



**REPORT TO  
THE CONGRESS OF THE UNITED STATES**

**REVIEW  
OF THE  
PRICING OF MATERIEL DELIVERED  
TO THE  
MILITARY ASSISTANCE PROGRAM  
BY THE  
MILITARY DEPARTMENTS**



**BY  
THE COMPTROLLER GENERAL OF THE UNITED STATES  
FEBRUARY 1960**



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON 25

B-133280

FEB 29 1960

Honorable Sam Rayburn  
Speaker of the House of Representatives

Dear Mr. Speaker:

Enclosed is our report on review of the pricing of materiel delivered to the military assistance program by the military departments. This review was limited to grant aid provided by the United States.

The military departments have received improper reimbursements for deliveries of materiel to the military assistance program (MAP). These improper reimbursements resulted from charging MAP for materiel that should have been transferred without charge as excess stocks and from charging MAP higher prices for nonexcess equipment than is provided for by the Mutual Security Act. With respect to nonexcess equipment, (1) older types of equipment have frequently been transferred at original cost without reduction to reflect current condition and market value, (2) certain assemblies and spare parts have been transferred at replacement costs which were much higher than original acquisition costs, and (3) other items were transferred at incorrect prices because of weaknesses in the compilation or use of pricing information.

Revised Department of Defense guidance is expected to improve or alleviate these pricing problems. However, we are recommending that the Department of Defense aggressively monitor the pricing policies and practices of each military department to assure that charges for materiel delivered to the military assistance program are in accordance with the intent of the legislation.

Further, the Department of Defense has not required appropriate adjustment for amounts previously paid to the military departments in excess of those authorized by law. Ordinarily, we initiate corrective action in instances of improper payments in order to effect compliance with the applicable legislation. However, in this case determination of the amount of the adjustment is a matter that must be ascertained by the Department of Defense. Therefore we are advising the Secretary of

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Defense that the military departments must either make appropriate adjustments for the improper charges to the military assistance program for both excess and nonexcess materiel delivered to MAP or obtain from the Congress specific relief from the provisions of the Mutual Security Act pertaining to the pricing of such materiel.

This report is also being sent today to the President of the Senate. Copies are being sent to the President of the United States and to the Secretaries of Defense, the Army, the Navy, and the Air Force.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "W. W. Campbell".

Comptroller General  
of the United States

Enclosure

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REPORT ON REVIEW  
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INTRODUCTION

The General Accounting Office, as a part of its review of the Military Assistance Program (MAP) within the Department of Defense, has reviewed the pricing of equipment and supplies delivered to military assistance grant aid recipients by the Departments of the Army, Navy, and Air Force. Our review was made pursuant to the provisions of the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67). The scope of the audit work performed is described on page 30 of the report.

Equipment and supplies provided as grant aid to foreign military forces under the military assistance program are procured for this purpose generally by the military departments, or are transferred from the inventory stocks of the military departments. The Congress has provided that for excess stocks transferred to recipient countries the military departments will be reimbursed for rehabilitation and repair costs only and has established criteria for determining the amount of reimbursement to be received by the departments for transfers of nonexcess materiel.

The Congress, in 1956, changed the pricing provisions pertaining to reimbursable transfers to correct certain inequities that had been authorized by the mutual security legislation, including the use of prices based on replacement costs that greatly exceeded departmental acquisition costs. It is our understanding that these changes were made to assure that mutual security appropriations for military assistance are applied solely for the purposes set forth in the enabling mutual security legislation and that any benefits accruing to the military departments, such as the opportunity to dispose of older or less desirable stocks, are essentially by-products of the military assistance program arising from the recognized desirability of making maximum use of equipment already owned by the United States.

## HIGHLIGHTS

Our review of the pricing of materiel for transfer to the military assistance program by the military departments shows that they have failed to adequately implement or comply with the Mutual Security Act. Our findings are summarized below and are discussed in greater detail in the following pages of this report.

The military departments are being reimbursed by the military assistance program for deliveries of significant quantities of materiel that should be transferred without charge as excess stocks. We are recommending that the Department of Defense aggressively monitor the pricing policies of the individual military departments and their implementation to assure that the military assistance program is not charged for deliveries of materiel that are excess to the military departments' mobilization reserve requirements at the time of initiation of supply action. (See pp. 8-16.)

Although significant reductions have been made in certain areas in the prices charged the military assistance program for materiel being delivered from service stocks, reimbursable transfers of nonexcess equipment frequently are not being priced in accordance with the 1956 amendment to the Mutual Security Act. In general, the Department of the Navy has not adjusted its unit prices for condition and market value; the Department of the Air Force has made some reductions in the prices of aircraft but has not adjusted prices for other equipment; and the Department of the Army has reduced the prices of substantially all the major end items but not major assemblies or repair parts. Some of the latter are being transferred at replacement costs which greatly

exceed original acquisition costs. In a number of instances the military departments are using incorrect prices for materiel delivered under MAP. We are recommending that the Department of Defense review the pricing policies of each military department and utilize internal audit to assure that the military departments determine in a uniform and consistent manner the price reductions required by the 1956 amendment to the Mutual Security Act. (See pp. 17-29.)

Furthermore, the Department of Defense has not required appropriate adjustment for amounts previously paid the military departments in excess of those authorized by law. We recognize the difficulty in arriving at an appropriate adjustment and that an approximation may be necessary. However, we believe that the Department of Defense and the military departments must comply with the existing provisions of law. We are requesting the Secretary of Defense to make an appropriate adjustment or obtain from the Congress specific relief from such provisions.

## BACKGROUND

The military departments have been assigned the responsibility for implementing approved military assistance programs, subject to the basic responsibility of the Assistant Secretary of Defense for International Security Affairs (ISA) for administering the military assistance program within the Department of Defense.

Items which are in common use by United States forces and military forces of recipient countries are financed originally from regular military appropriations subject to reimbursement from the mutual security appropriation upon delivery. Military assistance funds are earmarked by means of a common item order which specifies end items or general equipment categories required for delivery to MAP during a specified period. The military assistance funds so designated are set aside to reimburse the military departments and are not considered obligated until the materiel is delivered or services are performed. The military departments are authorized to incur obligations in anticipation of reimbursement from such allocations.

The Mutual Security Act of 1954, as amended, provides that the military departments may transfer equipment or materiel to the military assistance program on either a reimbursable or a nonreimbursable basis.

The military departments are not reimbursed, except for gross costs of repair, rehabilitation, or modification, for the transfer of equipment or materiel which is in excess of the mobilization reserve requirements for such materiel. Mobilization reserve requirements are defined as the quantities of equipment and materiel required to support mobilization of the United States armed forces

in the event of war or national emergency until such time as adequate additional quantities of such equipment and materiel can be procured. The military departments are reimbursed for materiel transferred to the military assistance program from the departmental mobilization reserves, irrespective of whether the materiel requires replacement in kind.

The Mutual Security Act of 1956, which amended the Mutual Security Act of 1954, directed the Secretary of Defense to prescribe, at the earliest practicable date, pricing regulations that would, in general, make the pricing policy for the military assistance program similar to that in effect for transfers between the armed services. The military assistance program would be charged for equipment or materiel obtained from the military departments at the same price charged in a similar transaction between the military departments. Where there were no comparable transactions, the military assistance program would be charged the gross cost to the military department, adjusted to take into account the condition and market value of the item being billed. Previously, the Mutual Security Act and the Department of Defense pricing policy provided for billing the military assistance program the estimated replacement cost, whether or not the acquisition would be the same type of item or an improved and more expensive item. Under this policy the military assistance program was, in many instances, furnished with World War II-type equipment but was charged with the cost of the later and more elaborate equipment bought as a replacement by the military departments, or was charged at 170 percent of the acquisition cost.

Department of Defense Directive 7510.1, approved December 31, 1956, establishes a uniform pricing policy for materiel, supplies, and equipment, other than aircraft and stock fund items, financed by the military appropriations. It provides that reimbursable items transferred to the military assistance program should be priced identically with similar items transferred to other military departments or to other Federal agencies; if no similar transfers existed, the prices should be adjusted to reflect condition and current market cost. This directive was to be implemented for all deliveries to the military assistance program after December 31, 1956.

On November 24, 1956, the Assistant Secretary of Defense, Comptroller, issued instructions for pricing aircraft being delivered to the military assistance program. These instructions provide for a depreciation factor for each year that the aircraft has been in Air Force inventory.

Department of Defense Directive 7420.1, "Regulations Governing Stock Fund Operations," which was issued on December 11, 1956, provides that the same standard prices are to be charged the military assistance program and other stock fund customers. Standard prices are to be reduced when there is a difference between the utility or desirability of items due to age, condition, or model.

Department of Defense Directive 4140.13, "Policies for the Transfer of Department of Defense Supply System Inventories," dated January 27, 1959, redefines the classes of military stocks and contains criteria to govern the determination of reimbursable and nonreimbursable stocks.

## FINDINGS AND RECOMMENDATIONS

### IMPROPER CHARGES FOR EXCESS EQUIPMENT

The military departments are being reimbursed for deliveries under the military assistance program of significant quantities of materiel that should be transferred without charge as excess stocks. The Office of the Secretary of Defense has not developed effective management controls over the practices and procedures of the military departments for determining nonreimbursable deliveries.

#### Economic and contingency reserves not considered as excess stocks

The Mutual Security Act of 1954, as amended, provides that for equipment or materiel in excess of the United States mobilization reserve the military assistance program will be charged only the gross cost of repairing, rehabilitating, or modifying such equipment or materiel.

Although Department of Defense directives provide that materiel in economic and contingency retention stocks is excess to mobilization day (M-Day) materiel requirements and will be charged to the military assistance program at the gross cost of repairing, rehabilitating, or modifying such equipment, our review disclosed that the military departments were charging standard inventory prices for much of the materiel delivered from economic and contingency retention stocks.

The following are examples of programmed equipment for which the Navy's Bureau of Ordnance records showed that inventories exceeded mobilization reserve requirements as of January 1, 1958, but for which funds had been reserved and deliveries intended at standard prices:

<u>Equipment</u>	<u>Program year</u>	<u>Funds reserved to reimburse Navy upon delivery-- December 31, 1957</u>
Director, Gun, MK-51	1957	\$ 113,066
Gun, 5"/54 Single		
Mount MK-39	1957	1,582,350
Plotter, Attack MK-1	1957	380,889
Ammunition, 5"/38	1957	859,028
Ammunition, .50 Cal.	1957	333,057

We also observed that the Navy Ordnance Supply Office made no effort to determine whether parts being furnished MAP should be transferred on a nonreimbursable basis although studies by that office indicated that approximately 80 percent of the ordnance repair parts inventory was excess to mobilization requirements as of June 30, 1958.

Despite the existing directives on this matter, representatives of the Department of the Navy have informed us that, for purposes of transfer and reimbursement, only those stocks which exceed their own retention levels are excess; that Navy retention levels include M-Day materiel requirements plus economic or contingency retention stock; and that the Navy's bureaus have been instructed to apply such criteria in determining items excess to Navy needs.

The Air Force is also charging the military assistance program standard inventory prices, which normally greatly exceed

repair and rehabilitation costs, for materiel delivered from Air Force economic and contingency reserves. It is our understanding that the Air Force has taken the position that all materiel authorized for retention, which includes economic and contingency stocks as well as mobilization reserve stocks, shall be transferred at the standard price.

The Army, unlike other military departments, has agreed that deliveries from economic retention stocks will be provided to the military assistance program as excess stocks. Army materiel retention policy issued in February 1958 provides that, when economic retention stocks are used to fill approved military assistance requirements, issue will be made without reimbursement, except for the cost of repair, rehabilitation, modification, packing, crating, handling, and transportation.

Our review disclosed, however, that this policy had as yet not been fully implemented by the Army. For example, procedures at the Ordnance Tank-Automotive Command and the Ordnance Weapons Command did not identify whether spare parts being delivered to the military assistance program were being provided from economic retention stocks or from mobilization reserves. Therefore, the military assistance program was being charged standard prices for all spare parts that had not been declared excess.

Since our review the Department of the Army has initiated action to adjust retroactively erroneous charges for nonreimbursable deliveries for fiscal year 1959. We are evaluating these adjustments in conjunction with our review of the MAP aspects of the Army's excess disposal plan.

Although ISA has informed the military departments that all items being retained as economic or contingency retention stocks are available for delivery to the military assistance program as excess stocks, provided that such items are excess to the military requirements of the other departments, we saw no indication during our review that the Navy and the Air Force were administering or planned to administer their portions of the military assistance program in this manner. Subsequently, we were informed by Defense officials that implementation of directive 4140.13, issued January 27, 1959, will require that economic and contingency reserve stocks, with certain minor exceptions, be transferred as excess materiel.

Reimbursability not governed by inventory position when item delivered

Current Department of Defense directives do not state whether the determination as to whether equipment will be delivered as excess or on a fully reimbursable basis will be made at the time of programing or at the time of delivery. In the absence of any positive guidance on this matter the military departments have generally held that the time of programing will govern. For example, Air Force regulations provide that, unless materiel is programed as excess, it will not be delivered as excess even though at the time of delivery the asset status has changed and the materiel is excess. Determination of reimbursability at time of programing rather than at time of delivery results in the military departments' receiving greater reimbursements than is warranted in some cases, for the following reasons:

1. Much of the materiel being furnished the military assistance program is being phased out of our own military departments and is being replaced by more modern equipment. At the time of deliveries, materiel previously programed as reimbursable is often excess to United States requirements because as much as 3 years may elapse between the time an item is programed and the time of delivery.

For example, the Air Force is charging the military assistance program inventory prices for F-84F and F-86F aircraft being delivered under prior year programs even though quantities of these aircraft were reported to be excess in the March 1958 aircraft inventory allocation report. On March 31, 1958, 133 F-84F and 309 F-86F planes programed for military assistance on a reimbursable basis at more than \$100 million were undelivered and were excess to Air Force requirements.

In another instance, at Ogden Air Materiel Area we noted that quantities of .50 caliber cartridges were delivered and charged to the military assistance program in the amount of \$988,050 during January, February, and March 1958 although this type of ammunition had been excess for more than a year to Air Force requirements.

As another example, we noted at the Major Item Supply Management Agency that the Army had charged the military assistance program \$617,000 for 25 105mm howitzers and 12 155mm howitzers supplied several months after materiel control studies revealed that these quantities were excess to Army requirements.

2. Approved programs do not contain itemized lists of repair parts requirements; instead, a dollar amount is inserted to cover estimated repair parts, which are specifically identified at a later date. Therefore, the reimbursability for repair parts normally can be determined only during the implementation of approved programs. We have noted that in many instances the military departments deliver repair parts in excess status to the military assistance program and charge standard prices for these items since they have not been, and under current procedures cannot be, identified as excess in the programs. For example, at the Middletown Air Materiel Area all grant aid shipments of repair parts to the military assistance program are charged to the military assistance appropriation, irrespective of whether these parts are excess to Air Force mobilization requirements.

The status of materiel may also change from excess to service stock during the period between programing and delivery, but this does not necessarily mean that the departments transfer such items without reimbursement. The military departments are able to submit program amendments and in this way secure reimbursement regardless of the fact that the materiel was in an excess status at the time of original programing. There are indications that the military departments have been more prone to amend promptly the program in this manner when it was to their advantage to do so than when amendment would reduce the amount of reimbursement. For example, in transmitting the consolidated 1950-58 programs, Headquarters, Air Materiel Command, emphasized to the depots and Air Materiel Areas that, in the event an item determined to be excess to

Air Force requirements at the time of programing becomes a valid Air Force requirement before delivery, the prime depot may submit a request that the program be amended to reflect the changed supply status. No mention was made of the more likely possibility that materiel programed as service stock would become excess before delivery, or whether the prime depots were expected in such cases to submit program amendments to reflect the changed supply status.

We believe that the determination as to whether an item is excess for delivery to the military assistance program should be made at the time specific supply action is initiated, and in no case more than 6 months before delivery. It would seem reasonable that materiel in excess supply should be delivered on a nonreimbursable basis unless it can be demonstrated that the excesses are generated directly by specific procurement to meet military assistance requirements.

#### Agency comments

We have been informed by the Air Force that anticipated reimbursements from the military assistance program are taken into account at the time of development of Air Force appropriation requests and that these requests are reduced accordingly. Therefore, if the amounts anticipated were not realized at time of delivery because the items concerned had become excess, the Air Force program would be underfinanced by that amount.

We recognize that transfers by the Air Force at lower prices than those contemplated in developing its budget may result in underfinancing of Air Force programs. However, this does not justify

charging prices to MAP in excess of those authorized by law. Furthermore, our examination disclosed that military assistance programs are flexible and that frequent and substantial changes are made in the programmed items and in the quantities and prices of the items. Thus, adjustment of price in recognition of the status of the materiel at time of delivery is only one of the factors which affects the amount of ultimate reimbursement.

Defense officials have commented that current revisions to Department of Defense Instruction 2110.16 will provide specific guidance as to when determination of excess is to be made. This revision, together with Department of Defense Directive 4140.13 and an internal audit program inaugurated in June 1958, will, according to the Department of Defense, afford the management controls we recommend.

#### Conclusion

We believe that the varying interpretations of Defense policy exemplified above demonstrate the need for additional Defense control over the implementation of its policy by the military departments. The comprehensive internal audit that has been initiated for the military assistance program can provide one important means of Defense control over the actions of the military departments in this area.

We believe further that the mutual security legislation is clear with respect to the criteria to be used in determining whether or not the military departments are to be fully reimbursed for equipment delivered under the military assistance program. Although the Department of the Army has made retroactive adjustments

to correct most of the erroneous charges for deliveries to MAP from excess stocks in fiscal year 1959, it has made no adjustments of charges for such deliveries in prior years. The Departments of the Air Force and the Navy have not made any adjustments for improper charges for materiel transferred to MAP from excess stocks.

We recognize the difficulty in arriving at an appropriate adjustment and that an approximation may be necessary. However, we believe that the Department of Defense and the military departments must make an appropriate adjustment in the amounts charged to MAP or obtain from the Congress specific legislative relief from the provisions of the Mutual Security Act pertaining to charges for equipment or materiel in excess of the United States mobilization reserve.

#### Recommendation

We recommend that, in addition to taking the above-mentioned action with respect to prior charges to MAP, the Department of Defense aggressively monitor the pricing policies of the individual military departments and their implementation to assure that the military assistance program is not charged for deliveries of materiel that are excess to the military departments' mobilization reserve requirements at the time of initiation of supply action. We believe this could be achieved most readily for major items by reviewing such items remaining undelivered under approved military assistance programs whenever materiel planning studies are revised and by issuing program amendments to show the current sources of supply.

## IMPROPER CHARGES FOR NONEXCESS EQUIPMENT

Although significant reductions have been made in certain areas in the prices charged the military assistance program for materiel being delivered from service stocks, reimbursable transfers frequently are not being priced in accordance with the 1956 amendment to the Mutual Security Act. In general, the Department of the Navy has not adjusted its unit prices for condition and market value; the Department of the Air Force has made some reductions in the prices of aircraft but has not adjusted prices for other equipment; and the Department of the Army has reduced the prices of substantially all the major end items but not major assemblies or repair parts. Some of the latter are being transferred at prices which greatly exceed original acquisition cost. In a number of instances the military departments are using incorrect prices for materiel delivered under the military assistance program.

### Failure to consistently adjust prices of older type equipment

The military departments frequently are charging to the military assistance program the gross cost of materiel being transferred, without an appropriate price adjustment for condition and reduced market value.

A significant portion of the materiel being furnished the military assistance program is being phased out of the military departments and will be replaced with more desirable models having greater operational utility. It is our understanding that it is the intent of the mutual security legislation to charge the military assistance program an equitable price for a nonexcess item being delivered by considering, among other things, what it would

cost to buy that same item--not a new or better one--at the time of delivery. We have found that this frequently is not being done.

Section 545(h) of the Mutual Security Act of 1954, as amended in 1956, provides that the price of equipment and materiel delivered to the military assistance program which are not subject to interservice sales will be the gross cost to the United States adjusted as appropriate for condition and market value.

Department of Defense Directive 7510.1, dated December 31, 1956, which implements this statutory provision except for the deliveries of aircraft and stock fund items, provides that, where there is an actual difference in utility or desirability between an unused and a repaired or used item or between a current and older model of a similar item, a lower price will be established. This directive was to be implemented for pricing sales to the military assistance program commencing with deliveries subsequent to December 31, 1956.

#### Navy

Navy policy directives require establishment of a reduced price to MAP when there is an actual difference in utility or desirability between the materiel being delivered to MAP and similar items being retained or replaced by the Navy. Our review indicates, however, that large quantities of World War II-type equipment are still being furnished the military assistance program, that some of such equipment is obsolescent and not to be replaced, and that normally no consideration has been given to the age or the desirability of the equipment in establishing the price to the military assistance program. Furthermore, standard unit prices

currently being charged the military assistance program for World War II-type equipment are based on replacement costs developed prior to the enactment of the Mutual Security Act of 1956 and are about 150 percent of acquisition costs.

We have been informed by the Navy that, when World War II materiel is supplied to meet military assistance requirements, it is completely new or completely reworked with new parts. The Navy stated that the equipment is in first-line condition, and the cost of placing it in this condition is not added to the unit cost of the materiel but is absorbed in the standard price. The standard price charged to the military assistance program is considered to be the current market value of the equipment.

The prices charged the military assistance program by the Navy do not give effect to the decreased utility of items which are limited standard or obsolescent and in our opinion do not represent market value as contemplated by the mutual security legislation.

#### Air Force

The Air Force adjusted prices for aircraft delivered under the military assistance program pursuant to criteria established by the Assistant Secretary of Defense (Comptroller) on November 24, 1956. The instructions for pricing aircraft being programed to MAP provide for deducting from the original cost a depreciation factor of 10 percent for each year the aircraft, other than transport types, have been in the Air Force inventory, and the addition of total rehabilitation costs. Further, the Air Force is charging for modifications by adding 4-1/2 percent for each year the

aircraft have been in the Air Force inventory. In practice, fighter and trainer aircraft now being sold to MAP become excess to the Air Force after being in inventory an average of 7 years although the 10 percent depreciation factor is predicated upon the aircraft becoming obsolete after approximately 10 years. Accordingly, a higher depreciation factor would be more equitable for these types of aircraft.

Except for aircraft, the Air Force has not adjusted the prices for equipment being delivered to the military assistance program as contemplated by section 545(h) of the Mutual Security Act of 1954, as amended. Air Force Regulation 67-93, dated April 17, 1957, specifies that standard prices, computed as outlined in the regulation, will be used as the basis for pricing all sales, transfers, and issues and that, when prescribed, reductions in sales prices will be made at the time of the sale.

These same provisions are contained in section 31 of Air Force Manual 67-1, vol. 1, dated February 14, 1958, which provides further that the circumstances under which reductions or changes are to be made in sales prices are stated in appropriate directives governing sales of materiel. However, we have been informed by Air Force officials that no directives have yet been issued on this subject.

We have also been informed by the Air Force that its failure to implement fully Defense policy with respect to adjusting the prices of equipment delivered to the military assistance program has been due to its inability to reconcile conflicting instructions contained in a proposed Defense directive and that

discussions have been underway to resolve this matter. Subsequently we were informed by ISA that issuance of Directive 4140.13 should enable the Office of the Secretary of Defense to follow up with the Air Force on reducing prices for sales due to condition and Air Force practices in establishing and revising standard prices.

Army

The Army has implemented Defense Directive 7510.1, providing for consideration of condition and utility in pricing transfers to MAP, for the principal categories of tanks, vehicles, artillery, weapons, and communications and electronics equipment. We have been informed by Army officials that, in addition to reducing the prices charged for major end items, consideration is being given to price reductions for major assemblies and repair parts but that it does not appear administratively practical to do so.

Chemical, engineer, and signal equipment were repriced in compliance with the Department of Defense Directive, commencing with deliveries beginning January 1, 1957. Ordnance equipment was repriced commencing with deliveries beginning in January 1958, except for M47 tanks which had been repriced in August 1956. The Office of the Secretary of Defense authorized this delay on the premise that the Army procurement and production appropriation would suffer a loss in anticipated reimbursements of approximately \$40 million if the price adjustments were applied to calendar year 1957 deliveries.

There are inconsistencies within the Army in granting reductions for the age and condition of materiel transferred to the

military assistance program. The Ordnance Corps generally charges 80 percent of the catalogue price for standard major items coming from stock on the assumption that the items are used but rebuilt. Signal Corps charges full list price on the basis that standard equipment is in condition equal to new condition. For limited standard items the Signal Corps charges the military assistance program only the rebuild cost whereas the Ordnance Corps may charge for rebuild costs or a higher price based on an Army formula recognizing operational utility, obsolescence, and rebuild.

#### Department of Defense report on price reductions

The Department of Defense, in a report submitted to the Congress in December 1958, estimated that through fiscal year 1959 the military assistance program will realize savings of \$232.2 million from price reductions for equipment furnished of an older type or diminished utility. We believe that this estimate is overstated and that the price reductions during this period will total about \$160 million. For example, the guided missiles for which Defense estimated savings of \$22.5 million have been deleted from MAP, and therefore these price reductions will not be made. Defense estimated savings on electronic and communication equipment to be \$35.5 million and savings on combat vehicles to be \$23.8 million. Based on our tests of information secured from the technical services involved, we believe that price reductions in these categories will actually be about \$16 million and \$10 million, respectively.

#### Inflated prices charged for repair parts

The military assistance program is being charged at inflated prices for certain assemblies and repair parts for ordnance

vehicles and weapons delivered by the Department of the Army. Standard prices are being increased through the use of price indices to arrive at estimated replacement costs, which greatly exceed acquisition costs, for items to be transferred to the military assistance program.

Prior to the 1956 amendments to the Mutual Security Act, a substantial portion of the World War II-type materiel, the utility of which was limited and which probably would not be replaced in kind, programmed for military assistance recipients, was billed at an estimated replacement cost computed at 170 percent of the original acquisition cost. In many cases this was inequitable since the military department would be utilizing military assistance funds for modernizing its stock, and the value of supplies and equipment furnished under the military assistance program was inflated.

These inequities have not been corrected completely by a new pricing formula. This formula provides for pricing certain ordnance repair parts and major assemblies at replacement costs computed by applying index factors to the acquisition costs. At the Ordnance Tank Automotive Command (OTAC) the following indices, which we were informed were based on United States Bureau of Labor Statistics price indices, were being used to compute standard prices for stock issues, including deliveries under the military assistance program.

<u>Year of most recent procurement</u>	<u>Index applied</u>
1949 or earlier	225%
1950	155
1951	145
1952	135
1953	128
1954	124
1955	118
1956	111
1957	105

For example, if the most recent procurement occurred in May 1949 at a unit price of \$187, the billing price would be \$446, applying a 225 percent factor plus a 6 percent charge for transportation and other costs. OTAC has estimated that the dollar value of its inventory increased by \$100 million in the last quarter of fiscal year 1958 due largely to this practice.

At the Ordnance Weapons Command the following index factors, which differed substantially from those used by OTAC, were being applied to acquisition costs to determine billing prices. We were unable to secure any explanation of the basis for these factors.

<u>Year of most recent procurement</u>	<u>Index applied</u>
1950	130%
1951	128
1952	126
1953	124
1954	122
1955	120
1956	110

After we brought this matter to their attention, Department of the Army officials directed the Chief of Ordnance to exclude from the computation of standard prices the application of an index factor to acquisition costs in order to reflect replacement costs.

### Inaccurate pricing of deliveries under MAP

In a number of instances the military departments are using incorrect prices for the materiel delivered under the military assistance program. Although the military departments review periodically the accuracy of their standard prices, there are considerable differences as to the scope and effectiveness of such reviews, depending upon the quantity and nature of stock, the availability of procurement data, and the time devoted to these reviews.

#### Army

The periodic pricing reviews were not effective at the Ordnance installations we visited. All items had been scheduled for an annual cyclical review irrespective of the volume of transactions or size of inventory. This resulted in the reviewer's being without knowledge of the relative significance of the items to be reviewed so that he may have devoted an undue amount of time re-pricing an item which has a relatively low dollar volume of transactions.

Other factors affecting the effectiveness of the pricing review are incomplete historical procurement records due to transfers of responsibility from one installation to another, inflated costs for arsenal production on account of curtailed manufacturing with accompanying greater overhead per unit, and inadequate indoctrination of personnel. In some commands the implementation of accounting for items in terms of value as well as quantity had been too recent to afford a means of appraising the effect of price adjustments on the total value of the inventory.

We also noted that the Major Item Supply Management Agency was not carrying out its responsibility for reviewing the pricing of items by the other Ordnance commands as prescribed by Ordnance instructions.

The Army Audit Agency reported that MAP had been overcharged at least \$400,000 in fiscal year 1958 due to the Signal Corps' failure to keep its fiscal year 1957 adjusted MAP prices current with respect to changing prices and obsolescence of the items. Its tests of selected MAP deliveries valued at \$4,000,000 disclosed overbillings of \$797,202 and underbillings of \$379,731. Examples of improper billings are:

<u>Item</u>	<u>MAP price</u>	<u>Standard price</u>	<u>Difference</u>	<u>Delivered quantity</u>	<u>Overcharge or undercharge (-)</u>
AN/PRC-6	\$ 194	\$ 123	\$ 71	4,891	\$325,961
AN/TCC-22	3,660	2,640	1,020	3	8,160
AN/PRC-9	311	459	-148	1,880	-278,240
PE-210	387	413	-26	342	-8,892

The procedures were changed on June 30, 1958, to minimize erroneous charges in the future, and we were informed that the improper 1958 billings were corrected in January 1959.

#### Air Force

In many instances the Air Force charged the military assistance program for deliveries of materiel at prices which did not agree with the most currently available cost information. In some cases supply catalogue prices, on which MAP billings were based, were not being received promptly in the billings offices, were not being revised currently to reflect price changes, and were unrealistic in comparison with current purchase prices. We also noted

billings to MAP at unit prices which exceeded current cost data. Billing personnel could not explain the use of the higher prices.

Rome Air Force Depot was not performing periodic reviews of prices on an established cyclical basis in order to keep the Air Force supply catalogue in a current condition. For some of the items listed, including the following, the unit prices listed in the Air Force supply catalogue appeared unrealistic in comparison with current contract prices.

<u>Item</u>	<u>Air Force catalogue price</u>	<u>Current contract price</u>
AN/FPS-6A	\$350,000	\$177,695
AN/FPS-20A	350,000	447,225
MPN-110	1,000	316,762

Immediately prior to our review, Headquarters, Air Materiel Command (AMC), personnel had noted that price reviews were not being accomplished at Rome Air Force Depot. We were informed by base personnel that corrective action was being initiated to develop more realistic prices.

At Middletown Air Materiel Area we noted that unit prices charged MAP for shipments under the program did not agree with the unit prices contained in the Air Force supply catalogue in effect at the time shipment was made. Items tested indicated both underbillings and overbillings to MAP. The failure to supply the latest price data promptly and delays by the Air Materiel Area in processing price change notices have resulted in the use of outdated prices and inaccurate accounting and reimbursement for shipments of materiel to MAP. We were informed by base personnel that in many instances stock list publications and stock list changes

were not received from Headquarters, AMC, in sufficient time to permit local processing of stock price changes. We were also informed that Middletown and Headquarters, AMC, recognized this problem and were attempting to overcome the lag in the receipt of price data.

#### Conclusion

We believe that substantial additional price reductions on materiel transferred to the military assistance program could have been made if all of the military departments had applied in a consistent manner the pricing policies enunciated in section 545(h) of the Mutual Security Act of 1954, as amended, and that additional reductions are possible in the future if this is done.

Although some action has been taken to correct the overpricing of nonexcess stocks transferred to MAP, the departments have received, in our opinion, substantial reimbursements as a result of improper charges.

We recognize the difficulty of ascertaining the amount of such charges and that an approximation may be necessary. However, we believe that the Department of Defense and the military departments must make an appropriate adjustment in the amounts charged to MAP or obtain from the Congress specific relief from the provisions of the Mutual Security Act requiring adjustment of cost for condition and market value of materiel delivered to MAP.

#### Recommendation

We recommend that, in addition to taking the above-mentioned action with respect to prior charges to MAP, the Department of Defense utilize internal audit to examine critically the pricing

policies of the individual military departments and their implementation to assure that the military departments determine in a uniform and consistent manner the price adjustment required by section 545(h) of the Mutual Security Act of 1954, as amended. Further, we recommend that a reappraisal be made of the factors used in the aircraft pricing formula.

## SCOPE OF REVIEW

Our review included an examination of procedures, records, reports, and internal reviews in connection with the pricing of equipment and supplies transferred by the military departments in accordance with the Mutual Security Act of 1954, as amended.

We reviewed activity relating to (1) the basis for determining whether materiel would be transferred to the military assistance program with or without reimbursement and (2) the extent to which prices of reimbursable materiel were reduced because of age or condition. With respect to reimbursable materiel, we also made a limited review of the bases used by the military departments in establishing prices to be charged the military assistance program.

The review included examinations within the Office of the Secretary of Defense (International Security Affairs, Supply and Logistics, and Comptroller), the headquarters of the military departments, and the following selected installations: Headquarters, Air Materiel Command, Middletown Air Materiel Area, Ogden Air Materiel Area, Rome Air Force Depot, United States Army Signal Supply Agency, Ordnance Tank-Automotive Command, Ordnance Weapons Command, Ordnance Ammunition Command, Major Item Supply Management Agency, Bayonne Naval Supply Depot, Naval Ordnance Supply Office, and Ships Parts Control Center.

We examined selected transactions and made such other tests as we deemed appropriate to enable us to consider the adequacy and the effectiveness of the management controls.

**APPENDIX**



ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON 25, D. C.

INTERNATIONAL SECURITY AFFAIRS

In reply refer to: I-2250/9

JUN 24 1959

Dear Mr. Bailey:

We appreciate the opportunity to comment upon the draft report prepared by the General Accounting Office on its review of the pricing of materiel delivered to the Military Assistance Program.

It is regretted that our comments, attached, were not available sooner. Copies of the draft report were sent to various agencies and offices for comment and their comments were received only recently.

Because of the world-wide operations of the Military Assistance Program, and the comparative small staff of this office, ISA must rely to a large extent upon the military departments' implementation of the program and their interpretation of DOD Directives and Instructions. The internal audit of the Military Assistance Program in the Department of Defense, inaugurated in June 1958, will provide additional information concerning possible misinterpretations of Directives, Instructions, regulations and operational deficiencies on which corrective action can be taken.

Sincerely yours,

(SIGNED) Wm. M. LEFFINGWELL

Wm. M. Leffingwell  
Special Assistant  
to the Deputy Assistant Secretary

1 Attachment

Mr. C. M. Bailey  
Associate Director of the Defense  
Accounting & Auditing Division  
U.S. General Accounting Office

Distr:  
R&C  
ISA RF  
OSD Comptroller  
QR&C  
Budget chron  
Budget subj

Prep by: WAComer/dj/28 May 59  
3D-239, Ext. 75638  
Rewritten WAComer /dj/5 June 59

DOD COMMENTS ON GAO REPORT  
ON REVIEW OF THE PRICING OF MATERIEL  
DELIVERED TO  
THE MILITARY ASSISTANCE PROGRAM

GENERAL

1. In order properly to equate findings with corrective actions, it is requested that future draft and final reports specify the period during which the review was conducted.

2. On pages 1, 2 and 9 of the draft report, comment is made pertaining to reimbursements to the military appropriations for delivery of materiel that should be transferred as excess stocks. It is suggested that the language be clarified to make it clear that the materiel referred to is that which is furnished under the Grant Aid Military Assistance only.

3. The comments in paragraph 1, page 5 of the report to the effect that Congress does not have an opportunity to approve the total resources being applied to the program, is contrary to the facts. The Congressional submission now before Congress states by country and world-wide totals the amount of excess programmed in the prior year, the current year, and the budget year, as well as cumulative deliveries of excess stocks made to date. Congress, therefore, does have an opportunity to approve the total resources being applied. It would appear expedient to recognize this fact in the final report.

To inflate the military assistance appropriation by the value of excess materiel appears to be an unnecessary bookkeeping exercise and would provide Congress with no additional information.

4. On page 6 the suggestion is made that the military accounts be reimbursed only for equipment deliveries replaced in kind, and that the military departments increase their budgets to include the more modern equipment which replaces equipment sold to MAP.

Such a procedure implies that ISA could and would definitize its program and the military departments could screen the programmed items for supply action prior to the budget request. This would be nine months to a year earlier than is now possible. If the suggestion is adopted, it should be recognized that drastic changes would be required in existing legislation.

5. It is stated on page 9 of the draft report that "The military assistance funds so designated are set aside to reimburse the military departments and are not considered obligated until materials are delivered or services performed." While this may be a correct statement, it nevertheless must be recognized that the funds reserved pursuant to the provisions of Sec. 108 are a legal liability running from the military assistance appropriation to the military appropriations.

ITEM 1. Improper Charges for Excess Equipment. Page 2 and comments on pages 12-22.

DOD Directive No. 4140.13, Subject: "Policies for the Transfer of Department of Defense Supply Systems Inventories", dated January 27, 1959, establishes uniform policies for the transfer of materiel in inventory between inventory managers of the military service supply systems. This directive, the issuance of which was made known to your office in our replies to the draft reports on the Navy (October 31, 1958) and Air Force (November 14, 1958) administration of the Military Assistance Program, clearly divides inventories into transferable-reimbursable and transferable-nonreimbursable categories thus affording the specific direction necessary to assure proper distribution of charges.

Current revisions to DOD Instruction 2110.16 will provide specific guidance when determination of excess is to be made, which, together with DOD Directive 4140.13 plus the internal audit program inaugurated in June 1958, will afford the management controls recommended in the draft report.

ITEM 2. Failure to Adjust Consistently Prices of Older Type Equipment. Page 3 and comments on pages 23-28.

A comprehensive report on the implementation of the pricing provisions of Sec. 545(h) of the Mutual Security Act of 1954, as amended by the Mutual Security Act of 1956, was submitted to Congress in December 1958. Additionally, our reply to the draft reports covering the Departments of the Navy and Air Force implementation of the MAP included comments on the pricing of old equipment.

These actions by DOD have not been recognized in the draft report which further fails to recognize that implementation of DOD pricing policies is a prerequisite to implementing the requirements of the MSA for pricing transfer and sales to the MAP. The recommendation on page 28 is misleading by failure to recognize:

a. GAO concurrence with DOD pricing policy for the Military supply system inventories.

b. That price reductions (for condition and market value) are required by DOD regulations for all customers when appropriate.

c. The requirements of Sec. 545(h) of the Mutual Security Act of 1954, as amended, to distinguish the difference between the price to be applied where there are similar transactions between the Armed Forces and where no similarity exists.

It is suggested that the above comments be incorporated to the extent possible in the final report.

**ITEM 3. Inflated Prices Charged for Stock Fund Deliveries. Page 3 and comments on pages 29-31.**

The recommendations (page 31) that the Department of the Army follow up on the implementation of its directive regarding the revision of standard prices for Stock Fund Items, are being carried forward.

**ITEM 4. Inaccurate Pricing of Deliveries to MAP. Page 4 and comments on pages 32-35.**

a. Under date of 16 June 1958, the Audit Division of the Office of the Assistant Secretary of Defense (Comptroller) issued "Guidelines for Audit of the Military Assistance Program", to provide necessary instructions for the Department of Defense internal auditors in connection with the integrated audit of the Military Assistance Program in the Department of Defense. On page 19, Section B-5 of these guidelines, under Program Development, it is stated as one of several objectives: "Evaluate whether prices for programming are established on a realistic basis." Again under Funding and Accounting, page 50, Section B, Audit Objectives, item 4, states: "To ascertain that pricing policies and procedures for reimbursement by MAP to military appropriations are sound, reliable and uniformly applied by the three departments."

b. It would appear, therefore, that the recommendation that the DOD utilize the internal audit program to review, on a continuous basis, the pricing practices and procedures of the military departments, is somewhat belated.

ITEM 5. Failure to Reduce Service Appropriation Requests for Anticipated MAP Reimbursements. Pages 4-6 and comments on pages 36-38.

The recommendation on page 4 of the draft report, while properly directed to the DOD, is not germane to the implementation of the MAP. ISA has no jurisdiction over the military department appropriations. However, the following comments do represent the DOD position. In the fall of the year, at the time the military budget is prepared for the Congress, the Military Assistance Program for the budget year has not solidified to a point where a determination can be made of the amount of credit to a military account for sales to MAP not required to be replaced in U.S. inventories. Estimating the amount of new obligational authority to be credited to each military appropriation or account in the budget, to be received from the military assistance appropriation (as is done now) is still precarious because of the many changes made in the Military Assistance Program during the year of program execution. Estimates of credits to military appropriations or accounts made at the beginning of the budget year, or earlier, must be revised continuously throughout the year. For example, at the beginning of fiscal year 1959, the estimate of the value of MAP orders was \$987 million, but it now appears that \$891 million worth of orders will materialize. This reduction will affect many of the military accounts, forcing changes in military department programs up to the end of the year.

Furthermore, the amount of reimbursements for the sale of items to MAP that do not have to be replaced in inventory has diminished to the point where they will have little impact on the amount of new obligational authority requested of the Congress for the military appropriations. A rough estimate of this "not in kind" replacement for fiscal year 1960 is in the neighborhood of \$100 million. It is believed that this benefit to military appropriations will continue to be relatively small because of the trend toward the programming of newer and more modern equipment for MAP from procurement and because the recently issued DOD supply Directive requires that much of the equipment formerly sold to MAP will now be furnished as excess.

It is the opinion of the DOD that there is little to be gained by attempting to estimate the amount of reimbursements from the current (budget year) military assistance appropriation for reduction of military appropriation budget requests. Attention is also directed to the information made available to Congress on anticipated reimbursements to

military appropriations included in the president's Annual Budget Document (see pages 538-539 of the FY 1960 Budget Document). It should also be recognized that the development of firm FY MAP on which reimbursements to military appropriations can be based cannot be done until after the annual enabling legislation and subsequent appropriation bill is passed by Congress. While a global estimate of total reimbursements is made the incorporation of estimated reimbursements to specific military appropriations in the budget year is impractical and worthless from a financial planning standpoint. It is, therefore, suggested that the proposed recommendation that the Secretary of Defense inform Congress relative to anticipated reimbursements from MAP as well as the suggestion that Congress may wish to consider certain legislative restrictions in this area be reconsidered.