United States General Accounting Office

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Report to the Secretary of Defense

May 2000

FOREIGN MILITARY SALES

Air Force Controls Over the FMS Program Need Improvement

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United States General Accounting Office
Washington, D.C. 20548

Accounting and Information Management Division

B-284676

May 3, 2000

The Honorable William S. Cohen
The Secretary of Defense

Dear Mr. Secretary:

Since October 1998, we have issued four reports on the results of our reviews of the Department of Defense's (DOD) accounting and reporting on the costs of the foreign military sales (FMS) program.[1] These reports identified internal control weaknesses that resulted in DOD's failure to properly charge foreign military sales customers for goods and services already received. In response to these reports, DOD has taken positive steps, including the collection of over $400 million from FMS trust fund accounts, to address our recommendations. This report presents the results of our review of the Air Force's accounting for the FMS program.

Results in Brief

The Air Force did not have adequate management controls over its foreign military sales program to ensure that foreign customer accounts were properly charged for goods and services. Specifically, the Air Force was not generating reports that would identify instances where customer accounts were not charged for goods and services received or where there were discrepancies between the recorded value of delivered goods and services and the corresponding value of charges to customer accounts. Without such reports, the Air Force could not readily ensure that FMS accounting records were accurate and that customer accounts were properly charged.

[1]The four reports are *Foreign Military Sales: Millions of Dollars of Nonrecurring Research and Development Costs Have Not Been Recovered* (GAO/AIMD-99-11, October 20, 1998), *Foreign Military Sales: Recovery of Nonrecurring Research, Development, and Production Costs* (GAO/AIMD-99-148R, May 19, 1999), *Foreign Military Sales: Navy's Accounting for Sales to Foreign Customers Needs Improvement* (GAO/AIMD-99-213, August 24, 1999), and *Foreign Military Sales: Efforts to Improve Administration Hampered by Insufficient Information* (GAO/NSIAD-00-37, November 22, 1999).

Our analysis of data contained in the Defense Finance and Accounting Service's Defense Integrated Financial System (DIFS)[2] as of July 1999, indicated that the Air Force might not have charged FMS customer trust fund accounts for $540 million of delivered goods and services. In performing a detailed review of $96.5 million of these transactions, we found that the Air Force was able to reconcile about $20.9 million. However, of the remaining $75.6 million, the Air Force had either

- failed to charge customer accounts ($5.1 million, 22 transactions);
- made errors, such as incorrectly estimating delivery prices ($44 million, 11 transactions); or
- could not explain differences between the recorded value of delivered goods and services and corresponding value of charges to customer accounts. ($26.5 million or 19 transactions).

The Air Force has since recognized that it must improve its controls over the FMS program and developed the capability to generate data necessary to help identify those instances where foreign customers' accounts have not been charged for goods and services received. However, according to responsible Air Force officials, the data are going to be made available only on an ad hoc basis, meaning that they will not be routinely available to the appropriate personnel for review, including managers, with the requirement that they use the information to ensure that customer accounts are being properly charged. Such steps are integral to ensuring the accuracy of FMS accounting and the prompt collection of funds owed. Our recommendations, therefore, focus on implementing these requirements as well as calling on the Air Force to review the transactions that were not included in our detailed review to make certain that customer accounts are properly charged.

In commenting on a draft of this report, DOD's Deputy Chief Financial Officer (CFO) generally agreed with our recommendations and stated that the Under Secretary of Defense (Comptroller) will request that the Air Force and Defense Finance and Accounting Service implement our recommendations.

[2]DIFS is the primary Defense Finance and Accounting Service's system used to consolidate delivery and disbursement data. It is used to account for and report on the status of DOD's foreign military sales programs to foreign customers.

Background

The Arms Export Control Act gives the President authority to sell defense articles and services to eligible foreign countries, generally at no cost to the U.S. government. While the Defense Security Cooperation Agency (DSCA) has overall responsibility for administering the FMS program, the Army, Navy, and Air Force generally execute the sales agreements—commonly referred to as sales cases.

Foreign military sales are made on an individual case basis. A foreign country representative initiates a case by sending a letter of request to DOD asking for information, such as the price and availability of goods, training, technical assistance, follow-on support, or other services. Once the customer decides to proceed with the purchase, DOD prepares a Letter of Offer and Acceptance (LOA) stating the terms of the sale for the items and services being provided. After the LOA is accepted, the FMS customer is generally required to pay, in advance, amounts necessary to cover costs associated with the services or items purchased from DOD. The Department of the Treasury holds these advance payments in an FMS trust fund.

DOD policy requires that FMS customer accounts be charged as goods and services are delivered to the FMS customer. If, for some reason, DOD fails to process the appropriate charges against the FMS trust fund accounts, amounts paid in advance to cover the costs of goods and services FMS customers receive could eventually be erroneously returned to the FMS customers.

Objective, Scope, and Methodology

Our objective was to determine whether the Air Force was properly charging FMS customer trust fund accounts for goods and services already provided. To determine the requirements and procedures for charging the FMS trust fund for goods and services, we reviewed applicable laws, regulations, policies, and procedures. To assess whether the Air Force was effectively following these requirements, we analyzed financial information from pertinent Air Force and Defense Finance and Accounting Service (DFAS) accounting records and reports.

Because Air Force systems did not produce reports to identify transactions for which FMS customers had not been charged for goods and services already received, we met with Office of the Secretary of Defense and Air Force accounting officials to identify alternative sources of information. The officials agreed that DFAS' foreign military sales accounting system, DIFS, contained the data necessary to identify transactions in which FMS customers have received goods and services but may not have been properly charged for them.

In analyzing the DIFS' database as of July 1999, we identified 2,001 Air Force FMS delivery transactions for which there were no charges comparable to the value of the deliveries to indicate that the FMS customers' trust fund accounts had been charged the full amount for goods and services already received. In total, the value of 2,001 delivery transactions exceeded the value of corresponding charges to the trust fund accounts by $540 million.[3] We judgmentally selected 150 of these transactions—totaling $96.5 million—for further review. The following describes how we judgmentally selected the 150 transactions.

- DOD and Air Force officials agreed that an FMS customer's account should show a charge for the value of goods and services received. Therefore, we selected all those transactions for which the DIFS report showed that the FMS customer had received goods and services but no charges had been recorded against the trust fund accounts for the value of goods and services received. In total, there were 146 of these transactions with an overall difference totaling $28.3 million.
- We selected four additional transactions with a total difference between reported deliveries and charges of $68.2 million primarily based on (1) large dollar differences between the value of reported deliveries and charges or (2) previous audit findings which showed that the Air Force had not charged the FMS customers promptly.
- In further reviewing these transactions, we met with Air Force officials knowledgeable about the FMS cases to identify the (1) value of goods and services the FMS customer received and (2) amount that the FMS customer's trust fund account had been charged for the goods and services. For those transactions where it was determined that customers had not been charged or errors were identified, we met with

[3]The actual difference for the 2,001 transactions totaled $750.6 million. However, we excluded $210.6 million from this total because the Air Force had already begun collecting this amount. In fact, as of December 1999, the Air Force had completed this collection. We first identified these outstanding charges, which related to nonrecurring research and development costs for F-15 aircraft already delivered to Saudi Arabia, in a May 1999 report (GAO/AIMD-99-148R). At the time, the Air Force had failed to recoup $152.1 million of nonrecurring costs; however, as of July 1999, this unrecouped balance had increased to $210.6 million.

or contacted responsible Air Force and DFAS officials to try to identify the underlying contributing causes.

We performed our work at DOD headquarters, Office of the Under Secretary of Defense (Comptroller); Air Force Aeronautical Systems Center and Air Force Security Assistance Center at Wright-Patterson Air Force Base, Dayton, Ohio; and the Defense Finance and Accounting Service, Denver, Colorado. We conducted our review from June 1999 through February 2000 in accordance with generally accepted government auditing standards. The Office of the Under Secretary of Defense provided written comments on a draft of this report. These comments are discussed in more detail in the "Agency Comments and Our Evaluation" section and are reprinted in full in appendix I.

Air Force Did Not Have Adequate Management Controls for FMS Accounting

When we began our review, the Air Force did not have adequate information to readily identify instances where FMS customer accounts were not being properly charged for goods and services received or where there were discrepancies between the recorded value of delivered goods and services and the corresponding value of charges to customer accounts. According to responsible Air Force officials, Air Force financial systems were not programmed to produce such data.

Our review of data contained in DFAS' DIFS as of July 1999, indicated that the Air Force may not have charged FMS customers' trust fund accounts for $540 million of delivered goods and services, i.e., the recorded value of delivered goods and services for these transactions was $540 million more than the corresponding value of charges to the foreign customer accounts.

Our detailed review of $96.5 million of this amount—150 transactions—found that the Air Force was able to reconcile about $20.9 million of the differences, finding that these variances were due either to timing issues or special freight forwarding refund accounts.[4] However, of the remaining $75.6 million, the Air Force had either failed to charge customer accounts, made errors, or could not adequately explain the differences. Table 1 provides additional details.

[4]Freight forwarding refund accounts are unique transactions used to track and refund payments to foreign customers for freight costs that should have been paid from the FMS trust fund account. DIFS records these refunds as delivery transactions without recording corresponding charges against the trust fund accounts.

Table 1: Reasons for Differences for Sampled Transactions

Dollars in millions

Reason	Number of transactions	Dollar amount
Timing/refunds	100	$20.9
Charges not processed to customer accounts	22	5.1
Could not determine cause of difference	19	26.5
Errors	11	44.0
Totals	**152**[a]	**$96.5**

[a]Total transactions exceed 150 because two transactions were included in two categories.

The following sections describe our findings with regard to some of these transactions.

FMS Customers Not Charged for $5.1 Million

For 22 transactions totaling $5.1 million, the Air Force had not charged FMS customers' accounts for goods and services they had already received. One transaction—the sale of three aircraft drones to the United Kingdom between mid 1998 and early 1999 valued at $4.8 million—made up most of this total. Since the drones were from Air Force inventory, the United Kingdom's account should have been charged so that the appropriate Air Force account that was used to initially purchase the drones could be reimbursed. However, according to the Air Force official responsible for the United Kingdom program, as of July 30, 1999, no charges had been processed against the United Kingdom's account. The official stated that the United Kingdom's account had not been charged because personnel initially responsible for overseeing that this was done were replaced and the new personnel did not follow up to ensure that the charges were processed. After we brought this problem to the Air Force's attention, it collected $2.1 million of the $4.8 million owed and is planning to collect the remaining $2.7 million.

Similar mistakes were made for the remaining 21 transactions, which totaled about $300,000. We found that these were reimbursable payment transactions which required that funds be collected from the FMS customers' trust fund accounts to allow the reimbursement of the DOD activities that initially paid for the goods and services. However, because of errors in processing the transactions, no actions had been taken to charge the FMS customers' funds. Air Force officials told us that this was due primarily to inexperienced staff who had since been notified of the mistake. After we brought the problem to their attention, Air Force officials began collecting the $300,000 owed.

The Air Force Was Unable to Reconcile $26.5 Million of Deliveries With Charges

For 19 of the 150 transactions we reviewed, the Air Force could not adequately explain $26.5 million in differences between the value of reported deliveries and corresponding charges to the FMS customers' trust fund accounts. For example, for one transaction involving the sale of F-15 aircraft to Saudi Arabia, the reported value of delivered goods and services exceeded the reported charges against the trust fund account by $48.1 million. A review of this difference identified errors and other adjustments totaling $30.5 million that had resulted in the overstatement of delivery values. Most of this amount—about $22 million—was due to the Air Force's failure to revise its per unit delivery cost when it was determined that charges for sustained engineering services initially factored into overall costs were not required. However, the Air Force could not explain the remaining $17.6 million difference. Air Force officials generally believed that this remaining difference was also due primarily to incorrect delivery prices, but could not provide documentation to support their contention. Nor could they rule out the possibility that the Saudi's account had not been properly charged for all goods and services received to date.

According to Air Force officials, these differences will eventually be cleared up when all the goods and services associated with this case have been delivered and the financial transactions are reconciled during the case closure process. However, the reconciliation process is not expected to be done until sometime in fiscal year 2001.

In another instance involving the sale of F-16 aircraft to South Korea, DFAS accounting records showed that the value of delivered goods and services exceeded the value of charges to South Korea's trust fund account by about $14 million. Our review found that $12.2 million of the overstatement was due to a miscalculation in the reported delivery price of 13 "kits" of government-furnished equipment.[5] However, there was still an additional $1.8 million difference remaining that the Air Force could not explain. As with the Saudi Arabia transaction, the Air Force believed that the

[5]The Air Force mistakenly computed the unit costs of "kits" of government-furnished equipment resulting in an overstatement of $12.2 million of their actual value.

remaining difference was due to additional incorrect delivery reporting but did not rule out the possibility that South Korea's account may not have been charged for all the goods and services already received. According to Air Force officials, reconciliation of this case should be completed by the end of fiscal year 2000.

Air Force Actions to Improve FMS Accounting Need to Be Strengthened

During the course of our review, the Air Force recognized that it lacked a tool that provided the information necessary to help identify those instances in which FMS customers had either not been properly charged for goods and services or errors had occurred in processing deliveries and charges against the trust fund accounts. As a result, in August 1999, it developed the capability to produce computer-generated data that would identify those instances. However, Air Force officials responsible for overseeing the development of the data told us that the information would be made available only on an ad hoc basis. That is, while program officials responsible for an FMS case would be trained to access and use the data to assess the status of their FMS programs, the Air Force does not plan to formally require that officials, including headquarters personnel, routinely use the data to review FMS customer accounts to identify instances where customers are not being properly charged or accounting errors may have occurred—and then take corrective action. Such steps would provide FMS program managers and decisionmakers with information and management processes necessary to improve the Air Force's financial management of the FMS program.

Conclusion

The Air Force has lacked adequate controls over foreign military sales accounting to ensure that it (1) promptly charges FMS customer accounts to recover its costs for delivered goods and services and (2) reconciles accounting errors. It has since produced data that will help to identify instances where FMS customers are not being properly charged. Nevertheless, it must ensure that these data are routinely produced and used properly to confirm that FMS customers' accounts are being properly charged. Furthermore, since our review found that the differences for about 78 percent of the $96.5 million of transactions reviewed were caused by accounting errors, failure to charge customers, or could not be determined, it is important that the Air Force complete the review of the remaining $443.5 million of balances to ensure that any amounts owed are promptly collected and any errors and their causes are corrected.

Recommendations

We recommend that the Secretary of Defense direct the Secretary of the Air Force to ensure that the (1) $5.1 million identified in this report as owed by FMS customers is collected and (2) $26.5 million, for which the cause of the differences could not be readily determined, is promptly reviewed and resolved.

We also recommend that the Secretary of Defense direct the Secretary of the Air Force to ensure that officials responsible for managing the FMS program, including headquarters personnel, are (1) properly trained to use the data being produced to identify instances in which FMS customers have not been properly charged for goods and services received and (2) required to routinely use the data at least monthly to review customer accounts, identify instances in which they are not being properly charged, and act promptly to correct the control problems causing the differences.

Lastly, we recommend that the Secretary of Defense direct the Air Force, in cooperation with the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service, to review the remaining $443.5 million of transactions to (1) identify and collect any amounts FMS customers owe for goods and services already provided, (2) correct any erroneous transactions, and (3) determine the causes and act to eliminate similar errors in the future. Cost-effectiveness should be considered when selecting the transactions for detailed review.

Agency Comments and Our Evaluation

In commenting on a draft of this report, the Defense Deputy Chief Financial Officer agreed with our recommendations and stated that the Under Secretary of Defense (Comptroller) will request that the Air Force and Defense Finance and Accounting Service act to implement the recommendations.

However, with regard to the $540 million difference between DOD's reported delivery value of goods and services and related disbursements, the Deputy CFO noted that the Air Force sometimes uses estimated delivery prices, instead of the actual value of the deliveries, when recording deliveries of goods and services to FMS customers. He pointed out that the $540 million GAO identified as reported differences between the value of deliveries and DOD disbursements associated with those deliveries was based, in part, on estimated delivery prices. Therefore, according to the Deputy CFO, because estimates are involved, DOD does not agree that the

$540 million difference necessarily means that the FMS customers have not been properly charged for goods and services received.

Our report does not state that the $540 million difference between deliveries and disbursements was due to FMS customers not being properly charged for goods and services received. Rather, it points out that DOD's own records showed that FMS customers had received $540 million of goods and services for which there was no corresponding disbursement recorded in DOD's system to show that the FMS customers' accounts had been charged for the goods and services. The $540 million was not a GAO estimate as the Deputy CFO's letter states. We noted that this difference indicated only that FMS customers may not have been properly charged for the goods and services and that the differences should be reviewed to identify and collect any amounts owed and correct any errors. In fact, we state that our review of $96.5 million of the differences found that $75.6 million (78 percent) were due to accounting errors, failure to charge customers, or could not be determined from the information in DOD accounting records. The Deputy CFO recognized this distinction in his response when he stated "With respect to the overall findings included in the draft report, the GAO indicated that the Air Force might not have charged FMS customer trust fund accounts for $540 million of delivered goods and services." Finally, the thrust of our report recommendations, with which the DOD agreed, is to determine the reasons for the remaining $443.5 million of differences that we did not review, and to take appropriate action in those cases where problems are identified.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Reform no later than 60 days after the date of this report. A written statement must also be submitted to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report.

We are sending copies of the report to Senators Ted Stevens, Fred Thompson, John W. Warner, Robert C. Byrd, Carl Levin, Joseph I. Lieberman, and Representatives Dan Burton, Stephen Horn, David R. Obey, Ike Skelton, Floyd D. Spence, Jim Turner, Henry A. Waxman, and C. W. Bill Young in their capacities as Chair or Ranking Minority Member of Senate and House Committees and Subcommittees. We are also sending copies of this report to the Honorable F. Whitten Peters, the Secretary of the Air Force, and the Honorable Jacob J. Lew, Director of the Office of Management and Budget. We will make copies available to others upon request.

If you have any questions regarding this report, please contact me or Larry W. Logsdon, Assistant Director, at (202) 512-6240. Other key contributors to this report were Harold P. Santarelli and John A. Spence.

Sincerely yours,

Linda D. Koontz
Associate Director, Governmentwide and Defense
Information Systems Issues

Comments From the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

APR 11 2000

Mr. Jeffrey C. Steinhoff
Acting Assistant Comptroller General
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Steinhoff:

This is the Department of Defense response to the General Accounting Office (GAO) draft report, "FOREIGN MILITARY SALES (FMS): Air Force Controls Over the FMS Program Need Improvement," dated March 9, 2000 (GAO Code 511664/OSD Case 1964).

The Department reviewed the draft report and recognizes the intent of the recommendations. Detailed comments on the recommendations contained in the report are provided in the enclosure.

With respect to the overall findings included in the draft report, the GAO indicated that the Air Force might not have charged FMS customer trust fund accounts for $540 million of delivered goods and services. The GAO amount of $540 million represents the GAO's estimate of the difference between the values of deliveries to FMS customers and DoD disbursements associated with those deliveries. That amount represents less than 1 percent of current deliveries (valued at $69.6B) made by the Air Force. The Department does not agree that the estimated differences necessarily mean that the accounts of the FMS customers have not been properly charged. Of the $20.8 billion of deliveries reviewed by the GAO, values used for $10.1 billion (or 50 percent of the deliveries reviewed by the GAO) represented estimated, not actual, values of the deliveries. Thus, the GAO's conclusion regarding actual differences between the value of deliveries and the amount of actual disbursements appears to be somewhat speculative and perhaps unsupported.

The Department appreciates the opportunity to comment on the draft report. My staff point of contact on this matter is Ms. Kay O'Brien. She may be contacted by e-mail: obrienm@osd.pentagon.mil or by telephone at (703) 697-0586.

Sincerely,

Nelson Toye

Nelson Toye
Deputy Chief Financial Officer

Enclosure

GAO DRAFT REPORT DATED MARCH 9, 2000
(GAO CODE 511664) OSD CASE 1964

"FOREIGN MILITARY SALES (FMS): Air Force Controls Over the FMS Program Need Improvement"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense direct the Secretary of the Air Force to ensure that the $5.1 million in transactions identified in this report as owed by FMS customers is collected.

DoD RESPONSE: The Under Secretary of Defense (Comptroller) will request the Air Force to ensure that if any portion of the $5.1 million is in fact actually owed by FMS customers that it be collected.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense direct the Secretary of the Air Force to ensure that the $26.5 million in transactions for which the cause of the differences could not be readily determined are promptly reviewed and resolved.

DoD RESPONSE: The Under Secretary of Defense (Comptroller) will request the Air Force to (1) review and resolve those transactions for which differences were not readily determined and (2) to collect any portion of the $26.5 million that is in fact actually owed by FMS customers.

RECOMMENDATION 3: The GAO recommended that the Secretary of Defense direct the Secretary of the Air Force to ensure that officials responsible for managing the FMS program, including headquarters personnel, are (1) properly trained on how to use the data being produced to identify those instances where FMS customers have not been properly charged for goods and services received and (2) required to routinely use the data on at least a monthly basis to review customer accounts, identify instances where they are not being properly charged, and take prompt action to correct the control problems causing the differences.

DoD RESPONSE: The Under Secretary of Defense (Comptroller) will request the Air Force to determine if officials responsible for managing the FMS program, including headquarters personnel, have been properly trained and appropriately use available data. If it is determined that this is not the case, the Air Force will be requested to ensure that necessary training and management oversight--including prompt corrective actions--occur for the FMS program.

RECOMMENDATION 4: The GAO recommended that the Secretary of Defense direct the Secretary of the Air Force, in cooperation with the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service, to review the remaining $443.5 million of transactions to (1) identify and collect any amounts FMS customers owe for goods and services already provided, (2) correct any erroneous transactions, and (3) determine the causes for the errors and take action to eliminate similar errors in the future. Cost effectiveness should be considered when selecting the transactions for detailed review.

DoD RESPONSE: The Under Secretary of Defense (Comptroller) will request the Air Force, in cooperation with the Defense Finance and Accounting Service, to review completed transactions where actual delivery values exceed actual disbursements. In such instances, the Air Force will be requested to ensure that: (1) any amounts that may be due for goods and services already provided are collected, (2) any erroneous transactions that are discovered are corrected, and (3) causes of any such errors be identified so that necessary actions may be determined to eliminate future similar errors.

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