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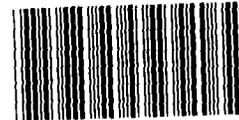
Testimony

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DOD's Financial Management of the
Foreign Military Sales Program

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 am pleased to have this opportunity to comment on the Department of Defense's (DOD) current efforts to improve Foreign Military Sales (FMS) accounting. The financial management of this multibillion dollar program has been the subject of over 50 GAO reports, which have identified a variety of accounting and cost recovery weaknesses over the past 15 years. (Attachment I includes a selective listing of these reports.)

For at least 10 years, DOD's lack of accounting control over FMS trust fund cash has hindered the department's ability to manage several aspects of the FMS program. Serious accounting and internal control weaknesses have resulted in unreconcilable differences indicating that DOD has spent hundreds of millions of dollars more than it has reportedly delivered and billed to customer countries. As a result, 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.

If DOD cannot resolve these discrepancies and adequately account for all disbursements of customer advance deposits, our government faces the possibility of refunding substantial sums at the taxpayers' expense.

Further, because DOD does not revise customer payment schedules to reflect actual progress on the execution of FMS orders, DOD cannot ensure that each country's trust fund balance is maintained at an appropriate level. This, along with apparently excessive delays in sales case closure that are aggravated by the reconciliation problems I have just described, has led to customer-country dissatisfaction with DOD's financial management of the FMS program.

After years of delay and inadequate corrective actions, DOD is now implementing its most comprehensive revision of FMS accounting methods to date, involving a new centralized system and interfacing systems operated by the military services. We support this departmentwide effort to improve the accuracy and timeliness of DOD's centralized FMS accounting and billing. However, we urge DOD to ensure that the activities that originate the transactions control the accuracy and validity of data entered into the system. In addition, DOD is establishing the Reconciliation and Case Closure Board to address discrepancies in existing records that cannot otherwise be resolved. Together,

these efforts ought to provide the control and discipline needed to (1) ensure that our government does not inappropriately subsidize foreign military sales and (2) fulfill our fiduciary responsibilities to over 100 foreign countries and treaty organizations whose funds we hold in trust.

OVERVIEW OF THE FMS PROGRAM

A brief description of the FMS program is useful in understanding the problems that DOD is trying to resolve. The Arms Export Control Act 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. DOD normally 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.

Since the 1950's, foreign countries have signed agreements initiating thousands of FMS sales cases valued at over \$157 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 about \$7 billion in fiscal year 1986. As

of September 30, 1986, the remaining value of unfilled orders was \$57.1 billion, and the trust fund balance stood at about \$6.5 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 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, accounting for individual cases, and reporting related data, such as deliveries and disbursements of cash, to DSAA's Security Assistance Accounting Center (SAAC) in Denver. SAAC is responsible for collecting and centrally accounting for customer-country funds held in the FMS trust fund and providing customers with periodic statements that summarize amounts charged for deliveries of materiel, performance of services, progress payments, 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 issues disbursement authority to the implementing agencies. 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. I now will go over the major problems with FMS accounting in more detail and give the status of DOD efforts to correct the problems.

LACK OF CONTROL OVER TRUST FUND CASH

Major accounting and internal control weaknesses are impairing DOD's ability to properly manage and control the FMS trust fund. Imbalances between trust fund cash records and billing records indicate that SAAC and the services are not properly accounting for all disbursements and deliveries related to FMS cases. In addition, because DOD does not adequately revise customer payment schedules to correspond with changes in case progress, many customers are not making deposits to the trust fund in accordance with their schedules but are instead apparently paying according to their own estimates.

Although these problems have been reported since 1979, DOD's corrective actions to date have not provided the discipline and control needed to ensure that FMS activity is properly accounted for and that trust fund cash is maintained at an appropriate level.

Disbursements Exceed Billings

A comparison of SAAC's trust fund cash records with billing records indicates that SAAC has spent hundreds of millions of dollars more than it has reportedly delivered and billed to customer countries. As of December 31, 1986, a summary of SAAC's cumulative records showed a trust fund cash balance of \$5.6 billion. However, when the value of deliveries reported in billing statements to customers was subtracted from the total amount of customer deposits, a balance of \$6.2 billion remained, indicating that our government had spent about \$600 million more than the value of deliveries reported to customers. In addition, as of December 31, 1986, SAAC records indicated that \$158 million had been disbursed from the FMS trust fund, with no record showing which countries' funds had been spent.

December 31, 1986, reconciliation figures compiled by SAAC for five major participants in the FMS program illustrate the problem on an individual country basis, indicating that, for these five countries alone, DOD spent \$171.2 million more than it billed. The following table shows each country's cash balance according to SAAC's trust fund records and according to billing records, after adjustment for certain reconciling items, such as an allowance for delays in SAAC's receipt of delivery reports from the military services.

	<u>Cash balance according to trust fund cash records</u>	<u>Cash balance according to billing records (adjusted for reconciling items)</u>	<u>Disbursements that exceed deliveries reported to customers</u>
----- (millions) -----			
Country A	\$156.9	\$245.3	\$ 88.4
Country B	95.9	138.6	42.7
Country C	24.9	40.5	15.6
Country D	115.8	131.1	15.3
Country E	<u>7.1</u>	<u>16.3</u>	<u>9.2</u>
Total	<u>\$400.6</u>	<u>\$571.8</u>	<u>\$171.2</u>

Apparently, most customer countries are not aware of these discrepancies, because quarterly billing statements from SAAC only report amounts collected into the trust fund and amounts charged for deliveries and performance; the statements do not report amounts actually disbursed from the trust fund. Due to the sensitive nature of this information, we have not identified individual customer countries by name.

Reconciliation Efforts

Have Been Unsuccessful

Despite numerous efforts, DOD has not been able to reconcile imbalances between trust fund cash and billing records, or even to identify precisely the discrepancies. During fiscal year

1982, eight DOD auditors spent 7 months attempting to reconcile trust fund cash and delivery records for seven customer countries. They identified \$11 million in unreconcilable imbalances and concluded in a 1983 report¹ that, because SAAC's records were not adequately controlled, a complete reconciliation was impossible. Prompted by this report, SAAC has tried unsuccessfully to reconcile the imbalances that exist between trust fund and billing records on a quarterly basis since 1983. During this time, the unreconciled differences varied dramatically, sometimes indicating that cumulative disbursements exceeded billings by as much as \$743 million and other times indicating that billings exceeded disbursements by as much as \$1.2 billion. The amount of the imbalance stabilized somewhat during 1986 but still ranged from \$422 to \$743 million in disbursements that exceeded amounts reportedly delivered.

DOD officials suspect that some of these unreconcilable imbalances are due to delays in reporting of delivery data that cannot be precisely estimated and to inadequate control over transactions rejected by SAAC's accounting system. However, some of the discrepancy is apparently due to erroneous or incompletely reported transactions that have never been identified and corrected. Similar errors have been discovered as a result of

¹Foreign Military Sales Trust Fund Management (Office of the Inspector General, Department of Defense, No. 83-147, June 16, 1983).

customer inquiries or individual country reconciliations. For example, during one country reconciliation, SAAC discovered \$157,000 in disbursements for one country that were erroneously recorded as disbursements of another country's trust fund cash. DSAA officials say that they suspect other similar errors could have occurred that have not yet been identified and corrected or that FMS trust fund cash may have unintentionally been spent for non-FMS activities.

Individual Customer Balances
Are Not Adequately Controlled

These imbalances make it difficult, if not impossible, to ensure that FMS cases are being financed with advance customer deposits as required by the Arms Export Control Act. To comply with the advance deposit requirement, FMS accounting procedures direct implementing agencies to contact SAAC and request specific authority before they disburse funds related to FMS cases. When such a request is received, SAAC checks the related country's trust fund balance and grants or denies the requested disbursement authority. If funds are available and authority is granted, SAAC reserves the related amount to indicate that this amount is about to be disbursed and, therefore, is not available for subsequent requests.

DSAA officials say that most countries maintain a trust fund

balance that is adequate to cover disbursements associated with their cases. However, because of the imbalances that I have previously described, we believe that SAAC cannot be sure that its records of trust fund cash balances are correct and, thus, cannot be sure that customers' funds are indeed sufficient to cover disbursements made on their behalf.

The failure of the implementing agencies to comply with prescribed disbursement procedures also hinders SAAC's ability to adequately monitor and control trust fund cash. According to SAAC records, the implementing agencies disbursed \$341.6 million from the trust fund between December 1985 and November 1986 without first requesting authority from SAAC.

System and Internal Control

Deficiencies Are Primary Causes

DOD's lack of control over trust fund cash is rooted in specific accounting and internal control deficiencies at both SAAC and the military services. A major problem is that SAAC cannot match its records of disbursements from the trust fund with related records of performance billed to customers in order to identify and resolve discrepancies in individual transactions. Such matching is currently impossible because SAAC's records of trust fund cash disbursements are maintained on a customer-country level, while billing records are maintained on an

individual case level. Therefore, when a discrepancy between summary-level records is discovered, SAAC cannot readily identify the specific transactions that caused the out-of-balance condition.

If disbursement records were maintained at the same level of detail as billing records, SAAC could match individual disbursements with related detailed reports of performance and, thus, identify discrepancies at a level of detail that would allow further investigation. For example, if a trust fund disbursement could not be matched to a corresponding report of performance contained in the billing records, SAAC would be able to identify the specific case and line-item for which the disbursement was made, which would facilitate further investigation of the discrepancy. Likewise, any performance reports that could not be matched to disbursement reports could also be identified and resolved. Such matching and subsequent resolution of discrepancies would help ensure that all disbursements are for FMS-related items and that these expenditures are promptly billed to the right customer.

In addition, SAAC's current accounting system does not include basic internal controls to identify or prevent errors and ensure that data is submitted promptly. For example,

-- SAAC's current summary-level account structure does not

adequately control subsidiary records related to individual cases.

- Errors that existed prior to the establishment of SAAC in 1976 and prior to the implementation of SAAC's current accounting system in 1980 were never segregated and controlled and are, therefore, incorporated in the current cumulative balances.
- Data is submitted to SAAC from over 100 sources in 13 implementing agencies via a variety of media and in non-standard formats and classifications, making it difficult for SAAC to successfully control and consolidate this information.
- System checks on the quality of data are nonexistent or inadequate. Data is not subjected to standard checks or edits before it is submitted to SAAC, and edits within SAAC's current system were designed to speed processing rather than ensure accuracy.
- SAAC does not control transactions that are not accepted by the accounting system to ensure that they are corrected and resubmitted promptly.
- Activities that submit data to SAAC do not always use the

same monthly cut-off date, increasing the difficulty of reconciliation.

-- Controls have not been in place to ensure that SAAC and service-level records are consistent.

DOD's new FMS accounting systems, which I will describe later, have been designed to overcome these weaknesses.

Payment Schedules Are Not Adequately Revised

A separate but related problem that affects DOD's ability to control trust fund cash is that case managers in the military services frequently do not adjust customer payment schedules to reflect actual case progress and the amount needed by DOD to pay bills due in the subsequent quarter. When an FMS agreement is initiated, DOD is to develop an estimated payment schedule designed to ensure that there is always enough money in each country's trust fund balance to cover disbursements related to that country's cases. DOD's FMS Financial Management Manual prescribes that case managers in the implementing agencies review these schedules periodically and revise them as needed. However, according to DSAA officials, although case execution often lags behind original estimates, payment schedules are rarely adjusted

to reflect this delay. Thus, customers are required to deposit their funds too soon.

DSAA officials say that they have urged the services to see that payment schedules are adjusted for changes in estimated case execution progress, but that their efforts have met with little success, primarily because case managers at the implementing agencies place a low priority on revising payment estimates to reflect delays in case execution.

To avoid depositing funds in the trust fund unnecessarily early, many customer countries adjust their payments as they see fit, a practice that appears to shift control over financial requirements inappropriately from DOD to the customers. Excluding 12 countries with special billing agreements, which authorize DSAA to alter the amount due, only 10 of 96 customers receiving December 31, 1986, bills paid them according to their payment schedules. SAAC officials told us that they usually do not formally question customers' revised payments because they cannot defend payment schedules that may not be correct.

Statistics provided to us by SAAC regarding two major FMS customers indicate that their payment schedules required much more money than was needed by DOD to cover disbursements in the quarter for which the payment was to be used, and the customers, apparently aware of the problem, did not pay the amounts

requested. For one country, \$2.8 billion was due according to the payment schedule, but the country paid only \$590 million. During the quarter in which the funds were to be used, only \$510 million was disbursed. For the other country, \$176.8 million was due according to the payment schedule; the country paid \$121 million; and \$59 million was disbursed.

We believe that because DOD does not adequately estimate and control customer payments, our government is not fulfilling its fiduciary responsibility to ensure that an adequate, but not excessive, level of trust fund cash is available to cover costs associated with each customer's purchases.

Problems Are Not New

These problems are not new. Since 1977, GAO and DOD internal auditors have reported the same conditions that I have just described, identifying imbalances in SAAC's records of hundreds of millions of dollars and highlighting the need for DOD to determine correct amounts due from customers. For the record, in an attachment to my statement (Attachment I), I have included a list of these reports and a brief summary of each report's findings.

LACK OF CONTROL MAY COST

UNITED STATES GOVERNMENT

DOD's failure to gain control over trust fund cash could eventually result in expenditures of our government's money to cover DOD's disbursements of customer funds that cannot be supported by FMS performance records. As an increasing number of FMS cases are brought to closure, DOD will have to perform final reconciliations and resolve discrepancies related to individual cases.

One case, currently under investigation at DOD, although not involving a large dollar amount, illustrates the potential problem with such final reconciliations. Investigations prompted by a customer's May 1986 request for a refund identified a disbursement that was not supported by documented delivery or performance, and, therefore, had never been billed to the country. Officials at the implementing agency that made the disbursement say that they believe the transaction predates both SAAC and the service's FMS accounting system and that further reconciliation is unlikely because detailed records and key personnel are no longer available. At the close of our review in April 1987, the customer country was pressing DSAA for a refund, but DOD had not yet determined a course of action on this matter.

DOD officials told us that they expect similar cases to arise as the FMS program matures and more cases near closure. SAAC designates a case as "closed" when (1) the agency executing the case certifies that all ordered items have been delivered and all ordered services have been performed and (2) SAAC has verified that all related records have been reconciled and all billed amounts have been collected.

Because the trust fund has been constantly replenished with deposits from customer countries, imbalances between amounts spent and amounts billed have been allowed to exist without resolution, much like a checkbook that has never been reconciled. Many cases, initiated during the 1970's when the FMS program was growing dramatically, are either ready for or nearing closure, and customer countries are likely to increase pressure for DOD to finally reconcile and close those cases for which all deliveries have been made.

CUSTOMERS ARE DISSATISFIED

In addition to the potential loss to our own country, DOD's financial management of the FMS program has led to customer dissatisfaction. Representatives from three customer countries with whom we met said that their major concern with DOD's financial management of the FMS program, in addition to DOD's failure to revise payment schedules promptly, was the inordinate

delay in case closure. They said that such delays unnecessarily tie up their funds, complicate bookkeeping, and are difficult to explain to officials in their home countries who may not be familiar with DOD procurement policies.

DSAA officials told us that it is not uncommon for cases to remain open 2 to 4 years after all deliveries have been completed, and one customer representative cited delays of over 5 years. Research and resolution of imbalances in accounting records contribute to the delay. As of January 31, 1987, 579 cases that had been reported to SAAC as ready for closure were being delayed because related accounting records were out of balance. According to SAAC's aged schedule of cases awaiting closure, 54 cases had been delayed for this reason for 1 year or longer. However, DSAA officials say that factors outside of accounting control, such as audits and delays caused by contractors, add to the problem.

DSAA officials say that most of the FMS customer countries have complained about their payment schedules at one time or another and at least five countries keep precise case records of their own with which they justify deviations from paying according to schedule. One European country routinely submits detailed case-by-case justifications for not paying according to its payment schedule and, according to DSAA officials, its calculations are usually correct. In this country's 50-page

justification for deviating from its September 1986 scheduled payment, the country's officials had adjusted the payment schedule amount due for the subsequent quarter from \$212.4 million to \$35.2 million because, according to their billing statement and based on their own research into the progress of their cases, DOD did not yet need the full scheduled amount.

CORRECTIVE ACTIONS

Over the years, DOD has taken a variety of steps to improve FMS accounting, but these efforts have been piecemeal and have not yet provided SAAC with adequate control over trust fund cash.

Prior to 1976, FMS accounting and billing was accomplished by the individual services on systems that had not been specifically designed to handle FMS cases. The dramatic growth of the FMS program during the 1970's overwhelmed the services, resulting in criticism by GAO and DOD auditors that the services were not adequately accounting for their FMS cases and would not standardize their procedures. As a result, in November 1976, DOD established SAAC to centrally account for the FMS trust fund and to bill and collect from customer countries.

In 1977, to improve accounting control, SAAC was directed to develop the Defense Integrated Financial System, which, after several delays, was implemented in 1980 and still serves today as

the official FMS accounting and billing system. This system has not provided the discipline needed to adequately account for trust fund cash primarily because it did not include basic internal controls to ensure data integrity and timeliness, and because disbursement data was not maintained in enough detail to allow reconciliations with case-level delivery data.

New Systems Are Designed

Prompted by a 1979 GAO report² and by 1980 and 1982 House Appropriations Committee reports, DOD tested the feasibility of further centralizing FMS accounting but concluded that this would not be cost-effective and would not solve problems in existing systems that would still be required under a centralized organization. Instead, DOD established the FMS Financial Management Improvement Program to provide strong centralized direction for identifying and improving FMS systems problems. After a year of analyzing recognized FMS problems, the project team recommended that DOD undertake a comprehensive effort to develop a new centralized accounting and billing system at SAAC and an interfacing systems at each military service.

DOD is now in the process of implementing these systems,

²Centralization: Best Long-Range Solution to Financial Management Problems of the Foreign Military Sales Program (FGMSD-79-33, May 17, 1979).

which together are to prevent out-of-balance conditions from worsening. In addition, DOD is establishing the Reconciliation and Case Closure Board to resolve existing unreconcilable discrepancies that cannot otherwise be eliminated from FMS accounting records.

SAAC's new centralized system is designed to provide greater control and discipline over all FMS transactions, including matching of disbursements with related deliveries by country, case, and line item. In addition, the new system is to provide periodic reports to managers on out-of-balance conditions, rejected transactions awaiting correction, delinquent performance reports, and other aspects of FMS financial management that may need attention.

The three major services are developing their own interfacing systems for consolidating FMS data and transmitting it to SAAC in a format that can be accepted by the new centralized system. The Air Force and the Navy are each designing one interfacing system, while the Army plans to transmit data to SAAC from two interfacing systems. The services' systems are to incorporate standard data definitions and formats, controls to ensure that all data sent were correctly received, and standard system checks to ensure that errors and omissions are corrected before data are forwarded to SAAC.

Cost of New System

The new systems are being paid for by the FMS administrative fund, which is controlled by DSAA and funded by a surcharge on customer orders. In December 1984, when the concept for the new system design was presented to DOD's Major Automated Information System Review Council, which reviews and approves major system development projects, the overall cost estimate for the new systems was \$34.2 million. However, due to refined estimates of design costs and identification of the need for increased computer hardware and communication capabilities, by December 1986 the department had increased its estimate for system design, development, and hardware to \$43.9 million with an additional \$600,000 estimated to operate the system over an 8-year period. DOD is now in the process of developing estimates of additional costs that will be incurred as a result of testing delays. As of March 31, 1987, DOD had spent \$35.4 million on the new systems.

Although the systems are not expected to result in reduced operating costs DOD-wide, we believe this spending is justified in light of the need for DOD to gain control over its records of trust fund cash and billings to customer countries. However, due to the decline in new FMS orders, funds available to pay administrative expenses have decreased, making it more important than ever for the agencies involved to use these funds wisely and for FMS support only.

System Implementation

Has Been Delayed

Because testing has taken longer than originally estimated, initial implementation of the new system at SAAC has been delayed from DOD's original October 1986 target date. When we last spoke with DOD officials, the system was to begin "live" operations in May 1987. Despite this delay, we believe that it is important for the department to allow time to test and implement the new FMS systems properly, in order to avoid piecemeal measures that have characterized past corrective actions.

Once the new system begins operating, DOD expects to operate both the old and the new systems concurrently for about 6 months before designating the new system as the official FMS accounting and billing system. We plan to continue monitoring DOD's progress during this period.

Service Interfaces Are

To Be Phased In

All three services have begun to gradually phase in their interfacing capability, meaning their ability to electronically transmit data to SAAC in a format acceptable to the new centralized system. However, complete interfacing capability is

not expected to be available at all services until November 1988. Until that time, DOD will not realize the full benefits of new internal controls and improvements to system efficiency.

New System Will

Improve Central Control

If implemented as planned, the new FMS systems should significantly improve the accuracy of data resulting from future transactions and SAAC's control over the trust fund. However, it is important that the services fully implement their interfacing systems as soon as possible so that the benefits of planned controls can be realized. More importantly, all activities that originate FMS transactions must exercise the discipline and internal controls needed to ensure that the data they report are timely and accurate. Without this effort, the new systems cannot succeed and the resources used to devise them will be largely wasted.

The new centralized system will not directly address the problem of unadjusted payment schedules, but it is being designed to provide managers with periodic reports on cases that need attention in this area. The primary responsibility for improving the timeliness of payment schedule revisions lies with the implementing agencies and cannot be controlled by DSAA alone.

Existing Imbalances Require
Special Attention

One of the most important obstacles that must be overcome before SAAC can be sure that its records are accurate is the identification, control, and resolution of the imbalances that exist among current records. Although the controls that are to be implemented as part of DOD's new FMS accounting systems should help prevent imbalances from worsening, they will not correct the imbalances that already exist when the new system begins operation.

To accomplish this, SAAC plans to establish a series of transition accounts that will isolate existing imbalances and allow for adjustments as delayed transactions are reported or as errors are discovered and corrected. These accounts are to be established when the new system's data base is initially loaded, but before any new transactions have been recorded. They will classify imbalances at two levels: one set of accounts will isolate disbursements that cannot be identified by country; the second set will isolate disbursements or deliveries that can be identified by country but that cannot be related to a specific case. As monthly transactions are submitted under the new system, some of the amounts isolated in transition accounts may be adjusted as late reports arrive from the military services and as errors are identified and corrected. DOD estimates that most

of these adjustments will be made during the first 6 months of the new system's operation. After that, most easily correctable discrepancies should have been made and DOD will have to consider how to further resolve the remaining balances.

Since the official load of the data base was not to occur until early May 1987, we have not examined the transition accounts and cannot yet comment on their validity. However, as of April 1987, DOD officials expressed their concern that the military departments would not be able to provide the detailed accurate disbursement data that SAAC needed to establish the accounts.

This could be a serious problem since the validity of all FMS records, including the transition accounts, will depend on the accuracy of the data that SAAC and the services initially load into the new system's data base. SAAC and the services should be sure that all data entered is supported by documentation and that any estimates that may be required are clearly identified as such. In addition, once the new system begins operating, adjustments to the transition accounts should be carefully controlled and documented, since their balances are likely to eventually be the subject of much scrutiny when DOD considers their final resolution.

The newly chartered Reconciliation and Case Closure Board,

whose members are the DSAA Comptroller, DOD's Director of Accounting Policy, and a representative of the implementing agency involved in the issue under examination, will examine unreconcilable imbalances related to individual cases and countries and determine what action should be taken. According to the Board's charter, such action could include additional billings to customer countries or "actions necessary to bring accounting records into balance."

In addition, when case closure is being unduly delayed because a related contract has not been completed, the Board will have the authority to estimate additional amounts needed from the customer and bill these amounts as contingent liabilities. Such action would allow DOD to close cases when they are fully delivered and substantially billed, even though final costs have not been precisely determined.

The Board was chartered in March, but as yet cases to be examined first have not been identified and, therefore, the Board has not acted. DOD officials said they could not yet estimate the volume of the discrepancies that will have to be resolved.

Board determinations should be carefully considered and documented since they could result in additional billings that may be contested by customers or in losses to our own government. Until the discrepancies in current accounting records have been

isolated and stabilized, it will not be possible to precisely identify cases and countries that will be affected or the dollar amounts involved. However, as indicated by reconciliation attempts to date, these amounts could be significant.

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In conclusion, I would like to express our support for DOD's effort to correct the deficiencies in its FMS accounting. However, it is important that

- DSAA and the services continue to work together to fully implement their new systems so that benefits can be realized as soon as possible,
- DOD ensures that the accuracy and timeliness of data originated by service-level systems are adequately controlled,
- adjustments to and final resolution of existing imbalances are carefully controlled and documented, and
- corrective actions taken are effective on a continuing basis. (In this respect, DOD officials may want to institute annual audits of FMS trust fund balances by independent auditors to measure the department's progress

in reducing existing discrepancies and ensuring that new ones are not created.)

We intend to further monitor DOD's progress in improving FMS accounting and in resolving discrepancies in FMS records. The Subcommittee's continued interest in these areas will help ensure that DOD successfully implements its FMS financial management improvement plans.

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.

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).

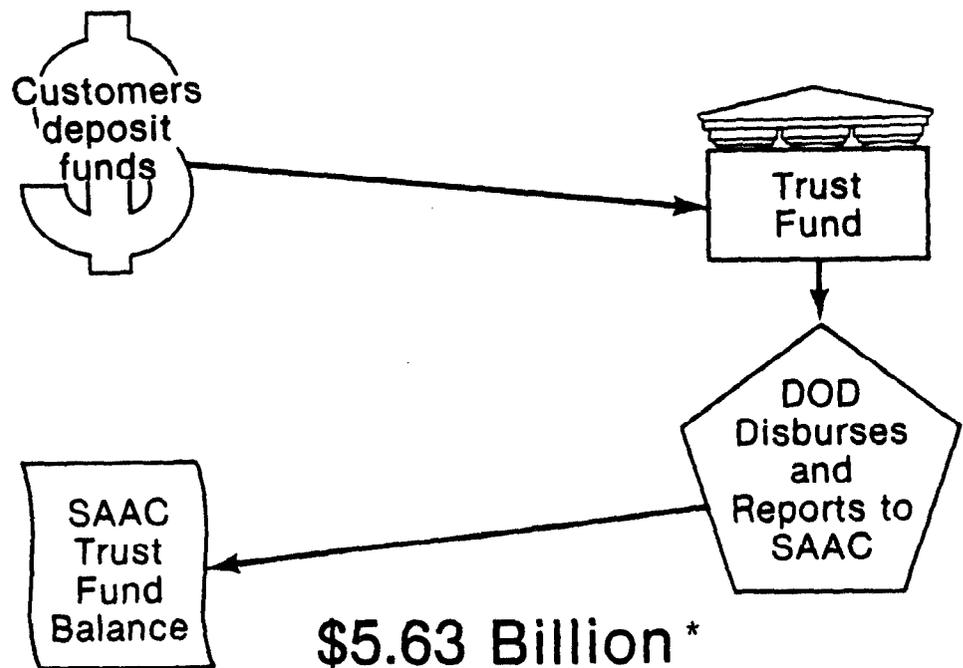
SAAC's cash balances for individual countries were not accurate enough to ensure that the United States government was adequately protected in case of a foreign government's default.

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

1976	Security Assistance Accounting Center is established.
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 & 81	DOD tests centralized accounting and disbursing.
1980 & 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.

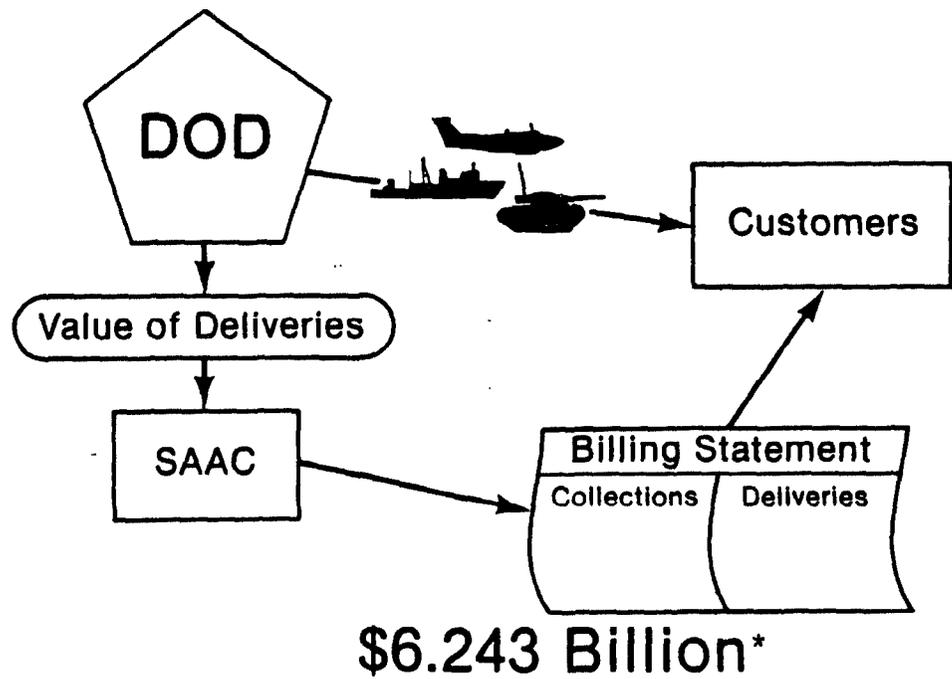
April 1983	FFMIP office becomes operational.
January 1984	FFMIP issues summary report on specific FMS accounting problems that must be addressed.
December 1984	Conceptual design for new systems is published.
August 1985	Conceptual design approved by DOD's Major Automated Systems Review Council.
Early 1986	Military services begin designing their interfacing systems.
February 1986	Detailed design for new system is approved by Major Automated Systems Review Council.
1986-present	New systems development and testing is in progress.

GAO Trust Fund Cash Balance



*Cash balance according to trust fund records as of December 31, 1986

GAO Billing Record Cash Balance



*Customer deposits less reported deliveries as of December 31, 1986

GAO **Comparison of FMS
Customer Cash Balances**

	Cash balance Trust Fund Records	Cash balance Billing Records (Adjusted for reconciling items)	Difference
Country A	\$156.9 million	\$245.3 million	\$88.4 million
Country B	\$ 95.9 million	\$138.6 million	\$42.7 million
Country C	\$ 24.9 million	\$ 40.5 million	\$15.6 million
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All FMS Customers	\$5.63 billion	\$6.243 billion	\$613 million
