

**GAO**

Report to the Chairman, Legislation and  
National Security Subcommittee,  
Committee on Government Operations,  
House of Representatives

September 1988

# FOREIGN MILITARY SALES

## Redirection of Accounting Improvement Efforts Is Appropriate



---

---



Accounting and Financial  
Management Division

B-204400

September 15, 1988

The Honorable Jack Brooks  
Chairman, Legislation and National  
Security Subcommittee  
Committee on Government Operations  
House of Representatives

Dear Mr. Chairman:

On March 31, 1988, your subcommittee held a hearing on the Department of Defense's (DOD) efforts to correct long-standing accounting problems in the foreign military sales (FMS) program. Following that hearing, you requested that we continue to monitor DOD's efforts in this area. This letter summarizes Defense's actions since the March hearing and provides our assessment of decisions the Deputy Secretary of Defense communicated in a July 11, 1988, memorandum.

The Deputy Secretary's July memorandum redirects FMS accounting improvement efforts by terminating the Department's most recent central accounting system development effort, reassigning responsibility for central FMS accounting and billing from the Defense Security Assistance Agency (DSAA) to the Air Force, and directing the establishment of a second FMS trust fund by October 1989.

We believe these efforts are important steps toward correcting long-standing FMS accounting problems and show an apparent recommitment by high-level Defense officials to the success of FMS accounting improvements. Reassigning this responsibility is appropriate in light of DSAA's more than 10 years of unsuccessful efforts to improve FMS accounting. In addition, a new trust fund will segregate old discrepancies from accounting activity associated with newly implemented cases. However, for these efforts to be ultimately successful, DOD must correct fundamental accounting weaknesses that have allowed errors and omissions in FMS records to go unresolved for years.

---

## Background

The Arms Export Control Act of 1976, as amended, gives DOD authority to sell defense articles and services to foreign countries, generally at no profit or loss to our government. Since the 1950s, foreign countries have signed agreements initiating thousands of FMS cases valued at over \$180 billion. As of September 30, 1987, about 16,600 cases with an estimated

value of \$142 billion were open. Approximately \$54 billion of this amount consisted of undelivered orders.

The act generally requires foreign customers to pay, in advance, amounts sufficient to cover current expenditures associated with their sales agreements. The U.S. 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 the FMS agreements.

FMS accounting is a DOD-wide responsibility. In most cases, the Army, Navy, and Air Force execute sales while DSAA has overall responsibility for administering the program. The agencies that execute cases are responsible for reporting detailed accounting data to a central activity which maintains each country's trust fund balance and issues periodic statements summarizing amounts charged for performance related to the country's sales cases. DSAA's Security Assistance Accounting Center, located at the Air Force Accounting and Finance Center in Denver, Colorado, has carried out the central accounting and billing function since its establishment in 1976. Prior to the Deputy Secretary's July memorandum, DSAA and the Air Force shared responsibility for managing the Center's operations, with DSAA exercising primary control.

For more than 10 years, GAO and DOD auditors have reported major accounting and internal control weaknesses impairing DOD's ability to properly manage the FMS trust fund and provide accurate statements to customers. These include (1) inadequate controls over the accuracy of data the military departments submit to the central system and (2) an inability to reconcile country-level trust fund balances with each country's subsidiary case balances. As a result, old discrepancies remain unresolved while new errors continue to occur, and complete reconciliations are difficult, if not impossible, without an extraordinary amount of research. Our testimonies<sup>1</sup> at hearings your subcommittee held in March 1988 and in June 1987 describe these weaknesses in detail and provide specific examples of their effects on the accuracy of FMS accounting records.

DOD's inability to reconcile differences between amounts spent from the trust fund and the value of performance reported to customers indicates

---

<sup>1</sup>"DOD's Financial Management of the Foreign Military Sales Program" (GAO/T-AFMD-87-12, June 4, 1987) and "Status of DOD Efforts To Improve Accounting for Foreign Military Sales" (GAO/T-AFMD-88-9, March 31, 1988).

---

the magnitude of the problem. Performance includes deliveries of materiel, performance of services, progress payments on as-yet-undelivered items, and administrative costs. As of December 1987, unreconcilable differences for individual customer countries showed that for some countries trust fund disbursements exceeded reported performance while for others reported performance exceeded trust fund disbursements. These differences totalled \$1.03 billion, with a net unreconcilable difference of \$229 million in trust fund disbursements exceeding reported performance.

In 1982, after 6 years of largely unsuccessful efforts to improve central FMS accounting, DOD established the FMS Financial Management Improvement Program under the Defense Comptroller. Under the program office's direction, DOD initiated a comprehensive plan to correct past deficiencies. DSAA's new central system was the centerpiece of this plan, which also included the development of interfacing systems in each military department. In early 1987, in conjunction with the improvement project, the Deputy Secretary established the Reconciliation and Case Closure Board to help resolve unreconcilable differences.

Despite apparent efforts to speed the system's implementation, originally planned for October 1986, the project fell behind schedule due to numerous technical and managerial problems. These difficulties, which are discussed in our March 1988 testimony, included more system design changes than originally anticipated after system development had begun and inappropriate shortcuts in system testing to meet ambitious implementation milestones.

---

## Objectives, Scope, and Methodology

The objectives of this report are to (1) summarize Defense's FMS accounting improvement actions since the March hearing and (2) assess the Deputy Secretary's decisions, outlined in his July 11, 1988, memorandum, which redirect these efforts. To accomplish our objectives, we discussed FMS accounting problems and the possible impact of the actions directed by the Deputy Secretary with officials in DSAA, the Directorate of Accounting Policy, and the military departments. We examined the results of tests and assessments of the now-terminated central FMS accounting system and related documents and records. In addition, we relied on previous GAO efforts in this area, including testimony before your subcommittee, which was based on reviews performed during 1987 and 1988. (See footnote 1.) We conducted our current review from April through August 1988 in accordance with generally accepted government auditing standards. As agreed with your office, we did not request or

---

obtain written agency comments on a draft of this report. However, we did discuss our findings with appropriate officials in the Defense offices listed above and have incorporated their views where appropriate.

---

## Defense Decisions

Since your subcommittee's March hearing, Defense's main actions have been the continued testing and assessment of the central accounting system development effort culminating in the issuance of the Deputy Secretary's July 11, 1988, memorandum. The memorandum mandated the immediate termination of the central FMS accounting system development effort, stating that this decision was based on findings of the Assistant Secretary of Defense (Comptroller), the Assistant Secretary of Defense (International Security Affairs), and the Director, DSAA, that

"the project has substantially exceeded cost and schedule estimates without achieving any systemwide capability and that testing in its present form could require another two or three years without any assurance that the system will operate as intended."

We believe that the Deputy Secretary's decision to terminate the central system project was appropriate because system tests and assessments conducted during the 10-month period prior to his decision had concluded that the central system was unable to process transactions successfully and could not be easily fixed. For example, during this testing and assessment period, Defense personnel could not successfully run even one module of the central system, hundreds of computer program problems continued to be identified, and deficiencies regarding the data base design and programming efficiency were identified.

In addition to terminating the central system's development, the Deputy Secretary initiated two actions intended to strengthen future FMS accounting improvement and reconciliation efforts. In the July memorandum he directed that

- responsibility for central FMS accounting, except reconciliation of trust fund balances, be transferred from DSAA to the Air Force as Executive Agent and
- a new FMS trust fund with a life of 3 years be established by October 1989.

---

## Transfer to Air Force

While terminating the latest system development effort, the Deputy Secretary appointed the Air Force as the Executive Agent to design.

---

develop, implement, and operate a new central FMS accounting system. The memorandum directed the Air Force to complete a cost-benefit analysis of alternative approaches for developing a new central system within 90 days. The Air Force is also to assume responsibility for the day-to-day operation of the existing central FMS accounting system and for providing FMS-related accounting guidance and direction to the military services. The memorandum directs the Air Force to report directly to the Assistant Secretary of Defense (International Security Affairs), whose office provides top-level policy guidance on international security affairs to DSAA and other components in DOD. Shifting FMS accounting responsibility away from DSAA is appropriate in view of the more than 10 years of unsuccessful DSAA efforts to improve FMS accounting. Since the Security Assistance Accounting Center is collocated with the Air Force Accounting and Finance Center, assigning central FMS accounting responsibility to the Air Force appears reasonable.

Although the July memorandum relieves DSAA of most FMS accounting responsibilities, it states that reconciliation of balances in both the existing and the new trust funds will be performed under the direction of the DSAA Director. While DSAA should have an advisory role in the reconciliation effort, especially regarding the resolution of sensitive or unusual cases, we believe the Air Force should be responsible for routine reconciliations and all adjustments to balances. Reconciliation is an integral function of any accounting system and should ensure the identification and resolution of errors and omissions that have not been detected through other accounting controls.

Also, the July memorandum did not address the role of the Reconciliation and Case Closure Board. Previously, the Department has portrayed the Board as an important element in FMS reconciliation efforts. Chaired by the DSAA Comptroller, the Board was established in February 1987 to facilitate timely case closure and issue determinations regarding additional billings or adjustments to FMS records that cannot otherwise be reconciled or closed within established DOD policies, procedures, and practices. Although FMS records contain some imbalances that have remained unresolved for years, the Board had not, as of July 1988, formally reviewed any cases. According to DOD's Director of Accounting Policy, the Board is postponing determinations on such discrepancies until the military services have exhausted attempts to research and resolve them. In view of the Board's inaction and in conjunction with the reorganization in FMS accounting responsibilities, Defense should clarify the Board's role in the reconciliation process.

---

## New Trust Fund

In his July memorandum, the Deputy Secretary directed the establishment of a new FMS trust fund to accommodate newly initiated cases. The DOD Inspector General recommended the establishment of a new trust fund in 1982, and your subcommittee recommended the same action in its June 23, 1988 report.<sup>2</sup> A new trust fund is generally seen as a way to isolate the errors associated with existing cases and provide a "clean slate" for cases initiated after the new fund's implementation. According to DOD's Director of Accounting Policy, the new trust fund's purpose would be to segregate activity associated with newly initiated FMS cases from the cumulative balances associated with cases in the existing trust fund. Thus, as existing cases close, this would "force a complete and final accounting for the old trust fund in the foreseeable future."

The establishment of a new FMS trust fund would isolate discrepancies in existing and old FMS case records from balances for newly initiated cases. Maintaining separate balances for these two groups of cases should make it easier for DOD managers to monitor efforts to (1) research and resolve discrepancies in the existing trust fund and (2) avoid the creation of discrepancies for new cases.

However, the new trust fund's success will not be automatic. Improving the reliability of FMS accounting records will ultimately depend on the following three factors.

First, procedures for establishing and operating the new trust fund must ensure that the old and new trust fund balances do not become commingled. This will require significant changes in the way customer orders and advance deposits have been handled in the past. At the close of our review, procedures to implement these changes had not been finalized. Second, because the deadline for establishing the new fund is October 1, 1989, its successful implementation is likely to depend on the new presidential administration's commitment. Third, and most importantly, fundamental accounting weaknesses affecting data reliability and Defense's ability to reconcile FMS accounts must be corrected to ensure that errors and omissions in future transactions are prevented or detected and resolved. Defense has recognized these significant deficiencies in FMS accounting and was to have corrected them in the now terminated central system. Because correcting these weaknesses is so important to any FMS accounting improvement effort, this issue is discussed in greater detail in the next section.

---

<sup>2</sup>Defense Department's Foreign Military Sales Accounting Problems Continue, House Report 100-727, dated June 23, 1988.



## Fundamental Weaknesses Must Be Resolved

If the actions directed by the Deputy Secretary are to succeed in improving FMS accounting, the Department must resolve fundamental problems related to data reliability and the reconciliation of discrepancies in customer accounts. Specifically, DOD must implement accounting controls to ensure that

- data transmitted from the military departments and recorded in the central system is complete and accurate and
- central FMS records contain sufficient information to facilitate the precise identification and timely resolution of imbalances so that accounts can be reconciled.

Most importantly, the Department must improve its controls over FMS data transmission from the military service activities that execute and record FMS transactions to the central accounting activity, which consolidates this information and uses it to prepare periodic statements to customers. In our previous reviews, we have found that the Department's central FMS records contain many errors and data omissions caused by inadequate controls over data transmitted between the services and the central FMS accounting activity. Controls must be implemented to ensure that all transmitted data is correctly received and recorded and that rejected transactions are properly resubmitted. If this is not done, errors and omissions will continue to occur, affecting the reliability of data recorded in both the old and new trust funds.

Second, the central system should be capable of maintaining complete case-level data so that imbalances in individual case records can be readily identified and reconciled. Although the services now routinely submit the needed data, the existing central FMS system cannot maintain case-level disbursement data. As a result, discrepancies between disbursements and performance cannot be routinely identified at the case level and, therefore, cannot be reconciled in a timely manner.

## Conclusions

Defense officials have recognized recent setbacks in their efforts to correct long-standing FMS accounting deficiencies, and, at the Deputy Secretary's direction, are planning actions that should significantly redirect future efforts. Terminating present efforts to develop a new central FMS system, transferring most FMS accounting responsibilities from DSAA to the Air Force, and implementing a new trust fund offer DOD a fresh start in overcoming past problems.

---

However, reorganizing FMS accounting responsibilities and establishing a new FMS trust fund will not necessarily remedy the fundamental problems that have plagued FMS accounting for years. Therefore, any forthcoming accounting improvement efforts must implement controls to ensure that central FMS records are accurate and that discrepancies between disbursements and performance can be identified at the case level to facilitate reconciliation. In addition, we believe that the primary responsibility for reconciling FMS accounts should lie with the same agency that is responsible for FMS accounting.

Finally, the ultimate success of a new trust fund and the Air Force's implementation of a new central FMS accounting system depends largely on the continuing support and commitment of DOD officials.

Since DOD had not decided on a system development approach at the close of our review, we are making no recommendations at this time regarding the design, development, and implementation of a new FMS accounting system by the Air Force. We outlined the accounting weaknesses that need to be corrected and the system development problems that led to the termination of the central system development project in our June 1987 and March 1988 testimonies. Our January 1987 publication entitled Critical Factors in Developing Automated Accounting and Financial Management Systems provides additional guidance regarding system development. In planning the new FMS accounting system, the Air Force needs to capitalize on the lessons learned from Defense's most recent attempt to design a new system. We will continue to monitor the Air Force's efforts to ensure that the key accounting weaknesses are addressed and that the system development problems experienced in the past are avoided.

---

## Recommendations

To ensure that reconciliations are an integral part of routine FMS accounting activities and to ensure that both routine and nonroutine reconciliation responsibilities are clearly defined, we recommend that the Secretary of Defense

- assign full FMS accounting responsibility, including reconciliation, to the Air Force and
- clarify the role of the Reconciliation and Case Closure Board in the reconciliation process.

We are sending copies of this report to the Secretary of Defense and to the Chairman, Senate Committee on Governmental Affairs. We will also

---

send copies of the report to other interested parties and make copies available upon request.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Brian P. Crowley".

Frederick D. Wolf  
Director







---

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office  
Post Office Box 6015  
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are \$2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

---

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

Official Business  
Penalty for Private Use \$300

First-Class Mail  
Postage & Fees Paid  
GAO  
Permit No. G100

---