Barker

The Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Accounting for Reports of Discrepancy under Foreign Military Sales Program

File: B-222666

Date: January 11, 1988

DIGEST

Security Assistance Management Manual (SAMM) is unclear on what should happen when a Foreign Military Sales (FMS) customer claims non-receipt of materiel and the responsible Army depot, while producing some evidence of shipment, cannot adequately document that it shipped the materiel nor determine with certainty whether inventories were reduced accordingly. Defense Security Assistance Agency (DSAA) believes discrepancy should be charged to Army appropriated funds rather than to FMS administrative funds. GAO defers to DSAA since DSAA is responsible for issuing SAMM and GAO cannot conclude that DSAA position is plainly erroneous.

DECISION

The question presented in this decision is whether Foreign Military Sales (FMS) administrative funds or the Army Stock Fund should be charged when an FMS customer claims non-receipt of materiel and the responsible Army depot cannot document that it shipped the materiel.1/ As explained below, we conclude that the Stock Fund should bear the charge under such circumstances.

SUMMARY OF THE PROGRAM

The transactions involved here were conducted under section 21 of the Arms Export Control Act,2/ 22 U.S.C. § 2761, which authorizes the President to "sell defense articles and defense services from the stocks of the Department of

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1/ The decision was requested by the Finance and Accounting Officer, United States Army Tank-Automotive Command, Warren, Michigan, and was transmitted to us through the Office of the Comptroller of the Army.

2/ The Act was at one time known as the Foreign Military Sales Act, hence the commonly accepted FMS designation.

Defense" (DOD) to eligible foreign countries. Generally, the purchasing country must agree to pay in advance (or upon delivery if the President determines it to be in the national interest) in United States dollars. 22 U.S.C. § 2761(a), (b). Stock items are shipped from responsible Army depots to FMS customers, often via common carrier. If the purchased defense article is not intended to be replaced in DOD stock, the price the FMS customer pays is "not less than the actual value thereof." If DOD does intend to replace the defense article in stock, the price for the FMS customer is the estimated cost of replacement of the article, including contract or production costs, less any depreciation in the value of the article. 22 U.S.C. § 2761(a)(1), (2). The price charged to FMS customers also includes a charge for administrative services, calculated on an average percentage basis to recover the full estimated costs of the administration of sales made under the Act. 22 U.S.C. § 2761(e).

The Security Assistance Management Manual (SAMM) prescribes the rules and procedures applicable to the FMS transactions at issue in this case. Under the SAMM, FMS stock sales are financed on a reimbursement basis. The financing process begins by the FMS customer depositing the purchase price amount into its FMS trust fund holding account. Upon delivery of the item, the deposited purchase money is transferred from the customer's Trust Fund account to the appropriation account used to buy the item for the DOD stocks originally. In these cases that "account" is the Army Stock Fund established under the authority of 10 U.S.C. § 2208.

The administrative surcharge is also handled on a reimbursement basis. Upon payment by the FMS customer, it is collected by the Security Assistance Center and deposited into a separate account in the FMS Trust Fund (FMS administrative funds). The administrative funds are then available for allocation to the military departments and DOD organizations which implement the FMS program to cover their program-related expenses.

THE REPORTS OF DISCREPANCY

When a customer claims it has not received defense articles ordered under the Act, a "Report of Discrepancy" (ROD) is filed. The SAMM provides guidance as to when RODs are to be charged to appropriated funds and when they are to be charged to FMS administrative funds.

In August 1984, 31 RODs were sent to the Army Security Assistance Center for approval for payment from FMS administrative funds. In each case, a customer was claiming

non-receipt of materiel and the responsible Army depot could not provide documentation to prove that shipment was made. The depots also cannot say whether their inventories were actually reduced by the supply actions connected with the RODs. Apparently, the customers' FMS Trust Fund accounts were charged for materiel which they claim they did not receive after the responsible Army depot processed Materiel Release Confirmations into the automated system maintaining Army accountable records. This processing in turn automatically generated the billing of the FMS customers under the Army's Interfund Billing System. United States Army Tank-Automotive Command's (TACOM) request for payment from administrative funds was based upon its interpretation of SAMM, Chapter 8, Section III, Table 8-III-3, paragraph 3.b, discussed more fully below.

Four RODs required Defense Security Assistance Agency (DSAA) approval for payment because of the amounts involved. The DSAA Comptroller denied approval of payment of the four RODs from FMS administrative funds. Instead, based on other language in the SAMM paragraph cited above, he concluded that payment should be made from the "applicable U.S. appropriation" (in this case the Army Stock Fund).

Essentially, we are asked to resolve the dispute between the DSAA and TACOM over the proper interpretation of the SAMM concerning the correct funding source for payment of the RODs.

DIFFERING VIEWS WITHIN DOD

The language the DSAA Comptroller cites to support his view that the RODs should be paid from appropriations originally used for the stock purchase is as follows:

> "If an item arrived short or is not delivered (e.g., short unit pack, misdirected shipment) and the carrier is absolved of liability, then the shortage or misdirection is determined to have occurred at the point of origin and will be absorbed by the applicable U.S. appropriation. In those instances, a credit may be given to the FMS customer's account and charged to the U.S. Government appropriation which was initially credited as a result of such transaction. Misdirected shipments not returned to stock will be absorbed as an inventory loss against the applicable U.S. Government materiel account." (Emphasis added.)

The Comptroller apparently views this language as controlling in that the responsible depot's inability to

document the shipment effectively absolves the carrier of liability. Stated another way, since the government cannot prove it delivered the materiel to the carrier, there is no way in which either it or the FMS customer can effectively hold the carrier liable for the loss (if indeed there was a loss), and thus, as a practical matter, the carrier is absolved of liability.

TACOM's view that FMS administrative funds should be used is based on language in the same section of the SAMM. When the nature of the discrepancy is nondelivery from stock, use of administrative funds is:

> "Not applicable, except in cases where U.S. action or inaction causes inability of the FMS customer to obtain satisfaction from the carrier. DOD policy requires that Receiving Reports/proof of shipment be obtained whenever materiel is released to a common carrier (including the U.S. Post Office). . . . FMS administrative funds may be used only when it is specifically substantiated that the U.S. Government failed to meet its responsibility relative to the shipment of the materiel (except as indicated under 'U.S. Government Appropriations/Funds' heading)." (Emphasis added.)

In TACOM's opinion, if this language does not apply so as to make administrative funds available in this case, it would be difficult to identify any situation in which an administrative fund payment would apply. The emphasized language states that administrative funds are to be used whenever government action or inaction causes inability of the FMS customer to obtain satisfaction from the carrier. It specifically states that the responsible depot is required to obtain proof of shipment whenever materiel is released to a common carrier. TACOM's argument is that in the case of the RODs at issue here, it is precisely the agency's failure to produce proof of shipment, constituting inaction on the part of the government, which prevents recovery from the carrier. It further argues that the language regarding the use of agency appropriations does not apply because the only thing that has been shown in these cases is that proof of delivery does not exist; the carrier has not technically been "absolved of liability."

GAO ANALYSIS

At the outset, we note that the issue here is not a mere bookkeeping question. If the RODs are charged to FMS administrative funds, the effect is to treat the losses as business expenses and pass them on to all FMS customers.

If, on the other hand, the RODs are charged to the Stock Fund, the public treasury bears the impact.

Looking solely at the language of the SAMM, it is not entirely clear to us exactly how the regulation was intended to apply in the situation presented here. Clearly, the carrier is "absolved of liability," at least in practical effect, where the inadequacy of government documentation precludes recourse against the carrier (DSAA position). Equally clearly, however, the government "failed to meet its responsibility relative to the shipment" either by failing to make the shipment or by failing to maintain adequate documentation (TACOM position).

There is some evidence of shipment (the Materiel Release Confirmations), but not enough to support a definitive conclusion. If it could be established that shipment was never made (including situations in which items were released from inventory but were somehow diverted or misdirected prior to being turned over to a carrier), logic and equity would suggest that the Stock Fund bear the burden.3/ If it could be established that shipment was made and that non-delivery was not attributable to fault on the part of the government (assuming that for whatever reason recovery cannot be had from the carrier), the argument for using FMS administrative funds becomes stronger. The problem, of course, is that neither of these propositions can be established in this case. All we know with certainty is that, quoting from TACOM's submission, "proof of delivery to the freight forwarder [or the United States Postal Service, as the case may be] does not exist."

At this point, one additional fact comes into play: the responsibility for directing the financial implementation of the FMS program--and specifically for issuing the SAMM--rests with DSAA. DOD Directive No. 5105.38, para. V.A.8. Thus, one of the conflicting interpretations in this case is that of the office which issued the regulation.

The United States Court of Appeals for the District of Columbia Circuit has recently stated the standard for reviewing an agency's interpretation of its own regulations as follows:

> "We note at the outset that courts are not at liberty to set aside an agency's interpretation of

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3/ Indeed, charging administrative funds in this situation would result in an augmentation of the Stock Fund, which already has the original purchase money.

> its own regulations unless that interpretation is plainly inconsistent with the language of the regulations. [Citations omitted.] The degree of deference due is great. [Footnote omitted.] We 'need not find that the agency's construction is the only possible one or even the one that the court would have adopted in the first instance.' Belco Petroleum Corp. v. FERC, 589 F.2d 680, 685 (D.C. Cir. 1978). As stated by the Supreme Court:
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> 'Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt . . . . [T]he ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation.' Bowles v. Seminole Rock Co., 325 U.S. 410, 413-14 . . . (1945)."

San Luis Obispo Mothers for Peace v. Nuclear Regulatory Commission, 789 F.2d 26, 30 (D.C. Cir. 1986). See also Udall v. Tallman, 380 U.S. 1, 16 (1965), in which the Supreme Court said:

> "When faced with a problem of statutory construction, this court shows great deference to the interpretation given the statute by the officers or agency charged with its administration . . . . When the construction of an administrative regulation rather than a statute is in issue, deference is even more clearly in order."

As indicated earlier, both of the conflicting interpretations in this case appear to have merit, and both derive support from portions of the regulation. Again, looking only at the language of the regulation, the question of when a carrier should be considered "absolved of liability" is subject to differing interpretations. Be that as it may, and while much space could be consumed arguing which is "better" from one perspective or another, the crucial factor is that DSAA interprets its regulation as requiring that appropriated funds bear the charge in the situation presented. We cannot conclude that DSAA's position is "plainly erroneous" or "inconsistent with the regulation." Accordingly, we must defer to DSAA and conclude that the RODs at issue here should be charged to the Stock Fund.

If the Secretary of the Army finds that this result is undesirable from a program or fiscal perspective, DSAA should be asked to consider changing the SAMM. In any event, we recommend that DSAA revise the SAMM to provide more explicit guidance.

for Comptroller General
of the United States