defense's (DOD) efforts to both improve Foreign Military Sales (FMS) accounting procedures and to resolve discrepancies in FMS accounting records. FMS accounting has been an area of long-standing interest to GAO. Over the past 16 years, we have issued over 50 reports on a variety of FMS accounting and cost recovery weaknesses, and we are anxious to see these deficiencies resolved. (Attachment I includes a selective listing, with brief summary statements, of GAO and DOD Inspector General reports that have been issued on the FMS program. These reports address the same issues that I am commenting on today.)

It was almost 1 year ago that I reported to this Subcommittee on Defense's long-standing lack of accounting control over FMS trust fund cash and related bills to customer countries.<sup>1</sup> Unfortunately, the improvements predicted by Defense and supported by us at that hearing have not been realized. As a result, central FMS accounting records continue to be inadequately controlled. After more than 10 years of improvement efforts by DOD, we see no good excuse for the current state of FMS accounting.

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<sup>1</sup>"DOD's Financial Management of the Foreign Military Sales Program," Statement of Frederick D. Wolf, Director, Accounting and Financial Management Division (GAO/T-AFMD-87-12, June 4, 1987).

Last June, I testified that centralized summary FMS accounting and billing records indicated that DOD had spent hundreds of millions of dollars more than the value of goods and services it has reportedly delivered and billed to customer countries and that, due to continuing deficiencies in accounting and internal controls, differences in these records could not be reconciled. Further, I reported that if DOD could not resolve these discrepancies and adequately account for all disbursements of customer advance deposits, our government would face the possibility of eventually refunding substantial sums at the taxpayers' expense. At this same hearing, the DOD Comptroller testified on the Department's FMS Financial Management Improvement Program, which he said was expected to result in the implementation of a new central FMS accounting system by the end of 1987.

We believe that, until a system of improved controls is implemented, DOD cannot be sure that

- customer funds are being spent only to pay costs attributable to the execution of FMS cases,
  
- all costs are being properly billed to the correct customer, or

-- cases are being financed in compliance with advance deposit requirements of the Arms Export Control Act of 1976, as amended.

Since last June's hearing, DOD's efforts to implement the new system have encountered serious difficulties resulting primarily from continuing changes in system design. These changes have necessitated both extensive modification of already completed computer programs and the development of new programs. This situation has been aggravated by top management's apparent failure to recognize system implementation problems and to adjust its milestones accordingly. Efforts to meet overly-optimistic milestones led to inappropriate shortcuts in system testing and a failed attempt to begin operating the new system before it was ready.

As a result of these difficulties, DOD's new FMS accounting system is now undergoing extensive additional testing. A new implementation date has not yet been set. Since the new system's improved controls over the accuracy and timeliness of FMS data have not been implemented, the Department has neither gained central control over current FMS accounting transactions, nor has it precisely identified and isolated discrepancies resulting from past transactions. As of December 31, 1987, unreconciled differences between amounts spent from the FMS trust fund and amounts billed to customers totalled just over \$1 billion. When

the unreconcilable differences for individual countries are netted, they result in a program-wide unreconciled difference of \$229 million, indicating that, as of December 31, 1987, our government had spent at least \$229 million more than could be accounted for in reported performance. The net difference may even understate the problems, since it is unlikely that all individual country errors would offset each other when resolved.

Despite the problems encountered to date, we believe it is imperative that DOD managers persevere in their attempts to bring the financial management of this large and complicated program under firm accounting control. Years of operating with inadequate controls cannot be remedied overnight, and it will take a sustained effort to implement an effective system and to investigate and resolve the discrepancies that currently exist in FMS records. For this reason, management commitment must continue throughout 1988 and into the succeeding administration. Only through such continuity of efforts can comprehensive improvements be achieved and maintained.

#### OVERVIEW OF THE FMS PROGRAM

A brief description of the FMS program is helpful in understanding the problems that DOD is trying to resolve. The Arms Export Control Act of 1976 gives DOD authority to sell

defense articles (such as aircraft and tanks) and services (such as training) to foreign countries, generally at no gain or loss to our government. The act generally requires foreign customers to pay, in advance, amounts sufficient to cover current expenditures associated with their sales agreements. Our Department of the Treasury holds these funds in trust. DOD then uses these moneys to pay private contractors and to reimburse DOD activities for the costs of executing and administering FMS agreements.

According to DOD records, since the 1950's, foreign countries have signed agreements initiating over 87,000 FMS cases and construction sales agreements valued at over \$180 billion. The program grew dramatically during the late 1970's and early 1980's and peaked in fiscal year 1982, with new orders of \$18 billion. The volume of new orders has since steadily declined to a level of just over \$7 billion in fiscal year 1987. As of September 30, 1987, there were about 16,600 open FMS cases valued at about \$142 billion, and the remaining value of undelivered goods and services was approximately \$54 billion.

Accounting for foreign military sales is a DOD-wide responsibility, and, therefore, requires cooperation among a variety of activities. Thirteen DOD agencies and, to a lesser extent, the Department of State are involved in the implementation of FMS agreements. Sales cases are executed

primarily by the Army, Navy, and Air Force, while the overall responsibility for administering the program lies with the Defense Security Assistance Agency (DSAA). The agencies that execute cases are responsible for developing cost estimates and payment schedules, managing individual cases, and reporting related accounting data, such as performance and disbursements of cash, to DSAA's Security Assistance Accounting Center (SAAC) in Denver, Colorado. Therefore, SAAC is dependent on the military services to provide complete and accurate data on a timely basis. SAAC is responsible for collecting and centrally accounting for customer countries' funds and providing them with periodic statements that summarize amounts charged for performance related to their sales cases. Performance includes deliveries of materiel, performance of services, progress payments on as-yet-undelivered items, and administrative costs. Each statement also includes payment schedules indicating amounts due and payable to SAAC in the coming quarters.

To ensure that each country has sufficient funds available to cover upcoming disbursements, SAAC monitors each country's trust fund cash balance and, upon request, issues specific authority to the implementing agencies allowing them to disburse FMS customers' funds. Subsequently, the implementing agencies report to SAAC on the actual disbursements they have made so that SAAC can adjust each country's trust fund balance. In order for SAAC to maintain accurate trust fund balances, disbursement

reports from implementing activities must be accurate, on time, and properly detailed.

#### LACK OF CONTROL OVER TRUST FUND BALANCES

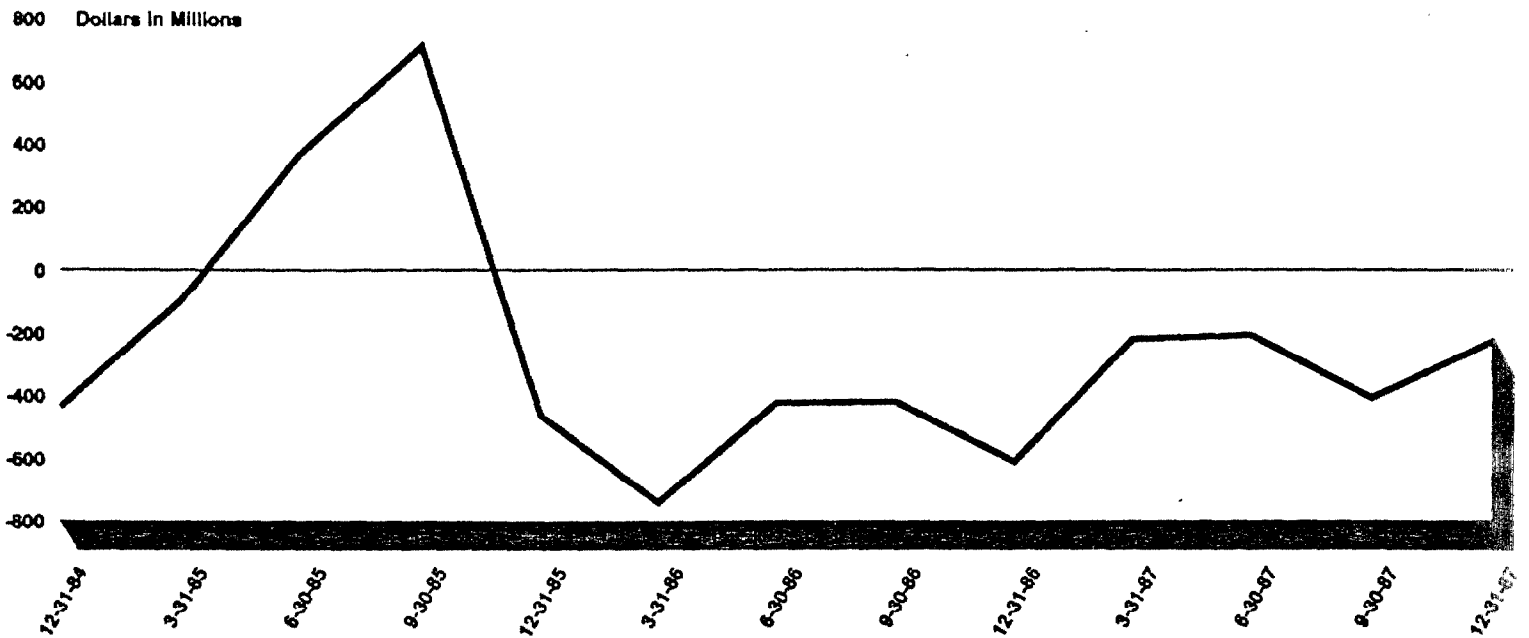
As I testified in June 1987, major accounting and internal control weaknesses are impairing DOD's ability to properly manage and control the FMS trust fund. Controls to ensure that records are accurate, complete, and up-to-date should be in place at all activities involved in FMS accounting. The service activities must adhere to FMS accounting policies and ensure that transactions are properly authorized, executed, and recorded. At the same time, SAAC must be able to control and consolidate data submitted by the services and ensure that errors and omissions are quickly detected and corrected. However, years of inconsistent recordkeeping and inadequate controls over the flow of data between the military services and SAAC continue to result in imbalances and discrepancies that sometimes cannot be easily identified and resolved.

An indication of the magnitude of FMS accounting problems is SAAC's inability to reconcile differences between amounts that have been spent from the FMS trust fund and the value of performance that has been reported to customers. Such reconciliations have been attempted on a quarterly basis since 1983 and have resulted in dramatically fluctuating net



unreconcilable differences of hundreds of millions of dollars. Although the unreconcilable difference for the total FMS program has stabilized somewhat in recent years, it has continued to vary considerably during 1987, as figure 1 shows.

Figure 1: Net Unreconciled Differences Between Balances Based on Disbursements From the FMS Trust Fund and Balances Based on Reported Performance



Positive values represent reported performance balances which exceed disbursements from the FMS trust fund.

Negative values represent disbursements from the FMS trust fund which exceed reported performance balances.

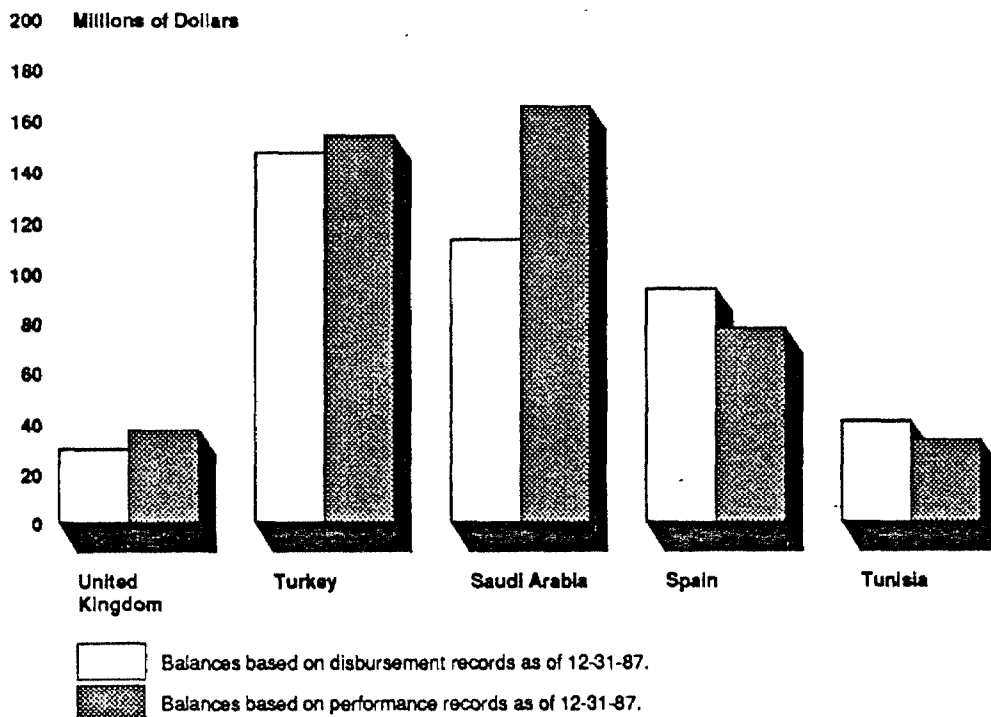
The magnitude of the problem appears even greater when unreconcilable differences are examined on an individual customer country basis, because for some countries, disbursements exceed performance, and for others, performance exceeds disbursements. When unreconcilable differences for individual countries are totalled rather than netted, the amount totals \$1.03 billion as of December 31, 1987. Since experience has shown that some errors offset each other and others do not, the real level of discrepancies that must be addressed probably lies somewhere between the net figure and the gross total.

Figure 2 further illustrates the problem for five customer countries by comparing December 31, 1987, trust fund balances according to SAAC's trust fund records with trust fund balances according to SAAC's performance, or billing records. For the United Kingdom, Turkey, and Saudi Arabia, SAAC's records of performance, which are reported quarterly to customers, indicate a greater trust fund balance than do SAAC's records of trust fund balances that are based on actual disbursements. This indicates that our government has spent more than can be accounted for in deliveries and services provided. If all disbursements are not eventually accounted for, our government could potentially have to make refunds either in cash or additional weapons or services.

For Spain and Tunisia, SAAC's records indicate that the values of goods and services provided exceed the amounts charged

to the countries' trust fund accounts. For these countries, our government could be spending appropriated funds without timely reimbursement from the trust fund, thereby resulting in SAAC's records of trust fund cash being overstated - a situation that could lead to authorizing expenditures for which trust fund cash is not available.

Figure 2: Comparison of Trust Fund Balances



The performance, or billing, records have been adjusted for known reconciling items, such as an allowance for delays in SAAC's receipt of performance reports from the military services.

The cause of the remaining imbalance, or unreconcilable difference, has not been determined. As of December 31, 1987, the unreconcilable differences were \$7.9 million for the United Kingdom, \$52.7 million for Saudi Arabia, and \$6.7 million for Turkey, indicating that for these countries, Defense has spent more from the trust fund than could be accounted for in performance. The unreconcilable differences were \$15.9 million for Spain and \$7.7 million for Tunisia, indicating that for these countries, Defense had provided weapons or services worth more than the amount that had been deducted from their trust fund accounts.

The specific causes of the unreconcilable differences described above cannot be readily determined. However, they could have been caused either by recent erroneous transactions or by errors and inconsistencies that originated years ago. New errors continue to occur and go undetected because controls over the entry and flow of data between the services and SAAC are still inadequate. Some of these errors may not be significant on an individual basis, but taken as a whole, they indicate control weaknesses that may have allowed mistakes to go undetected and uncorrected for years. The following examples illustrate this point.

- As of December 31, 1987, SAAC records indicated that a total of \$246 million had been disbursed from the FMS trust fund, with no record showing which countries' funds had been spent.
  
- A \$22 million performance report transmitted in March 1987 by Navy to SAAC was unaccountably lost in transit. As a result, the April 1987 statement to the customer country, Canada, did not reflect the \$22 million charge for goods delivered. The Navy began its investigation of the case in April 1987, after the customer country questioned the accuracy of its April statement. The Navy submitted an adjusting transaction that, according to a February 1988 report of SAAC's records, has corrected the problem.
  
- During 1987, a series of errors resulting from inadequate controls over the accuracy of data transmitted from the Air Force to SAAC led to misstatements of \$732,000 in SAAC's records of performance and trust fund balance both for a NATO agency and for Morocco. Although the errors were identified and corrected within a few months after they occurred, they contributed to the unreconcilable differences that existed as of June 30, 1987, for both NATO and Morocco. A SAAC official told us that he was alerted to the errors by chance when he noticed that a

reported disbursement was unusually large for the relatively small NATO agency program. Because no controls have been in effect to routinely detect such errors, he said that it is likely that similar mistakes have occurred in the past without being identified. He added that transactions involving several million dollars are not unusual for customers with large FMS programs and that erroneous transactions of this size could easily go undetected.

-- Army officials suspect that, prior to September 1986, an undetermined number of performance reports transmitted from the Army to SAAC were either not received or not recorded by SAAC. In September 1986, noticing that all performance reports transmitted to SAAC were not being recorded in SAAC's records, the Army began comparing its listings of performance reports transmitted to SAAC with SAAC's monthly listings of performance reports received. For the period between September 1986 and September 1987, about 14,000 missing transactions were discovered and subsequently resubmitted by the Army. An official we talked with said that the transmission problem was corrected in October 1987. However, he is concerned that some missing performance reports have not been identified and corrected and that, as a result, related performance records at SAAC are incomplete.

Other discrepancies result from errors that were made years ago. For this reason, their resolution may require a significant research effort because supporting documentation is either difficult to locate or is no longer available. The following examples illustrate such problems.

-- The Navy is currently in the process of reconstructing approximately \$50 million in performance records related to a 1974 purchase of aircraft by Greece. According to Navy officials, the records were lost when the Navy's major FMS accounting and logistics activity relocated in 1977. As a result, the related performance was apparently not reported to SAAC and, therefore, never reported by SAAC to Greece. According to Navy officials, the case, which was initiated in 1974, was fully delivered in the late 1970's, but related records had not been investigated and brought up to date. In January 1986, prompted by Greece's desire to close the case, the Navy began its current effort to reconstruct and submit the needed performance reports. After spending two years researching available records related to the case, Navy personnel say that they were able to document the missing performance reports. This data has since been reported to SAAC, and the Navy expects to close the case this year.

-- The Air Force recently researched and resolved a \$103.3 million discrepancy that had resulted in out-of-balance records for a Saudi Arabian case since 1984. After investigating several possibilities, Air Force personnel discovered that the problem occurred when SAAC's system rejected a performance report submitted by the Air Force sometime between October 1983 and March 1984. Since the report was to have adjusted a previous overbilling to Saudi Arabia, its rejection allowed \$103.3 million in excess performance to remain on SAAC's records for that country. To correct the error, the Air Force submitted an adjusting transaction to SAAC in February 1988.

-- Due to shifts in accounting responsibilities prior to 1981, the Army does not have detailed records of disbursements made before October 1981. As a result, Army's case-level disbursement records are incomplete for the 1156 currently open Army cases that were initiated prior to October 1981, making a complete reconciliation of disbursements to performance for those cases difficult, if not impossible.

DOD is aware of its long-standing FMS accounting problems and has reported FMS deficiencies in its reports to the President and the Congress, as required by the Federal Managers' Financial



Integrity Act of 1982 (31 U.S.C. 3512(b) and (c)). Since 1984, in response to section 4 of the act, the Department has included SAAC's central FMS system in its list of DOD accounting systems that do not conform to the Comptroller General's accounting principles, standards, and related requirements. In its 1987 report, the Department also reported as a material weakness its inability to reconcile \$600 million (the approximate unreconciled difference as of December 31, 1986) in disbursements of cash advances from customer countries with specific performance. Reports of material weaknesses in agency internal controls are required by section 2 of the act.

#### CORRECTIVE ACTIONS DELAYED

Since the 1970's, DOD has taken various steps to improve FMS accounting, with limited success. (These efforts and related events are listed in attachment II.) The current effort began in 1982 with the establishment of the FMS Financial Management Improvement Program (FFMIP). In accordance with recommendations resulting from a year-long analysis of recognized FMS accounting problems, SAAC and the military services, under the direction of the FFMIP, have attempted to design a new central FMS accounting system and four interfacing systems, which are to control the transmission and updating of FMS data so that newly occurring errors can be detected and corrected on a timely basis. The new central system is to be operated by SAAC. The interfacing

systems will be operated by the services and are to consolidate and transmit data to SAAC in a format that can be accepted by SAAC's new system.

Central system implementation, which was originally scheduled for October 1986, has been delayed repeatedly. At last June's hearing, the DOD Comptroller admitted that the Department had underestimated the complexities of the multiple systems that support the FMS programs and that the Department now expected implementation later in 1987.

Unfortunately, DOD's attempts to start the new system in 1987 failed, and implementation within the near future appears unlikely. DOD's attempt to begin operating the system last May was unsuccessful, and, in subsequent testing, SAAC personnel have discovered problems in the over 400 computer programs needed for initial implementation. These problems prevent system modules from processing transactions as they should. In the meantime, the services have continued to develop their interfacing systems. However, the success of the service systems cannot be measured until their ability to interface with the central system can be tested. This cannot be accomplished until the central system is operating properly. Army and Air Force officials say they are ready to begin interface testing as soon as the central system is ready. The Navy's interfacing system is still under development and is scheduled to be ready for interface testing in late 1988.

After extensive discussions with personnel involved in the system development effort throughout DOD and examination of related documentation, we have determined that a primary cause of the delay in implementing FMS accounting system improvements has been the continuing changes to system requirements. Ideally, system requirements, which detail how the system will operate, and specific expectations for all organizations involved should be agreed upon early in the system design process. Changes to system requirements after detailed design and development have begun are likely to result in delays because programmers may need to redo completed programs in order to comply with the new requirements.

A series of changes to the central system design and to requirements for the interfacing service systems have been directed since DOD's Major Automated Information Systems Review Council approved the system design in February 1986. These include

- changing the transmission and processing of data between SAAC and the service systems from an interactive environment (processing individual transactions on a continuing basis) to a batch environment (processing a group of transactions at one time);

-- adding procedures for implementing a new logistics support charge; and

-- changing data element definitions, formats, and codes.

The FFMIP office has yet to finalize an additional group of changes and expects to issue them in draft form in mid-April. The changes expected to be included in this last group were formally documented and distributed to SAAC and the services in November 1987. However, because of misunderstandings as to what the changes entail, the project office is still working to clarify them, and the services say that they have postponed their attempts to comply until a final requirements document is issued.

Some changes to system design during the development phase should be expected, and, based on estimates from the contractor developing the system, SAAC officials told us that they originally anticipated a growth and change factor of about 17 percent in the 366 computer programs then planned for the central system. However, the changes mentioned above and other modifications to detailed specifications resulted in an addition of 189 programs that will be required before a new system can replace SAAC's current FMS accounting system. This is a 50 percent increase. In addition, at least 28 percent of the new system's programs have been revised. Such additions and changes have resulted in delays as programs were written or modified and

retested. Project managers in the services also said that late changes in system specifications required them to modify completed programs and, thus, either devote additional resources to their system development effort or extend their own implementation milestones.

The difficulties in system development and implementation reached a critical stage last spring when system testing fell behind schedule and top managers failed to adjust milestones accordingly. The test plan issued by the FMS Financial Management Improvement Program office in December 1986 called for four stages of testing to be completed prior to the start of an initial system operation test period, which was at that time scheduled to begin on January 31, 1987. The four stages included tests of

- individual systems at SAAC and each of the services,
- data transmission capabilities among SAAC and the services,
- interfaces and compatibilities between SAAC and the services, and
- the processing of transactions between the service systems and the central system ("integration testing").

These tests were not completed by January 31, as planned, and continued into the subsequent months. At the same time, repeated attempts were made to convert data to the new system's format and load it onto the new data base. Service and SAAC personnel involved in these activities said that, because so many test activities were being conducted concurrently, it was difficult to identify the cause of specific problems. In addition, service personnel said that feedback on test transactions submitted to SAAC was slow or nonexistent and that some tests were terminated before problems were clearly identified and resolved. One service official told us that he considered the interface testing conducted last spring to be of no benefit since it did not result in the precise identification or correction of systems problems. He said that, as a result, all interface testing for his service's system would have to be repeated.

In May, in an apparent attempt to meet ambitious milestones, SAAC, under the direction of the FFMIP office, attempted to proceed with initial system operation even though problems encountered during testing had not been resolved. Project managers say that they had planned to complete testing during the early months of operation while the new system and the old system processed transactions in a parallel mode. However, conversion to the new system was never successfully completed,

and by August it had become apparent that the initial operations could not proceed without additional testing and modification of computer programs.

It is unclear why system testing and attempted implementation were allowed to proceed as they did. In December 1986, the Major Automated Information Systems Review Council recognized that the test and implementation schedule was "very aggressive," but nevertheless, the council approved plans to begin initial system operation on a test basis in January. SAAC officials contend that the pressure to implement a new system was so great that higher officials insisted on implementation according to schedule. When we talked with the FFMIP Director last April regarding the wisdom of pushing ahead at such an accelerated pace, he told us that he felt it was important to maintain the project's momentum and that revised milestones could result in even further delays. Whatever their motives, those in control apparently neither understood nor adequately communicated the severity of the problems being encountered and their effect on testing progress. This lack of communication apparently resulted in overly optimistic predictions of success and an apparent failure of top officials to fully comprehend the systems' status.

In August, realizing that the FMS accounting system development project was in trouble, the DOD Comptroller appointed

DOD's Director of Accounting Policy as the new FFMIP Project Director. In October 1987, the Project Director was again changed when the Comptroller assigned the Principal Assistant to the Deputy Assistant Secretary (Management Systems) to the position. At the same time, staff support in the FFMIP office was increased from 3 to 10 people. While indicating the Comptroller's concern and desire for strengthened project management, these changes appear to have temporarily stalled progress as new managers and staff studied the situation and decided on the best way to proceed. In addition, management changes resulted in some confusion and an almost total lack of guidance on how to proceed with system testing and implementation between August 1987 and late January 1988, according to SAAC and service officials.

During August and September, SAAC, in the absence of FFMIP guidance, independently began a methodical, but time-consuming, test effort, which is still underway. SAAC personnel involved in testing have been increased from about 12 to about 50. SAAC officials have developed and proposed a new test schedule that provides for 12 months of system testing and an additional 6 months of integration and conversion testing that would include the initial load of the new system. Based on these estimates, the new system would not be ready to begin operating until mid-1989.



SAAC's estimates appear reasonable if the current test procedures, which require extensive documentation, remain in place. SAAC's February 26 status report shows that testing is underway for 33 of the 107 groups of programs, referred to as "strings," needed to begin initial operations. Testing has been completed for one string. Another report used to monitor SAAC's testing progress shows that between September 1987, when the current test effort began, and February 25, 1988, SAAC had identified about 550 specific computer program problems. Each of these problems either has been or is to be corrected and the related program retested. The report indicates that, as of February 25, 171 of these identified program problems remained to be corrected and that 134 of the 171 had to be corrected before the new system could begin operating.

Each of the two FFMIP directors that have been appointed since last August have raised concerns regarding the feasibility of implementing the new accounting systems in a reasonable amount of time and regarding the ability of these systems to provide the accounting control envisioned in the approved system design. Unresolved concerns include the ability of the services, especially the Army, to provide complete and accurate disbursement data for the initial load of the new system and the feasibility of operating and maintaining system software that has grown to more than twice the size originally anticipated. The current FFMIP Director told us that his major concern at this

point is DOD's ability to develop a management plan that will provide for adequate control and direction of this complicated departmentwide effort. To address these and other concerns, he told us that he was considering contracting for an independent technical review of both the central system and the interfacing service systems. However, as of mid-March, a decision to proceed with such a review had not been made.

Delays Result in  
Additional Costs

As would be expected, the changes in functional requirements and delays in system testing and implementation have increased the cost of the new systems. As of December 1986, the total cost of the central system and the interfacing service systems was estimated to be \$44.5 million. As of December 1987, the total estimated cost had increased by \$30.8 million to \$75.3 million. Of this amount, \$40.8 million had been obligated as of September 30, 1987. The increase is due primarily to the cost of continued systems development and an increased level of effort by the FFMIP office.

All of these costs are to be paid from the FMS administrative fund, which can ill afford the increased expense. The fund, which is financed by a surcharge on the price of FMS sales, was established to enable DOD to recover the

administrative expenses of administering the FMS program. The DOD Inspector General analyzed FMS records as of September 1986 and reported in June 1987<sup>2</sup> that administrative revenues would not be sufficient to fund the projected administrative expenses cases in progress. The projected shortage, based on data provided by DSAA, was significant: unencumbered, uncollected revenues were projected to be \$409 million less than the \$717 million needed to pay projected expenses of administering the \$48 billion in undelivered orders that existed in September 1986. To address this problem, DSAA has revised pricing guidance to include a new charge for logistics support cases and asked the services to reduce their FMS administrative expenses. We have not analyzed the effect of the new charge on the administrative fund balance.

EFFORTS TO RESOLVE DISCREPANCIES  
ARE RESOURCE-INTENSIVE

In addition to trying to develop a new system to control current FMS transactions, DSAA and the services have recently undertaken a department-wide effort to specifically identify, research, and resolve FMS accounting imbalances for all active FMS cases. Originally, DOD did not plan a broad investigation of discrepancies in FMS records until such discrepancies could be more precisely identified through more detailed and better

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<sup>2</sup>Review of the Foreign Military Sales Administrative Account  
(Office of the Inspector General, Department of Defense No. 87-181, June 24, 1987).

controlled records, which the new system was expected to provide. By keeping more detailed records and by better controlling the flow of data from the services to SAAC, the new system is to provide managers a more accurate picture of the magnitude of existing discrepancies at the individual FMS case level. This would allow them to devote resources to the largest problems first and to more narrowly focus investigative efforts. However, realizing that implementation of the new system was not imminent, the DOD Comptroller, in January 1988, directed DSAA to "undertake an immediate effort to accomplish a case-by-case reconciliation of trust fund disbursements to performance." By mid-March, DSAA and service representatives had developed preliminary plans for performing reconciliations, but were still in the process of estimating milestones and needed resources.

If previous efforts are an indicator, DOD's reconciliation efforts will be expensive. Because each of SAAC's country-level trust fund balances is the cumulative result of years of largely uncontrolled accounting activity (which for some countries involves hundreds of cases), it is often impossible to identify and resolve specific errors without an inordinate amount of investigation and research. The problem is compounded when errors occurred years ago and related documentation is no longer readily available. Officials at DOD activities have identified some errors that originated in the 1970's and suspect that others also originated during that time. For example, during 1987, DSAA

enlisted the help of the DOD IG to resolve what appeared to be excess disbursements related to four FMS cases for India. According to the auditor in charge, at least some of these discrepancies originated in 1977. DOD IG has investigated the situation and, according to DSAA officials, has resolved most of the discrepancy. A DOD IG report on this investigation is expected soon. An additional example of a discrepancy that originated in the 1970's but was only recently resolved is the \$50 million in missing performance reports for Greece, which I described earlier.

In addition to the newly initiated case-level reconciliation efforts, SAAC is attempting to better define the reconciliation problem by refining its quarterly reconciliations. SAAC hopes to accomplish this by better estimating processing delays and by taking into consideration errors discovered and corrected by the services on a more timely basis. This will require the services to cooperate more closely with SAAC in identifying and communicating information on errors that they discover and correct and in estimating the volume of transactions in transit to SAAC. The December 31, 1987, reconciliation was the first to include input that had not previously been provided to SAAC by the services.

Further, as I reported last June, DOD has established a Case Reconciliation and Closure Board to centrally review and resolve

individual cases whose records contain discrepancies that cannot be handled by the military services. As of March 1, 1988, no cases had been reviewed by the Board.

REEXAMINATION OF COMMITMENT IS NEEDED

Not being able to account for hundreds of millions of dollars in FMS expenditures is a serious weakness in management control and could diminish customer countries' confidence in the FMS program. Until Defense straightens out financial records related to the sensitive area of arms sales, there will be questions about the legality, propriety, and accuracy of these transactions. After more than ten years of effort, any reasonable observer cannot help but question why it is taking the Department so long to correct the problem.

Last year I made four suggestions, which I believe are still valid if DOD is to succeed in implementing new FMS accounting procedures that impose adequate control over future FMS accounting transactions.

First, DSAA and the services must continue to work together to fully implement systems that will bring improved accounting control over FMS records. Without suggesting that the current system development effort be abandoned, I think that DSAA, the Comptroller's office, and the services should all reevaluate the

current problems, identify the fundamental difficulties in the way the FMS program is operated and accounted for, and determine what improvements can realistically be accomplished. Then, DOD should persistently move to implement corrective actions within realistic timeframes. To this I would like to add the need for continuity in the strength and direction of project management and the need for strong control over system design changes.

Second, I would like to reemphasize the importance of controls to ensure the accuracy and timeliness of data originated by service-level systems that execute and record transactions and transmit this data to SAAC.

Third, adjustments to and final resolution of existing imbalances must be carefully controlled and documented. This is especially important in light of DOD's recent initiation of a large-scale reconciliation effort. In conjunction with this effort, DOD should seriously consider establishing a new FMS trust fund to handle newly initiated cases. This was recommended by DOD's internal auditors in 1982. Such a move would isolate past activity, including errors associated with that activity, and could make it easier to audit future transactions.

Fourth, DOD must ensure on a continuing basis that corrective actions taken are effective. As the Department plans its strategy for continuing the FFMIP effort, consideration

should be given to instituting periodic audits of FMS trust fund balances by independent auditors in order to measure the Department's progress in reducing existing discrepancies and ensuring that new ones are not created.

These efforts will not be easy. They will require people who are resourceful and honest about what can and cannot be done. In addition, they will require a concerted effort by career civil servants to maintain continuity through the coming change of administration. Only with such commitment and persistence will DOD be able to produce a satisfactory FMS accounting system.

Mr. Chairman, this concludes my formal remarks. I would be pleased to respond to any questions you or members of the Subcommittee may have at this time.



GAO AND DOD AUDIT REPORTS ON FOREIGN MILITARY  
SALES TRUST FUND ACCOUNTING PROBLEMS

GAO REPORTS

1. Letter report on weaknesses in Defense's system for accounting, billing, and collecting for foreign military sales (FGMSD-77-46, September 16, 1977).

Due to accounting control weaknesses in its billing procedures, the Air Force could not be sure it was properly billing foreign governments for all costs related to their FMS orders.

2. Army Efforts to Restore Integrity to Its Financial Management System (FGMSD-78-28, April 27, 1978).

As of March 1978, Army officials had identified a net unreconcilable difference of \$2.4 million between Department of Treasury records of trust fund cash and the Army's records of trust fund cash.

3. Correct Balance of Navy's Foreign Military Sales Trust Fund Unknown (FGMSD-79-2, November 15, 1978).

As of June 1978, after more than a year and 3,000 staff days of effort, the Navy could not reconcile differences totaling \$163 million between records of trust fund cash and individual case records.

4. The Defense Department's Systems of Accounting for the Value of Foreign Military Sales Need Improvement (FGMSD-79-21, March 16, 1979).

GAO identified \$540 million in unreconciled differences between DOD's delivery records and accounting records.

5. Centralization: Best Long-Range Solution to Financial Management Problems of the Foreign Military Sales Program (FGMSD-79-33, May 17, 1979).

FMS accounting systems did not provide accurate or timely data, and SAAC was unable to ensure

that the correct country's trust fund had been charged for the items produced and delivered. GAO concluded that centralization of FMS accounting and disbursing would be a long-term solution to these problems.

6. Correct Balance of Defense's Foreign Military Sales Trust Fund Unknown (FGMSD-80-47, June 3, 1980).

Processing delays, incomplete data entries, nonstandard machine edit criteria, and errors related to closed cases complicated the reconciliation process and contributed to hundreds of millions of dollars in discrepancies between SAAC's disbursement and delivery records as of September 1979.

7. Better Accounting Needed for Foreign Countries' Deposits for Arms Purchases (AFMD-81-28, January 30, 1981).

Customers were not always promptly paying the amounts billed by SAAC. However, SAAC personnel were hesitant to pursue strict follow-up action for full payment because they could not be sure the bills were accurate since payment schedules were not revised when warranted.

8. Action Needed to Improve Timeliness of Army Billings for Sales to Foreign Countries (AFMD-81-61, April 30, 1981).

The Army did not report deliveries to SAAC at the time of shipment, which resulted in delayed billing to customers.

9. "DOD's Financial Management of the Foreign Military Sales Program" (GAO/T-AFMD-87-12, June 4, 1987).

Efforts to implement a central FMS accounting system and interfacing service systems have not yet been successful. As of December 31, 1986, an unreconcilable difference of \$613 million existed between records of trust fund disbursements and reported performance.

DOD REPORTS

1. Report on the Review of Accounting Procedures and Document Controls at the Security Assistance Accounting Center (Defense Audit Service No. 79-053, February 28, 1979).

DOD auditors reported that FMS customers were paying about one-half of the requested payment schedule amounts due because payment schedule estimates in many cases were inaccurate. Auditors also reported that SAAC's ability to serve as the central point of contact for FMS accounting and billing inquiries is impaired due to lack of control and maintenance of case files.

2. Report on Review of Foreign Military Sales Case Management (Defense Audit Service No. 80-129, September 2, 1980).

DOD auditors reported that payment schedules were not revised when actual financial requirements were significantly less or greater than initial estimates. Inaccurate payment schedules adversely affect foreign customers' budgeting decisions and goodwill toward the United States government.

3. Report on the Review of the Test of Centralized Accounting and Disbursing for Foreign Military Sales Direct Cite Procurement (Defense Audit Service No. 82-102, June 8, 1982).

DOD auditors noted inadequate accounting controls in the military services' FMS systems and recommended centralization of disbursement and delivery reporting.

4. Foreign Military Sales Trust Fund Management (Office of the Inspector General, Department of Defense No. 83-147, June 16, 1983).

DOD auditors unsuccessfully attempted to reconcile SAAC's records for seven countries as of September 30, 1981, identifying \$11 million in unreconciled differences. The resulting report stated that "many of the reconciliation problems relate to old foreign military sales cases. However, due to the condition of the FMS case

records, it is not possible to determine whether current transactions are creating new imbalances."

5. Cash Collections Into the Foreign Military Sales Trust Fund (Office of the Inspector General, Department of Defense No. 85-107, August 9, 1985).

SAAC's cash balances for individual countries were not accurate enough to ensure that the United States government was adequately protected in case of a foreign government's default.

6. Review of the Foreign Military Sales Administrative Account (Office of the Inspector General, Department of Defense No. 87-181, June 24, 1987).

The FMS administrative fund was insufficient to pay administrative expenses associated with existing FMS sales cases.

EVENTS LEADING TO DOD'S CURRENT EFFORTS TO IMPROVE  
FOREIGN MILITARY SALES ACCOUNTING

Prior to 1976	FMS accounting and billing was handled by individual services.
1976	Security Assistance Accounting Center is established to centrally account for FMS trust fund, bill customers, and collect their deposits.
1978	GAO reports that FMS trust fund balance for Navy is unknown.
1979	GAO recommends increased centralization as long-range solution to FMS financial management problems.
1980	Defense Integrated Financial Management System is implemented as SAAC's centralized accounting and billing system.
1980 and 81	DOD tests centralized accounting and disbursing.
1980 and 82	House Appropriations Committee recommends improvements for financial management of FMS.
June 1982	Defense Audit Service concludes that centralized disbursing would not be practical and would disrupt the flow of disbursement data through DOD systems.
1982	DOD concludes that centralized accounting and disbursing would not be cost effective and would still require reliance on existing subordinate systems.
June 1982	Memorandum from Assistant Secretary of Defense sets forth seven minimal requirements for improved FMS accounting primarily aimed at improving timeliness and internal control.
November 1982	FMS Financial Management Improvement Project (FFMIP) is chartered.
December 1982	House Appropriations Committee directs DOD to implement nine actions to improve FMS financial management, including standardizing delivery

reporting, establishing a new trust fund account, continuing the development of service-level customer order control systems, and assigning case managers responsible for financial and logistical aspects of each case.

April 1983           FFMIP office becomes operational.

January 1984        FFMIP issues summary report on specific FMS accounting problems that must be addressed.

December 1984      Conceptual design for new systems is published.

August 1985        Conceptual design approved by DOD's Major Automated Systems Review Council.

Early 1986         Military services begin designing their interfacing systems.

February 1986      Detailed design for new system is approved by Major Automated Systems Review Council.

1986 to present    New systems development and testing is in progress.