
REPORT BY THE
Comptroller General
OF THE UNITED STATES



Budget Authority For Foreign Military Sales Is Substantially Understated

The Office of Management and Budget and the Department of Defense recently changed the method of recording budget authority within the foreign military sales trust fund. The level of that program is now greatly understated--by \$2.6 billion in fiscal year 1977.

The new procedure is contrary to sound budgetary policy and decreases congressional budgetary control over foreign military sales. Furthermore, the change affects the congressional budget resolutions and scorekeeping. Unless the new method is changed the understatement will continue.

GAO recommends that the Director, Office of Management and Budget, and the congressional Committees on the Budget require that the calculation of foreign military sales trust fund budget authority be based on total, new acceptances.

GAO also recommends that the Congress enact legislation to limit total, new foreign military sales acceptances for a fiscal year to the amounts specified in annual authorizing and/or appropriation acts.



PAD-78-72
JULY 27, 1978

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-165069

The Honorable Robert L. Leggett
Chairman, Task Force on National Security
and International Affairs
Committee on the Budget
House of Representatives

Dear Mr. Chairman:

In your June 3, 1977, letter, you asked us to undertake a major study of unexpended budget authority in the Defense Department, including foreign military sales activities. We reported to you in our September 27, 1977, testimony before the task force, and in our January 13, 1978, report, "Analysis of Department of Defense Unobligated Budget Authority," (PAD-78-34).

In our September 1977 testimony, we noted that the executive branch revised the calculation of budget authority for the "Advances, Foreign Military Sales" trust fund (Treasury fund 8242), effective for fiscal year 1977. The foreign military sales (FMS) trust fund is used to account for orders by foreign countries for cash sales of defense articles and services. It consists of dollar payments by foreign countries in connection with cash sales. The question to be addressed is whether the executive branch's current method of showing "budget authority" for the FMS trust fund relating to cash sales 1/ is correct.

Prior to fiscal year 1977, each year's FMS trust fund budget authority corresponded to the dollar total of FMS new acceptances--i.e., new agreements with foreign governments for the United States to enter into obligations to obtain defense articles and services for them.

1/In addition to cash sales, the Arms Export Control Act authorizes long term FMS credit sales and Federal guarantees for sales repayments (22 U.S.C. 2763 and 2764). However, the budget authority for these transactions is provided by annual appropriations and, therefore, is not an issue here.

According to a provision of the Arms Export Control Act (sec. 36(b)), which has remained in effect during the period of changed budget treatment, the Congress must be given prior notification of any pending FMS letter of offer of \$25 million or more, or for the sale of major defense equipment for \$7 million or more. Such a letter of offer shall not be issued if the Congress, within 30 calendar days of receiving such notification, adopts a concurrent resolution stating, in effect, that it objects to such proposed sale, unless the President states that an emergency exists which requires such sale in the national security interests of the United States. Defense Department officials state that new acceptances in fiscal year 1977 totaled about \$11.2 billion, of which approximately \$6.3 billion represented new acceptances which were subject to congressional review under section 36(b).

Also before the 1977 change, there were annual recordings of year-end unobligated FMS budget authority, representing cumulative acceptances which had not yet resulted in implementing obligations. Such obligations were created when orders were issued to the Department of Defense's (DOD) own performing accounts, or when DOD signed contracts with contractors for which the FMS trust fund itself was cited as the immediate funding source ("direct cite" method). As of September 30, 1976, the unobligated total was approximately \$14.9 billion, of which \$9.9 billion was in the FMS trust fund and the balance in DOD's own performing accounts, which had received FMS orders from the trust fund.

Under the new procedure implemented in fiscal year 1977, FMS trust fund budget authority for a given year is made to match the portion of acceptances (old and new) which result in FMS trust fund implementing obligations during the year. For example, the budget authority recorded for fiscal year 1977 matched the obligations total, \$8.6 billion, instead of the level of new acceptances, \$11.2 billion--a difference of \$2.6 billion.

As a result of the new procedures, there can be no unobligated balances in the fund. Also trust fund orders to DOD's performing accounts reportedly are now being made on a more limited basis--i.e., orders are posted for a given year only to the extent that there is an expectation that the performing accounts will be able to obligate the orders in the same year. Consequently, unobligated balances in the performing accounts will be either nonexistent or minimal, reflecting administrative leadtime delays.

The executive branch wrote off all FMS trust fund unobligated balances which existed at the end of fiscal year 1977--\$9.1 billion. The amount written off was identified in the budget as "lapsing authority." Executive officials state that DOD services similarly eliminated about \$3 billion of balances in DOD performing accounts. 1/

The executive's redefinition of FMS trust fund budget authority, which permitted a write-off of billions in FMS unobligated balances, was seemingly prompted, in part, by recent congressional concern over the rise in military-related unobligated balances; and DOD officials noted in testimony before the Congress that the revised procedure "dramatically" reduced unobligated balances. 2/ There apparently was executive concern that large FMS unobligated balances in DOD's performing accounts might be mistakenly viewed as direct program unobligated balances, and lead to congressional reductions in DOD's direct programs.

Department of Defense officials also stated in congressional testimony that because FMS budget authority is in the form of contract authority, 3/ "* * * [it] should have been-- and hereafter, will be--reflected only as obligations are incurred. This is consistent with government-wide practice

1/DOD officials state that, technically, the \$9.1 billion and \$3 billion were not "lapsed," but rather placed in the status of "uncommitted acceptances" in the trust fund.

2/See "Department of Defense Appropriations for 1978," hearings before the Subcommittee on the Department of Defense, House Committee on Appropriations, 95th Cong., 1st sess., Part 1, p. 132.

3/Contract authority is "A form of budget authority under which contracts or other obligations may be entered into in advance of an appropriation or in excess of amounts otherwise available in a revolving fund. Contract authority must be funded by a subsequent appropriation or the use of revolving fund collections to liquidate the obligations. Appropriations to liquidate contract authority are not classified as budget authority since they are not available for obligation." Comptroller General of the United States, Terms Used in the Budgetary Process (PAD-77-9), p. 10.

in connection with contract authority." 1/ In the 1978 Budget Appendix (p. 75), the executive stated that the budget authority change for the FMS trust fund was made "* * * to conform with correct budget practice for funds of this type."

The 1978 Budget Appendix stated also that the budget concept change would not eliminate a display of FMS acceptances. A special section was added to the trust fund's Program and Financing schedule (p. 74) to display unobligated acceptances. These amounts, however, were not included in any way in the budget authority figures for the account or in the budget totals. Furthermore, the supplemental display was not included in the fiscal year 1979 Budget Appendix.

WHAT SHOULD CONSTITUTE BUDGET AUTHORITY?

With enactment of the Congressional Budget Act of 1974 (Titles I through X of Public Law 93-344), the Congress undertook assuring more effective congressional control over the budgetary process, the level of Federal revenues and expenditures, and national budget priorities. The 1974 legislation established several new procedures to accomplish these objectives, including a process for the Congress to systematically consider budget totals and set overall targets and ceilings on budget authority and outlays. Section 3(a)(2) of the Congressional Budget Act (31 U.S.C. 1302(a)(2)) defines budget authority as:

"* * * authority provided by law to enter obligations which will result in immediate or future outlays involving Government funds * * *."

The new congressional budget process, focusing on budget totals, was designed to complement the already existing (and often fragmented) program level controls exercised through many committees and pieces of legislation.

We have previously maintained, and emphasize again, that for the Congress to successfully implement the Congressional Budget Act, to effectively control the budget, and to oversee

1/See "Department of Defense Appropriations for 1978," hearings before the Subcommittee on the Department of Defense, House Committee on Appropriations, 95th Cong., 1st sess., Part 1, p. 5.

executive implementation, it is important that actions be avoided which diminish the meaningfulness of budget authority as a statement of the obligational authority that the Congress makes available to the executive. We have stressed that budget authority, properly understood, is a broad concept designed to express fully the spending authority which is made available to executive agencies.

In a prior opinion (B-159687, Mar. 16, 1976), we stated the following:

"* * * the fundamental objective of the Congressional Budget Act of 1974 was to establish a process through which the Congress could systematically consider the total Federal budget and determine priorities for the allocation of budget resources. We believe this process achieves its maximum effectiveness when the Budget represents as complete as possible a picture of the financial activities of Federal agencies. We further believe it is vital to maximizing the effectiveness of the process that Federal financial resources be measured as accurately as possible because priorities are actually established through decisions on the conferring of this authority. From this standpoint, therefore, the concept of 'budget authority' should (a) encompass all actions which confer authority to spend money, (b) reflect as accurately as possible the amount of such authority which is conferred and (c) be recognized at the point at which control over the spending of the money passes from the Congress to the administering agency."

In another prior opinion (B-171630, Aug. 14, 1975), we addressed the distinction between authority which is conferred (budget authority) and authority which actually is used (obligations) in circumstances where there is executive discretion over the use of funds. That opinion concerned the Department of Housing and Urban Development's (HUD) contracts with local housing bodies which provided for Federal annual contributions to assisted housing. We held that budget authority for the new contracts authorized by the Congress equals the maximum potential obligations which HUD could legally incur under the new contracts, even though the law permits the Secretary of HUD to affect the obligations' total by granting him/her latitude in setting the number of payment years to be covered by the new contracts. The following is from that opinion:

"* * * budget authority should reflect the maximum potential duration of contracts authorized by law [i.e., maximum potential obligations]. We believe this approach is consistent with the [Congressional Budget Act] definition of budget authority * * *."

In yet another opinion (B-114828, Jan. 31, 1977), concerning HUD's discretionary emergency mortgage purchase assistance program, we noted that the correct statement of budget authority was the "maximum" new authority made available by law, and not merely the portion which the executive uses.

We, therefore, have consistently maintained that budget authority, to have optimum meaning and usefulness as a concept and tool in the congressional budgetary process, should express the maximum potential obligations which may be incurred under authority being made available. Such a broad concept of budget authority provides the best assurance that budget totals and individual schedules provide a full disclosure of the possible financial consequences of budgetary decisions being requested by the President and considered by the Congress. The Congress cannot effectively exercise budgetary control on budget totals if it does not have complete and accurate information on the new obligational authority being made available to executive branch agencies.

This is especially important in activities such as FMS, where obligational authority is created with only passive congressional involvement, rather than through active authorization and appropriation action. Incomplete knowledge of new obligational authority for such programs can only diminish congressional budget control.

WHAT SHOULD CONSTITUTE BUDGET AUTHORITY
FOR FOREIGN MILITARY SALES?

In the budget, foreign military cash sales are being treated as an incidental reimbursable activity of the Federal Government with a relatively small net budgetary impact. The budget now appears to reflect a perspective that FMS is not a Government program; instead, the U.S. Government is acting only as an agent between the foreign country and the U.S. contractors.

We do not understand how the U.S. Government can step back and take the independent agent perspective for budgetary purposes and simultaneously be so deeply involved in individual transactions--including congressional action on

certain individual transactions, comingling of funds and procurement actions, and, in some cases, direct sale from U.S. Government inventories.

It seems that today foreign military sales are no longer incidental reimbursable activities of the military services. They are now in total and in many individual transactions major defense, international, and economic activities and they are also commitments of the U.S. Government. Consequently, existing controls under the Arms Export Control Act should be complemented by full congressional attention in the budget and appropriation processes.

Budget authority conferred
for foreign military sales

The authorizing legislation appears to confer permanent and indefinite contract authority, but with the limitation that transactions over a certain threshold are subject to congressional veto for a specified period before they can be offered as a U.S. Government commitment to deliver specified goods and services, which can be acquired if they are not already in stock.

When is budget authority conferred
for foreign military sales?

It is our position that budget authority should be recognized at the point at which control over spending the money passes from the Congress to the administering agency. Under the present congressional treatment of foreign military sales, which excludes affirmative appropriation action, the authority to spend for transactions below the threshold had permanently passed to the administering agency; and, for those that reach or exceed the threshold, the authority passes to the administering agency when the period of congressional veto ends without the veto occurring.

What is the amount of budget authority
conferred for foreign military sales?

As held in earlier opinions, the correct amount of budget authority is the maximum potential obligations which the administering agency could legally incur under the authority which the Congress makes available. For foreign military sales, the amount of budget authority is the fully funded cost (estimated) of the goods and services which the Government has agreed to deliver--the amount of new acceptances in a year.

We have discussed in a previous report to your task force, "Analysis of Department of Defense Unobligated Budget Authority," (PAD-78-34, Jan. 13, 1978), the full funding basis of budget authority for DOD's own procurements.

The obligations incurred in a year are one measure of the execution of a program, and not the total authority that the Congress makes available.

Difficulty in estimating

Executive officials have cited the difficulty in estimating FMS orders, acceptances, and the budget impact of foreign military sales. They note that relevant levels are influenced by the timing of other Governments' decisions. Difficulties in estimating (due to dependence on factors not under the control of the Federal Government) is not a sufficient basis for not making an estimate. Instead, it is an argument for full disclosure of the basis for the estimates--the underlying assumptions and the cost and timing factors used. It is also an argument for the analysis and reporting of variances between the estimates and actual amounts.

We have previously recommended to the executive that such analysis and reporting on DOD's obligations be conducted (PAD-78-34). After all, a "best estimate" is better than no estimate.

Consistency in the application of budget concepts

A major recommendation of the President's 1967 Commission on Budget Concepts stated:

"The Budget changes constantly in substance, in response to changing requirements for new and improved public programs and activities. But this does not mean that budget concepts and definitions must change constantly. On the contrary, they should have a basic consistency and constancy about them and should be clearly set forth and adhered to." 1/

1/Report of the President's Commission on Budget Concepts, 1967, p. 10.

Our intent is to examine the funding practices against the concept of budget authority expressed in our March 1976 opinion, and to strive for consistent adherence to this basic concept.

The change in FMS budget practices made by the executive branch to redefine FMS budget authority, to make it coincide with FMS obligations rather than FMS new acceptances, moves further from our concept of budget authority and control.

Our review of Federal accounts and funds identified only one account (not a trust fund) with the specific kind of budget authority used in the FMS trust fund--i.e., permanent indefinite contract authority. The identified account is the Commerce Department's general fund account, "Operating Differential Subsidies (Liquidation of Contract Authority)." This account also uses a restricted calculation of budget authority--budget authority equals obligations. We have not researched and given an opinion on this practice, but have pointed it out to committees as an example of a practice that does not appear to conform with the concept of budget authority. Besides the FMS trust fund, we could not identify any other nonrevolving trust fund which had permanent indefinite contract authority.

We do not think that this one case constitutes a "government-wide" standard. Furthermore, our review of the budget authority practices in selected trust funds shows that the new FMS budget treatment does not conform with other trust fund practices. (See app. I.) In these trust funds, budget authority, whether in the form of appropriations or contract authority, does not equal obligations.

From another perspective, the current practice for FMS is not consistent with the full funding concept used for DOD's own acquisitions which are funded through the same accounts and, in many cases, involve the same weapons systems, commodities, and procurement contracts. From the standpoint of Federal policies and decisions on defense, international relations, and the defense sector of our economy, consistency between FMS and DOD's own activities appears to be the most important. Full funding as it is being applied by DOD military acquisition is consistent with the concept of budget authority.

CONCLUSIONS

We conclude that the FMS trust fund budget authority change made by the executive interjected a new significant element of inconsistency into FMS trust fund procedures and reporting, without achieving offsetting improvements. The change is contrary to the usual meaning of budget authority, which essentially is authority that is conferred for making obligations. New acceptances (not obligations) represent the authority that is conferred.

The change eliminates from the budget totals and schedules reporting on the maximum potential FMS obligations which the executive may incur as a result of the new authority that new acceptances create. The current FMS budget authority calculation also eliminates standard reporting on FMS unobligated acceptances, and such information is important for evaluating budget and program execution.

We strongly believe that any impairment of full disclosure of possible financial consequences (total obligations) of budgetary actions (new acceptances) is contrary to sound budgetary policy, and dilutes appropriate congressional budgetary control. This runs counter to the purposes of the Congressional Budget Act of 1974.

RECOMMENDATION

We, therefore, recommend that the Director of the Office of Management and Budget and the congressional Committees on the Budget require that the calculation of foreign military sales trust fund budget authority be based on total, new acceptances.

RECOMMENDATION TO THE CONGRESS

The Congress should adopt additional budgetary controls over FMS trust fund activities. Showing FMS acceptances as budget authority achieves disclosure of important budgetary information, but this does not have full budgetary consequences if affirmative congressional action on the level of acceptances is absent.

We have previously held that public interest normally is best served when congressional control over executive activities is exercised through regular reviews and affirmative action in the authorization, budget, and appropriations processes. In the FMS area, this could be accomplished by enacting

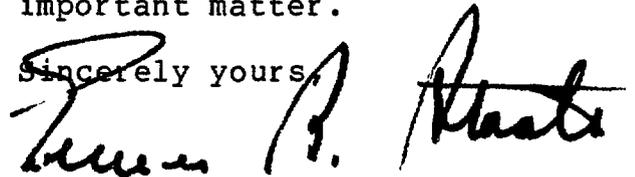
legislation to provide that total, new FMS acceptances for a fiscal year cannot exceed an amount specified in annual authorizing and/or appropriations acts. This control would not supersede the existing congressional review requirements for certain individual FMS transactions since these requirements serve a different purpose.

The Congress has a great deal of latitude in the degree of authorization, budgetary, and appropriations control it reserves to itself. In the case of the FMS trust fund, the Congress reserves the right to veto transactions that exceed a specified threshold--this is minimal program level control. Foreign military sales have increased very significantly in a very few years and have become a major defense, international, and economic factor. Therefore, we recommend that the Congress reconsider the degree of control it has delegated, and enact legislation to limit total, new FMS acceptances for a fiscal year to the amounts specified in annual authorizing and/or appropriation acts.

As you requested, we have not obtained executive branch comments for incorporation in this report. We shall, however, send the report to the Director of the Office of Management Budget, and to the Secretary of Defense, and provide you with the responses we receive. In addition, as arranged with your office, we are concurrently sending copies of this report to the Chairmen of the Senate Committees on the Budget, Appropriations, and Foreign Relations; the Chairmen of the House Committees on the Budget, Appropriations, and International Relations; Senator Ernest F. Hollings; Congressman Butler C. Derrick, Jr.; and the Director of the Congressional Budget Office. We shall also make the report available to other interested parties.

We are available to discuss the report and answer any questions you may have on this important matter.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Thomas P. Blasko". The signature is written in a cursive style with a large initial "T" and "B".

Comptroller General
of the United States

BUDGET AUTHORITY AND RELATED INFORMATIONIN SELECTED TRUST FUNDS

<u>Name of fund</u>	<u>Identification code</u>	<u>Budget authority (1978 est.) (note a)</u>	<u>Obligations (1978 est.) (note a)</u>	<u>Unobligated balance, end of period (1978 est.) (note a)</u>	<u>Type of budget authority</u>
		(000 omitted)			
Advances, Foreign Military Sales	11-8242-0-7-155	\$11,100,000	\$11,100,000	\$ -	Contract Authority (indefinite)-- Sum of New Obligations
Federal Old-Age and Survivors Insurance Trust Fund	20-8006-0-7-601	76,999,603	83,253,620	23,420,504	Appropriation (indefinite)-- Sum of Annual Collections
Unemployment Trust Fund	20-8042-0-7-999	15,400,000	11,800,000	10,018,623	Appropriation (indefinite)-- Sum of Annual Collections
Federal Aid Highway (Liquidation of Contract Authorization) (Trust Fund)	20-8102-0-7-401	6,842,778	7,682,164	5,449,058	Contract Authority (definite)-- Sum specified in legislation for entering contracts
Grants-in-Aid For Airports (Liquidation of Contract Authorization) (Airport and Airway Trust Fund)	69-8016-0-7-402	555,000	555,015	92,238	Appropriation (definite)-- Current congressional action Contract Authority (definite)-- Sum specified in legislation for entering contracts
Trust Fund Share of Highway Safety Programs	69-8016-0-7-401	177,660	199,918	139,445	Appropriation (definite)-- Current congressional action Contract Authority (definite)-- Sum specified in legislation for entering contracts

a/From 1979 Budget Appendix.

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