DEPARTMENT OF DEFENSE

AUDIT REPORT

PRICING AND BILLING OF STINGER MISSILES
SOLD TO FOREIGN MILITARY SALES CUSTOMERS

No. 91-055

February 27, 1991

Office of the
Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

February 27, 1991

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR POLICY
COMPTROLLER OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on the Audit of Pricing and Billing of Stinger Missiles Sold to Foreign Military Sales Customers (Report No. 91-055)

This is our final report on the Audit of Pricing and Billing of Stinger Missiles Sold to Foreign Military Sales Customers, provided for your information and use. Comments on a draft of this report were considered in preparing the final report. We made the audit from October 1989 through May 1990. The objectives of the audit were to determine whether the Military Departments were identifying and billing appropriate costs for foreign military sales (FMS) and Economy Act sales in a timely manner; to evaluate FMS payment schedules; to determine whether DoD had effectively implemented all security requirements before entering into FMS agreements; and to reconcile the total production of Stinger missiles to DoD and FMS inventories. We also evaluated the applicable internal controls. As of December 1989, the Army had entered into 37 agreements for Stinger missiles with 13 foreign countries at an estimated cost of $205.4 million. This report addresses the pricing and billing objectives of the audit. A separate draft report addressing the security requirements and inventory control objectives was issued on January 23, 1991.

The audit showed that the U.S. Army Missile Command (MICOM) did not properly identify and report the appropriate costs for FMS and Economy Act sales. Also, the Security Assistance Accounting Center (SAAC), an operating directorate of the Defense Finance and Accounting Service, Denver Center, Denver, Colorado, did not bill FMS customers for the correct transportation costs. The results of the audit are summarized in the following paragraphs, and the details and audit recommendations are in Part II of this report.

FMS customers were overcharged $1.7 million for packing, crating, and handling (PC&H) costs on Stinger shipments received from the Red River Army Depot. The method used to calculate these costs yielded an unreasonably high reimbursement for the effort expended. In a draft of this report, we recommended that the Comptroller of the Department of Defense direct the Army to rebill for PC&H costs on missiles shipped from Army stock. Based on the Office of the Comptroller's comments to the draft report, we have recommended that the Comptroller direct the Army to provide a different PC&H surcharge rate for the Stinger missile. We also recommended that the Commander, MICOM initiate a joint effort with Army depots to establish PC&H rates based on actual costs rather than using a standard rate (page 5).

MICOM did not price Stinger missiles sold under the Economy Act in compliance with the policies established by DoD Manual 7220.9-M, "Accounting Manual," issued September 18, 1986. As a result, MICOM overcharged a non-DoD agency $4.0 million on the sale of 1,606 Stinger missiles and undercharged the agency about $982,000 in PC&H and overhead costs. Also, MICOM's use of a force rearrangement factor to cover the cost of introducing improved items in inventory resulted in the procurement of 160 more missiles than were sold to the non-DoD agency. We recommended that the Commander, MICOM, reimburse the customer $3.1 million for these sales and comply with the policies in DoD Manual 7220.9-M for subsequent Economy Act sales. We also recommended that the Comptroller of the Department of Defense reevaluate the propriety of using a force rearrangement factor on inter-Government sales (page 9).

SAAC did not correct the erroneous transportation overcharges of $935,000 billed to the customers. These errors, which occurred between October 1983 and April 1987, affected 10 FMS cases. We recommended that the Director, SAAC, correct the transportation charges for each Stinger case, revalidate the charges on other FMS deliveries, and correct any erroneous charges (page 13).

MICOM improperly charged FMS customers with asset use costs for DoD-owned facilities. Also, MICOM charged an inflated asset use amount for Stinger missiles procured through the Special Defense Acquisition Fund (SDAF). This resulted in about $3.2 million in asset use overcharges billed to customers. We recommended that the Commander, MICOM, reprice the FMS procurement cases by deleting the improper asset use charges and adjust the SDAF cases by substituting rental fees for asset use charges (page 15).

MICOM did not promptly report shipments of Stinger missiles sold to FMS customers on 62 of 82 deliveries. As a result, SAAC delayed the billing of $115.9 million of missile deliveries to the customers. These delays distorted the status reports to FMS countries. We recommended that the Commander, MICOM, establish internal controls to monitor all contractor and Army shipments to ensure prompt billing to customers (page 19).

The audit identified an internal control weakness as defined by Public Law 97-255, Office of Management and Budget

Circular A-123, and DoD Directive 5010.38. MICOM used ineffective procedures to report contractor and Army shipments to SAAC so that SAAC could bill FMS customers promptly. Copies of this final report will be provided to the senior official responsible for internal controls in the Army. Recommendation E in this report, if implemented, will correct this weakness.

We have determined that monetary benefits of $4.1 million can be realized by implementing all recommendations (Appendix I).

We provided a draft of this report to the addressees on August 3, 1990, and requested comments by October 3, 1990. We received comments from the Office of the Comptroller of the Department of Defense on October 15, 1990; from the Assistant Secretary of the Army (Financial Management) on October 17, 1990; from the Acting Deputy Assistant Secretary of the Air Force (Financial Management) on October 11, 1990; and from the Director, Defense Security Assistance Agency on September 24, 1990. The comments are summarized in Part II of this report, and the complete texts of the responses are in Appendixes E, F, G, and H.

The Office of the Comptroller of the Department of Defense concurred with Finding B and Recommendation B.2. In a response to a draft of this report, the Office of the Comptroller nonconcurred with Recommendation A.1., stating that the Army correctly applied PC&H costs in accordance with existing DoD policy. We have reviewed the comments and have revised Recommendation A.1. and are no longer claiming the monetary benefits of $1.7 million. We request that the Comptroller comment on the revised Recommendation A.1. when replying to the final report.

The Army concurred with Finding E and Recommendation D.1. and partially concurred with Findings B and D, the monetary benefits identified in Recommendation D.1., and Recommendations B.1.a., B.1.b., and E. The Army nonconcurred with Finding A, the monetary benefits identified in Finding A and Recommendation D.2., and Recommendations A.2. and D.2. Based on information we received from the Army on Recommendation D.1., we have reduced the monetary benefits from $3.1 to $1.8 million. We have reviewed the remaining Army comments and have not changed our conclusions. We request that the Army reconsider its position on the monetary benefits identified in Recommendation D.2. and on Recommendations A.2. and D.2., and concur or nonconcur with the revised monetary benefits in Recommendation D.1. when replying to the final report.

The Air Force fully concurred with Finding C and Recommendations C.1. and C.2. The Air Force's reply did not fully comply with the requirements of DoD Directive 7650.3 because the response did not indicate concurrence or nonconcurrence with the monetary benefits identified in Finding C. Accordingly, we request that the Air Force comment on the monetary benefits identified in Finding C when replying to the final report.

The Director of Plans, Defense Security Assistance Agency (DSAA) nonconcurred with Finding D and Recommendation D.2. stating that the finding is contrary to the stabilized pricing concept for SDAF cases. We have reviewed the comments and have not changed our conclusions. We request that DSAA reconsider its position on Recommendation D.2. when replying to the final report.

DoD Directive 7650.3 requires that audit recommendations be resolved promptly. Accordingly, please comment on unresolved issues in the report within 60 days of the date of this memorandum.

The courtesies and cooperation extended to the staff during the audit are appreciated. If you have any questions about this audit, please contact Mr. David R. Stoker at (703) 614-1692 (DSN 224-1692) or Mr. Ronald C. Tarlaian at (703) 614-1365 (DSN 224-1365). A list of audit team members is in Appendix K. Copies of this report will be provided to the activities listed in Appendix L.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

cc:
Director, Defense Security Assistance Agency

REPORT ON THE AUDIT OF PRICING AND BILLING OF STINGER MISSILES SOLD TO FOREIGN MILITARY SALES CUSTOMERS

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Prepared by:
Financial Management Directorate
Project No. 0FA-0004

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REPORT ON THE AUDIT OF
PRICING, BILLING, AND INVENTORY CONTROLS OF
STINGER MISSILES SOLD TO FOREIGN MILITARY SALES CUSTOMERS

PART I - INTRODUCTION

Background

The Arms Export Control Act (AECA), which governs the sale of defense articles and services to foreign countries, requires that all costs incurred in these sales be fully recovered. DoD Manual 7290.3-M, "Foreign Military Sales Financial Management Manual," June 30, 1981, specifies the costs that must be included in the pricing of Defense articles and services to comply with the AECA.

The Defense Security Assistance Agency (DSAA) has overall responsibility for the coordination and implementation of all foreign military sales (FMS) agreements. The U.S. Army Missile Command (MICOM), as the inventory manager of Stinger missiles, is responsible for providing defense articles and services to satisfy the requirements of sales agreements. In addition, MICOM is responsible for reporting all costs of the sales agreements to the Security Assistance Accounting Center (SAAC), which bills FMS customers. As of December 1989, 13 foreign countries had entered into 37 sales agreements for 3,413 Stinger missiles with an estimated cost of $205.4 million. Through December 1989, 2,539 missiles with a reported cost of $133.0 million had been delivered to 13 countries.

Objectives and Scope

The objectives of the audit were to determine whether the Military Departments were identifying and billing appropriate costs for foreign military sales (FMS) and Economy Act sales in a timely manner; to evaluate FMS payment schedules; to determine whether DoD had effectively implemented all security requirements before entering into FMS sales agreements; and to reconcile the total production of Stinger missiles to DoD and FMS inventories. We also evaluated the applicable internal control procedures for each area. This report addresses the pricing and billing objectives of the audit. A separate draft report addressing the security requirements and inventory control objectives was issued on January 23, 1991.

During the audit, we reviewed the pricing, billing, and reporting documentation for all 37 FMS cases that were implemented from April 1980 through May 1989. We analyzed MICOM pricing and billing data, including the case and contract files and SAAC's delivery histories, to determine whether all appropriate costs were charged and billed in compliance with regulations. In addition, we evaluated SAAC's procedures for billing transportation costs to FMS customers. We reviewed payment schedules for selected FMS cases to ensure that they were consistent with estimated contractor delivery dates and to determine whether necessary adjustments were made. In addition, we analyzed the methods MICOM used to price sales under the Economy Act.

This program audit was made from October 1989 through May 1990 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. Appendix A lists the FMS Stinger missile cases reviewed during the audit. Activities visited or contacted during the audit are listed in Appendix J.

Internal Controls

We evaluated the internal controls over the pricing and billing of appropriate costs associated with the sale of Stinger missiles to FMS customers to determine whether MICOM complied with DoD pricing guidance. In addition, we assessed MICOM's internal controls over monitoring shipments and reporting them to SAAC for prompt billing of customers. We found an internal control weakness in the procedures MICOM used to report shipments of Stinger missiles from contractor and Army facilities. The weakness is discussed in Finding E, "Delivery Reporting of Stinger Missiles." Implementation of Recommendation E will correct the internal control weakness identified in this report.

Prior Audit Coverage

U.S. Army Audit Agency Report No. SO 89-200, "Foreign Military Sales Management, U.S. Army Missile Command, Redstone Arsenal, Alabama," December 20, 1988, concluded that the procedures for recouping the nonrecurring costs of research, development, and production for major defense equipment were not effective, and that the procedures for billing and accounting for foreign military sales were not always adequate. As a result of these deficiencies, the Government did not recoup $38.0 million in nonrecurring costs, which included $2.9 million for Stinger missiles. Also, billing inadequacies resulted in overcharges of $5.8 million and undercharges of $12.5 million to FMS customers. The Army Audit Agency recommended that MICOM recompute the nonrecurring cost recoupment rates for the Stinger missile system and correct the billing errors. Generally, MICOM concurred with the recommendations and was taking corrective action.

U.S. General Accounting Office Report NSIAD-87-114, "Iran Arms Sales, DoD's Transfer of Arms to the Central Intelligence Agency," March 13, 1987, OSD Case No. 7249, addressed problems with determining the correct price for TOW missiles and Hawk missile spare parts sold under the Economy Act. The incorrect pricing resulted in a $2.1 million undercharge to the Central Intelligence Agency (CIA). A recommendation was made for DoD to adjust the billing to the CIA and obtain reimbursement for the pricing deficiencies. Finding B in our report addresses problems in pricing an Economy Act order for the Stinger missile.

Other Matters of Interest

DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of U.S. Products and Technology," August 5, 1985, requires the Military Departments to charge a prorated share of research, development, test and evaluation (RDT&E) and nonrecurring production costs on sales of major defense equipment, such as Stinger missiles. This Directive specifies that when a model change occurs in major defense equipment, the nonrecurring cost recoupment charge will be recalculated based on the degree of commonality between each model. During the audit, we determined that MICOM incorrectly calculated the nonrecurring cost recoupment charge for all three models of Stinger missiles.

MICOM personnel did not properly recalculate the recoupment charge because they were not aware of this requirement. Subsequently, MICOM recalculated the nonrecurring recoupment charge in accordance with DoD policy. At the time of our audit, MICOM had not submitted the revised rates to the Defense Security Assistance Agency for its approval.

PART II - FINDINGS AND RECOMMENDATIONS

A. Packing, Crating, and Handling Costs

FINDING

The U.S. Army Missile Command (MICOM) overcharged foreign military sales (FMS) customers for packing, crating, and handling (PC&H) costs on shipments of Stinger missiles from Red River Army Depot (the Depot). The overcharges occurred because DoD's existing method of calculating PC&H costs did not reasonably approximate the actual effort expended by the depot. As a result, PC&H billings to FMS customers and reimbursements to the U.S. Army Missile Command (MICOM) were overstated by about $1.7 million.

DISCUSSION OF DETAILS

PC&H costs are the costs that DoD facilities incur for labor, materials, or services used to draw requisitioned articles from storage, prepare them for shipment, and confirm the release of materials. These costs are charged to a customer when the FMS Detail Billing Report indicates that an article has been shipped from DoD inventory. PC&H charges are computed at 3.5 percent of the unit price up to $50,000 and 1 percent for any portion of the unit price over $50,000.

Collections from customers for PC&H billings are reimbursed to the appropriation that financed the PC&H. Collections totaled $1.7 million for Stinger deliveries.

The Red River Army Depot is the primary wholesale storage and distribution point for the Stinger. Our observations of the procedures and our discussions with Depot personnel showed that processing the missiles requires only limited PC&H efforts. The missiles are delivered by truck from the manufacturer in banded packs of nine per pallet; they are off-loaded and stowed in designated bunkers. Normally, no other handling, assembling, or preparation is required. Pallets of missiles are shipped out in the same configuration as received, except for pallets that are broken to match the exact quantity requested or to issue specific serial numbers as directed by MICOM.

Officials at the Depot estimated that .34 worker hour was required to process each missile for shipment. Using the maximum rate of $35 per hour from the Army's Automated Labor and Production Reporting Manual, the PC&H costs would amount to approximately $12 per missile for the principal costs, including overhead. This amount is substantially less than the current PC&H rate charged to FMS customers, which has averaged about $1,800 per missile. For example, on FMS case SR-VHB for 400 Stinger missiles, PC&H billings totaled $773,986, or

$1,935 per missile. Based on the Red River Army Depot's estimate of actual effort expended for each missile, PC&H charges on that case would have been about $4,800. For the 18 FMS cases for which Stinger missiles were shipped from the Depot, PC&H charges at $12 per missile would amount to $11,412 compared to the $1,727,532 billed, resulting in an overbilling of about $1.7 million.

These extreme variances indicate that PC&H costs must be brought in line with actual costs. DoD Manual 7290.3-M, "Foreign Military Sales Financial Management Manual," June 30, 1981, permits the use of actual costs if the Military Department determines that a more equitable charge will result and the Comptroller of the Department of Defense has approved an exception. Estimated actual transportation charges for selected items, including the Stinger, have been developed and published in a look-up table that provides more realistic charges than applying the standard transportation percentages.

A similar approach would be appropriate for PC&H costs and could be adapted to other missile systems managed by MICOM. Accordingly, MICOM should initiate a joint effort with the Army depots to ascertain, by engineering analysis or other systematic means, the actual PC&H costs for the Stinger and other missile systems. The proposed PC&H rates should be submitted to the Comptroller of the Department of Defense for approval.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Comptroller of the Department of Defense direct the Army to submit a proposed surcharge for the Stinger missile. In the interim, the Comptroller should direct the Defense Finance and Accounting Service to suspend the packing, crating, and handling surcharge for the Stinger missile until a reasonable packing, crating, and handling charge is established.

2. We recommend that the Commander, U. S. Army Missile Command initiate a joint effort with the Army depots to establish packing, crating, and handling rates for foreign military sales customers based on actual costs for the Stinger and other missile systems.

MANAGEMENT COMMENTS

The Office of the Comptroller of the Department of Defense (Management Systems), nonconcurred with Finding A and Recommendation A.1. in the draft report to direct the Army to rebill packing, crating, and handling charges on Stinger missiles shipped from Army stocks, using a rate of $12 per missile instead of 3.5 percent of the selling price. The Office of the Comptroller stated that although the PC&H surcharge could result in individual billings that are higher or lower than actual costs, the objective of DoD Manual 7290.3-M is to recover PC&H costs in the aggregate and not on individual transactions. The Office of the Comptroller stated that the 3.5-percent surcharge was applied without regard to actual costs for individual shipments, and results in a more equitable application of PC&H costs to the entire FMS program. Further, he stated that DoD policy permits a deviation from the standard PC&H rate if the DoD Component requests an exception and submits supporting documentation before incurring PC&H costs. However, he stated that the Army acted within the policy prescribed by DoD Manual 7290.3-M; therefore, the amount charged to FMS customers for PC&H costs was in accordance with the DoD policy.

The Army nonconcurred with Finding A and Recommendation A.2. as worded in the draft report. The Army's comments stated that Army systems cannot gather and classify cost data that would be used to develop a separate PC&H rate for each missile system. However, the Army will ask DoD to reevaluate the current PC&H rates. Although the Army is not in favor of multiple rates, if DoD issues new standard rates, those rates should be applied in the aggregate and not on individual sales. The Army also nonconcurred with the monetary benefits of $1.7 million, stating that PC&H costs were charged according to existing DoD policy.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

We understand the Office of the Comptroller's reluctance to rebill the PC&H charges for the Stinger missile. The Army has spent the revenues generated by the overcharges; therefore, money is not readily available to make refunds. However, we are concerned about the Comptroller's willingness to let this system remain unchanged. We recognize that the use of a surcharge will result in both under- and over- recovery of costs. But in the case of the Stinger missile, the surcharge amounted to 15,000 percent of the actual costs. Such an excessive charge is likely to have a negative effect on foreign customers' willingness to buy from U.S. sources.

Under the current system, the Army (specifically MICOM) would have to propose any change to the prescribed surcharge. Since MICOM gets the benefit of the windfall funds, this is not likely to happen. In response to this final report, we request that the Comptroller comment on Recommendation A.1. in this final report. We are no longer claiming the monetary benefits of $1.7 million.

We disagree with the Army's position regarding PC&H surcharge rates. We recognize that the Army's accounting systems are not designed to accumulate actual PC&H costs on FMS orders; otherwise, there would be no reason to apply a standard percentage rate. The intent of our recommendation was for the Army to identify other missile systems for which standard PC&H

charges are not realistic and customer billings are inequitable. Therefore, we request that the Army reconsider its position on Recommendation A.2. when replying to the final report.

B. Pricing of Economy Act Sales

FINDING

MICOM did not accurately price Stinger missiles sold to a non-DoD activity under the Economy Act. This condition occurred because the MICOM Stinger Project Manager's Office (PMO) did not comply with DoD guidance and priced the sales using the standard price instead of replacement cost. In addition, the PMO added a 10 percent force rearrangement factor to cover the costs of putting an improved missile in the Army's inventory, but excluded PC&H and overhead costs. As a result, MICOM overcharged a non-DoD agency $4.0 million on the sales of 1,606 Stinger missiles and undercharged the same agency $982,000 for PC&H and overhead costs. Also, MICOM used force rearrangement funds to increase the Army's inventory by about 160 more missiles than were sold to the customer.

DISCUSSION OF DETAILS

Economy Act sales are authorized under United States Code (U.S.C.), title 31, sec. 1535. The U.S.C. states that Economy Act sales can occur within or between agencies. The sales we reviewed were reimbursable orders placed by Headquarters, Office of the Deputy Chief of Staff for Logistics. The Basic Stinger missiles sold under the Economy Act after March 1987 to a non-DoD agency were to be replaced with the reprogrammable microprocessor (RMP) Stinger model. DoD Manual 7220.9-M, "Accounting Manual," March 18, 1987, states that the pricing elements for Economy Act sales are replacement costs, a 10 percent force rearrangement factor, and PC&H and overhead costs. The DoD Manual further states that if the sale of a major item will reduce assets needed to meet approved requirements, the item must be replaced. An Army memorandum dated March 25, 1987, "New Guidance for Pricing Sales to Non-DoD Federal Agencies Under the Economy Act, 31 U.S.C. 1535," states that the replacement price should be used for Economy Act sales, subject to FMS criteria, when a procurement action for replacement is required. Army Regulation (AR) 37-60, "Pricing of Materiel and Services," dated April 3, 1989, states that if a major item needs to be replaced, either the current standard price or estimated replacement price, whichever is higher, will be used. MICOM sold 2,356 Basic Stinger missiles under the Economy Act from March 1986 through July 1988 at a cost of about $139 million.

Pricing Methodology. From March 1987 through July 1988, a non-DoD agency was overcharged about $4.0 million for 1,606 missiles sold under the Economy Act. The Stinger PMO calculated unit prices from the Army Master Data File's standard price for the missiles and their components, plus applicable charges for force rearrangement and engineering. Prices did not include PC&H and overhead costs.

Since Basic Stinger missiles were being replaced with RMP models, we repriced the sales using replacement cost factors, plus the required force rearrangement factor. We then computed PC&H costs at a standard rate and overhead charges at an estimated 1 percent. Our computations showed that the non-DoD agency was undercharged about $982,000 for PC&H and overhead costs. Appendix B explains our price computations.

Force Rearrangement Factor. DoD pricing guidance allows for a force rearrangement factor to cover such costs as changes in spare parts, support equipment, and expenses resulting from the introduction of an item into the DoD inventory. Since the contractor performs major maintenance on the Stinger missile, little support equipment that has not been included in the end product is required to operate the missile. Therefore, this factor probably should not have been included in the cost of the Stinger missiles sold under the Economy Act. Charging this cost to the non-DoD agency enabled MICOM to procure 160 more missiles at a cost of $4.0 million than were sold.

To comply with DoD regulations, MICOM should reprice Stinger missiles sold under the Economy Act to include actual PC&H and estimated overhead costs, and reimburse the non-DoD agency for any overcharges. In addition, the Comptroller of the Department of Defense should reevaluate the application of a force rearrangement factor to the sale of major items being replaced with improved models.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Commander, Army Missile Command:

a. Reprice the Stinger missiles sold to a non-DoD agency under the Economy Act from March 1987 to July 1988, using the appropriate pricing elements, and reimburse the activity for $3.1 million in overcharges.

b. Comply with DoD Manual 7220.9-M to ensure that applicable costs are recovered on future Economy Act sales.

2. We recommend that the Comptroller of the Department of Defense reevaluate the requirement to apply a 10 percent force rearrangement factor to all items replaced with improved models.

MANAGEMENT COMMENTS

The Army concurred in part with the finding and with Recommendations B.1.a. and B.1.b., stating that the pricing guidance applicable at the time of the Economy Act sales was unclear and contradictory. The MICOM Stinger Project Manager (PM) relied on an Army memorandum dated March 25, 1987, which stated that the replacement price should be used for these sales, subject to FMS criteria, when items sold to non-DoD agencies were replaced with improved models. The Army memorandum resulted from a verbal concurrence with the DoD Comptroller and assurance that appropriate changes would be made to DoD Manual 7220.9-M. Because the sale was made to a non-DoD agency, MICOM applied FMS pricing criteria from AR 37-60. Therefore, the PM correctly used the higher standard price instead of the replacement price for these sales. The Army also stated that the U.S. General Accounting Office (GAO) had criticized the Army for not charging whichever was higher, standard or replacement cost, in previous sales to non-DoD agencies. The Army concurred with the $982,000 undercharge to the non-DoD agency for overhead and PC&H costs incurred in these sales.

The Office of the Comptroller of the Department of Defense concurred with Finding B and Recommendation B.2., stating that a review of FMS surcharges, including the force rearrangement factor, should be complete by December 31, 1990. Based on this review, any changes to FMS pricing policy will be reflected in DoD Manuals 7220.9-M and 7290.3-M.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

We disagree with the Army's position regarding the pricing of Economy Act sales. As stated in the finding, DoD Manual 7220.9-M requires replacement cost pricing when the items are to be replaced with an improved model. The Army memorandum addresses FMS criteria in reference to determining a need for inventory replacement, not as a method for pricing Economy Act sales. Pricing guidance in DoD Manual 7220.9-M (replacement cost pricing) should have been used. The PM at MICOM misinterpreted the Army memorandum and used the standard price, rather than the replacement price, for the Economy Act sales. The GAO's criticism of the Army's method occurred before the Army memorandum of March 25, 1987, changed the pricing method to replacement cost. Therefore, we request that the Army reconsider its position on Recommendations B.1.a. and B.1.b. when replying to the final report.

The Office of the Comptroller's comments are fully responsive to the recommendation. The Comptroller has recommended that the force rearrangement factor be deleted from DoD Manual 7220.9-M, which has not been staffed throughout DoD.

C. Transportation Costs

FINDING

The Security Assistance Accounting Center (SAAC) had not corrected erroneous transportation charges to Basic Stinger FMS cases that occurred between October 1983 and April 1987. SAAC had corrected a programming logic error in the billing system that used the transportation look-up table, but had not made adjustments to the affected FMS cases. This condition occurred because SAAC determined that projected savings did not justify the effort required to adjust each case. As a result, 10 FMS cases were overcharged for transportation by $935,000, and one case was undercharged by $493,000.

DISCUSSION OF DETAILS

Before October 1, 1983, transportation charges on all FMS deliveries were computed by applying standard percentage rates to the selling prices of the articles. In October 1983, a transportation look-up table was established for a number of items, including the Stinger missile. The look-up table shows estimated actual costs when costs using standard transportation percentages are significantly different from actual charges. However, because of deficiencies in the automated billing system at SAAC, transportation charges on Stinger deliveries between October 1983 and April 1987 were a mixture of estimated actual costs from the look-up table, costs based on the standard percentage rates, and costs applied to price adjustment transactions that were not actual deliveries. Although the billing system's programming logic was corrected in 1987, erroneous charges to the FMS cases had not been removed.

We determined that SAAC had billed FMS customers $1,341,801 in transportation costs on 10 Stinger cases (18 case line numbers). About 70 percent of the transportation costs, or $935,000, was erroneously charged. SAAC did not correct these charges because identifying erroneous transactions would have been difficult and time-consuming, and the projected savings did not justify the effort required to make retroactive adjustments. During our audit, SAAC adjusted transportation undercharges to FMS case SR-VHB by $493,000. Appendix C summarizes the overcharges by case line.

We believe the erroneous charges were high enough to warrant corrective action by SAAC. Since similar errors probably occurred in transportation charges for other FMS articles on the look-up table, SAAC should revalidate transportation billings for all other look-up table items delivered between October 1983 and April 1987 and correct any erroneous charges.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Director, Security Assistance Accounting Center:

1. Correct the transportation charges for the Foreign Military Sales cases listed in Appendix C by the amounts shown.

2. Revalidate transportation charges on deliveries of other Foreign Military Sales articles that are subject to look-up table rates, and take action to correct any erroneous charges disclosed.

MANAGEMENT COMMENTS

The Air Force concurred with Finding C and Recommendations C.1. and C.2. SAAC will review and correct the transportation charges for each Stinger case. This review should be completed by November 30, 1990. SAAC will also use statistical sampling techniques to validate the transportation charges for other FMS articles. Depending on the results of the validation process, SAAC will develop a method of correcting the erroneous charges for each FMS case. This evaluation should be complete by December 31, 1990.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

Although the Air Force concurred with the finding and recommendations, its comments did not address the monetary benefits identified by the audit. Therefore, we request that the Air Force comment on those benefits when replying to the final report.

D. Asset Use Charges for DoD-Owned Facilities

FINDING

MICOM improperly charged asset use costs to FMS customers for DoD-owned facilities and equipment used to produce Basic Stinger missiles. In addition, sales of missiles procured through the Special Defense Acquisition Fund (SDAF) were not charged the applicable rental fee, but instead were charged a substantially higher amount for asset use. These conditions occurred because MICOM did not have adequate internal controls to properly process price and availability worksheets between the organizational elements responsible for FMS pricing. As a result, 23 of 28 Basic Stinger FMS cases had an improper or inflated cost for asset use, resulting in overcharges of $3.2 million to FMS customers.

DISCUSSION OF DETAILS

Background. Although the Stinger was manufactured by a contractor, its production also required the use of some DoD-owned assets, such as test equipment and special tooling. DoD Manual 5105.38-M, "Security Assistance Management Manual," October 20, 1989, provides that the sale of defense articles to any foreign country shall include appropriate charges for DoD-owned facilities and equipment used to produce the articles. These charges will be in the form of asset use charges, except where production of the articles is subject to rental fees assessed in accordance with the Federal Acquisition Regulation (FAR). DoD Manual 5105.38-M further states, "At no time will both a rental charge and an asset use charge be applied to the same defense articles on an FMS transaction."

For items procured through the SDAF in anticipation of future FMS cases, DoD Manual 7290.3-M states that contracts shall not include rental charges as provided by the FAR. This Manual further specifies that the DoD Component that has custody of the SDAF asset being purchased will be responsible for tracking the related unfunded costs until the asset is sold to an FMS customer.

We reviewed 28 cases and found that for 14 of 17 FMS cases, unit prices for the Basic Stinger included improper asset use charges, resulting in overcharges of $1.8 million to FMS customers. Inflated asset use charges of $1.4 million were assessed on 9 of the 11 SDAF cases. Appendix D is a schedule of the cases affected.

Asset Use Costs for Procurement Cases. For 14 of 17 procurement cases, $1.8 million was charged to FMS customers for asset use, even though a rental fee for DoD-owned facilities and equipment was included in the unit price. For example, on contract DAAH0182-C-A003, 646 Basic Stinger missiles were shipped to the customer for FMS case NE-VLH. Although unit prices included rental fees, the Stinger PMO improperly added asset use charges amounting to $1.3 million.

The improper charges occurred because asset use and rental charges were developed independently and at different stages of the FMS pricing process. Rental rates were determined during the procurement process in accordance with the FAR and were included as part of the contract unit cost. The Stinger PMO added a 4-percent asset use charge when developing the total FMS price for the Stinger. PMO personnel were not aware that the contract cost already included an appropriate rental charge.

SDAF Cases. Of the 28 Basic Stinger cases, 11 involved sales of missiles procured under SDAF procedures. The FMS price of these missiles included a 4-percent charge for asset use, but in accordance with DoD Manual 7290.3-M, the SDAF contract price excluded rental charges. The asset use charges on the SDAF missiles ranged from $1,559 to $2,625; the rental charges, ranging from $156 to $326, were applied to missiles procured with specific FMS customer funds under the same contracts. As a result of the difference between asset use and rental fees, customers who received SDAF missiles were charged $1.4 million more than if the missiles had been procured through normal FMS channels and properly priced and billed. Therefore, in our opinion, the Stinger missiles sold from SDAF sources should have been priced to include the appropriate contract rental charge rather than the 4-percent asset use charge.

Recent fair pricing legislation (Public Law 101-165) has eliminated asset use charges on defense articles delivered to FMS customers after December 1989. However, to comply with DoD regulations that existed before the legislation was enacted, MICOM needs to adjust the sales price of Stinger missiles by deleting the charge for asset use in all FMS procurement cases when an appropriate rental charge is included in the contract unit price. For SDAF cases, the appropriate rental charge should be applied instead of the 4-percent asset use charge.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Commander, U.S. Army Missile Command:

1. Reprice all Basic Stinger Foreign Military Sales procurement cases by deleting the asset use charge when an appropriate rental fee was included in the contract cost of the missile.

2. Adjust the Basic Stinger sales prices on Special Defense Acquisition Fund cases by substituting the appropriate rental fee for the 4-percent asset use charge.

MANAGEMENT COMMENTS

The Army concurred with Finding D and Recommendation D.1., and concurred in part with the monetary benefits associated with the Basic Stinger missile procurement cases. The Army will review all open FMS cases for missiles and delete the invalid asset use charges by March 30, 1991. The Army concurred with only $1.8 of the $3.1 million in monetary benefits related to procurement cases, stating that estimated costs on DD Form 1513, "U.S. Department of Defense Offer and Acceptance," were not actually billed to customers because of case amendments that deleted certain charges. The Army stated that the MICOM billing office has initiated action to refund the $1.8 million to the FMS cases that were improperly billed.

The Army concurred in part with Recommendation D.2. and nonconcurred with the monetary benefits of $1.4 million associated with SDAF sales, stating that MICOM used the proper DoD guidance in charging 4 percent for asset use on SDAF sales. However, the Army will recommend that the Comptroller of the Department of Defense reevaluate the DoD policy concerning asset use charges for SDAF sales. The Army stated that an adjustment of $1.4 million to customer billings would not be appropriate.

The Defense Security Assistance Agency (DSAA) nonconcurred with Finding D in relation to SDAF cases and with Recommendation D.2., stating that the finding is contrary to the existing policy of using stabilized pricing on SDAF cases. The stabilized pricing policy ensures that the price of major end items will remain the same from the Letter of Offer and Acceptance through case closure. DSAA cited Office of the Assistant Inspector General for Inspections Report No. 90-INS-15, issued July 26, 1990, which endorsed the "no-loss, no-gain" concept of stabilized pricing as a means of increasing efficiency and customer satisfaction.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

Based on additional information provided by the Army regarding asset use charges for procurement cases, we have changed the number of cases with inaccurate asset use charges from 17 cases to 14 cases and adjusted the monetary benefits from $3.1 to $1.8 million. The Army originally concurred with $1.7 million in monetary benefits; however, MICOM provided detailed case information that changed the amount to $1.8 million.

We disagree with the Army's position regarding Recommendation D.2. The references cited by the Army are found in paragraph 70601 of DoD Manual 7290.3-M, which states that unless appropriate rental charges are made, an asset use charge should be applied when FMS orders require the use of DoD assets. As the

Army pointed out, paragraph 71802.A.2. of DoD Manual 7290.3-M excludes rental charges on SDAF contracts. However, paragraph 71802.A.2. also excludes the 1-percent and 4-percent asset use charges to the SDAF. We believe that the intent of these exclusions was to avoid encumbering SDAF with charges that pass through the FMS Trust Fund and do not represent actual expenditures or outlays. When SDAF-owned articles are sold, we believe that rental or asset use, as appropriate, should be charged to the purchaser as intended under Section 706 of DoD Manual 7290.3-M. Although DoD Manual 7290.3-M may not be clear with reference to the SDAF, it is not practical to apply a different surcharge for asset use to SDAF items procured under the same contracts used for other FMS cases. Therefore, we request that the Army reconsider its position on Recommendation D.2. when replying to the final report.

We disagree with DSAA's position on Finding D and Recommendation D.2. The stabilized pricing concept protects FMS customers against price fluctuations from sources outside of DoD, such as inflation. However, on SDAF sales, stabilized pricing should not have been used to disguise internal pricing inconsistencies. DSAA nonconcurred with the "no-loss, no-gain" concept cited in Office of the Assistant the Inspector General for Inspections Report No. 90-INS-15. However, DSAA used that report as a basis for nonconcurring with the SDAF portion of the finding and recommendation. We request that DSAA reconsider its position on Recommendation D.2. if comments are made on this final report.

E. Delivery Reporting of Stinger Missiles

FINDING

MICOM took more than 60 days to report shipments of Stinger missiles to FMS customers on 62 of 82 missile deliveries. This condition occurred because MICOM did not have adequate internal controls to monitor the reporting of shipments diverted from Army stock, and shipments from contractors or depots to FMS customers. These reporting delays slowed billings of $115.9 million in missile deliveries. The delays also caused SAAC to understate the deliveries reported to FMS countries in quarterly billing statements.

DISCUSSION OF DETAILS

DoD Manual 7290.3-M states, "Implementing agencies shall report accrued expenditures (work in process) and physical deliveries to the Security Assistance Accounting Center (SAAC) through use of a billing and reporting procedure within 30 days of the date of shipment or performance." In order to report a physical delivery, MICOM must receive a confirmation of shipment from the contractor or depot involved. The contractor uses a "Materiel Release and Receiving Report" (DD Form 250) to notify MICOM of a direct shipment. For shipments from Army inventory, the depot enters a materiel release confirmation into the Commodity Command Standard System (the System), which automatically updates the information. After the shipment is confirmed, MICOM submits an "FMS Detail Billing Report" (DD Form 1517) to SAAC.

We reviewed 28 delivered FMS cases that had 82 separate shipments of Stinger missiles. We identified 62 deliveries that MICOM had not reported within 60 days of shipment; 14 deliveries were diverted from Army stock, and 48 were from contractors and depots. DoD criteria specify that customers should be billed within 30 days; however, SAAC processes bills on a fixed cycle, and the 30-day standard is not always achievable. Therefore, we allowed MICOM 60 days to complete the billing cycle.

Diversions From Army Stock. MICOM did not report that missiles had been diverted from Army stock to FMS customers within 60 days after the missiles were delivered. We identified 14 shipments with reporting delays totaling $41.0 million in missile deliveries. These missiles were diverted when FMS customers wanted them before the scheduled delivery dates. However, MICOM did not report the deliveries from Army stock until the Army replenished its inventory with missiles from the procurement contract, causing delayed billings to the FMS customers. For example, in April 1984, 400 Stinger missiles were diverted from stock at Red River Army Depot and shipped for FMS case SR-VHB. MICOM did not report the shipment to SAAC until

November 1984, when the Army's stock was replenished. This 7-month delay slowed billings of about $28.1 million to the customer.

Contractor and Depot Shipments. We identified 48 shipments for which the contractor and the depot had sent Stinger missiles to FMS customers, but MICOM had not reported the shipments to SAAC within 60 days. This resulted in reporting delays of $74.9 million. The reporting delays occurred because MICOM did not have effective internal controls to monitor the shipment of missiles. For example, 12 separate shipments of 646 missiles for FMS case NE-VLH were made between January 1984 and January 1985. For 8 of these 12 shipments, the average billing delay was 6 months. These delays, as well as delays in reporting the diversions from Army stock, caused a corresponding understatement in the delivery status reported to customers in the quarterly "Foreign Military Sales Billing Statement" (DD Form 645).

Delays in reporting shipments from contractors and Army depots had been previously identified by the U.S. Army Security Affairs Command (USASAC) in a study entitled, "Foreign Military Sales Army Procurement Appropriation (APA) Major Items Shipped-Unbilled," issued on October 6, 1988. The study, which included a review of MICOM procedures, concluded that approximately 35 percent of all billings for major items had not been made within prescribed time standards.

To ensure prompt billing and accurate reporting of case status to FMS customers, MICOM needs to develop effective internal controls to monitor and report shipments from contractors and depots.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Commander, U.S. Army Missile Command establish policies and procedures to monitor and report all shipments from contractors and depots, including diversions from Army stock, to ensure prompt billing to Foreign Military Sales customers.

MANAGEMENT COMMENTS

The Army concurred in principle with the finding and Recommendation E. The Army stated that internal control procedures will be improved to ensure that FMS Program Managers explore every means of enhancing earlier reporting and billing of Stinger missile deliveries. These improved procedures will be issued by October 31, 1990. The Army further stated that extenuating circumstances within the System, such as data input errors, precluded billing actions within the prescribed 30-day time frame.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

The Army's comments are not fully responsive to the recommendation. Although the Army stated that internal controls would be strengthened, the Army did not specify the policies and procedures it will use for monitoring and reporting when it procures new missiles to replace those shipped from Army stock. We request that the Army specify these policies and procedures when replying to the final report. As discussed in the finding, we recognized the problems inherent in the System, and we used a 60-day criterion to determine the adequacy of delivery reporting of contractor and depot shipments to SAAC for customer billing.

FMS STINGER MISSILE CASES IMPLEMENTED

Case	Purchased Quantity	Purchased Dollar Value	Delivered Quantity	Delivered Dollar Value
Basic Stinger				
BA-JUQ	70	$ 3,609,538	70	$ 3,651,538
XX-JUU	30	1,522,780	30	1,586,530
XX-UXW	34	2,295,791	34	2,095,676
FR-UYP	19	981,750	19	856,980
XX-JAA	18	954,510	18	954,510
XX-JWB	10	505,950	10	505,950
XX-VXD	5	635,500	5	343,048
IT-XKE	12	848,108	12	733,500
IT-XKS	612	31,885,686	601	29,361,312
JA-VFV	17	1,242,315	17	847,866
JA-VFW	7	513,613	7	352,348
JA-VHW	39	2,568,132	39	1,476,160
JA-VHZ	37	2,475,821	37	2,073,398
JA-VKH	14	1,204,959	14	800,876
JA-VKX	39	3,360,137	39	2,145,178
JA-VNC	27	2,008,716	27	1,425,178
JA-VND	29	2,160,038	29	1,489,172
JA-JEP	34	1,873,004	34	1,873,004
JA-JFX	28	1,556,588	28	1,556,588
NE-VLD	646	43,314,510	646	29,331,727
XX-VFD	120	6,236,280	120	6,236,280
SR-VHB	400	28,926,000	400	28,059,600
TK-UQB	62	3,966,939	62	2,723,502
TK-JAW	82	4,447,906	82	3,218,870
TK-JCP	72	4,060,440	72	3,691,800
UK-VSH	60	3,694,560	60	3,814,772
XX-VSN	8	485,440	8	457,299
UK-VTJ	18	1,291,104	18	1,290,090
Subtotal	2,549	$158,626,115	2,538	$132,953,193
Reprogrammable Microprocessor (RMP) Stinger				
GR-JXT	500	$ 29,047,250	0	0
GY-WNU	2	103,730	0	0
JA-VQE	41	2,759,690	0	0
JA-VQP	54	3,630,264	0	0
JA-VSO	45	2,361,087	0	0
JA-VSP	89	4,895,613	0	0
JA-JAD	48	3,148,137	0	0
JA-JAE	84	794,310	0	0
SZ-JAA	1	67,110	1	67,110
Subtotal	864	$ 46,807,191	1	$ 67,110
Total	3,413	$205,433,306	2,539	$133,020,303

ANALYSIS OF PRICING METHODS USED FOR ECONOMY ACT SALES

National Stock Number	DoD Replacement Price 1/	MICOM Billing Price 4/	Unit Overcharge	Quantity	Total Amount Overcharged	PCH and Overhead Unit Cost 5/	PCH and Overhead Costs	Net Overcharge
1427-01-230-8783	$61,673 2/	$62,486	$ 813	600	$ 487,800	$628	$376,800	$ 111,000
1427-01-230-8784	62,851 2/	63,588	737	186	137,082	641	119,226	17,856
1427-01-230-8783	57,717 3/	61,833	4,116	600	2,469,600	589	353,400	2,116,200
1427-01-230-8784	58,663 3/	62,934	4,271	220	939,620	599	131,780	807,840
				1,606	$4,034,102		$981,206	$3,052,896

1/ Includes replacement cost factors and a 10 percent force rearrangement factor.

2/ Pricing in effect from March 1 to October 14, 1987.

3/ Pricing in effect from October 15, 1987, to July 31, 1988.

4/ Missile Command's (MICOM's) price includes the standard price for missiles and their components, plus force rearrangement and engineering charges.

5/ $12 per unit for packing, crating and handling (PC&H) and applicable overhead rates.

NOTE: Total amount overcharged, PCH and overhead costs, and net overcharge amounts are not precise due to rounding of unit costs.

SCHEDULE OF ERRONEOUS TRANSPORTATION CHARGES

Country Case	Case Line	Amount Billed	Amount from Look-up Table	Difference *
FR-UXW	1	$ 13,718	$ 1,990	$ 11,728
FR-UXW	2	12,168	496	11,672
FR-UXW	3	12,319	1,785	10,534
FR-UXW	4	21,859	880	20,979
IT-XKE	1	10,975	1,592	9,383
IT-XKE	2	19,703	2,856	16,847
IT-XKS	1	143,640	86,340	57,300
IT-XKS	2	340,920	166,050	174,870
IT-XKS	13	0	542	(542)
JA-JFX	1	41,894	13,416	28,478
JA-VFV	1	6,713	270	6,443
JA-VFW	1	2,105	90	2,015
NE-VLH	1	451,689	56,076	395,613
NE-VLH	2	51,935	17,898	34,037
PK-VFD	1	6,760	4,200	2,560
TK-JCP	1	174,950	47,812	127,138
TK-UQB	1	28,197	1,680	26,517
TK-UQB	2	2,256	2,356	(100)
Total		$1,341,801	$406,329	$935,472

* Positive amount is total overcharge and negative amount is total undercharge.

SUMMARY OF FACILITY ASSET USE AND RENTAL CHARGES

Procurement Cases

Case	Contract Number	Line No.	Quantity Purchased	National Stock Number	Facility Asset Use Charges	Rental Charge Per Unit	Total
FR-UXW	A088	1	5	1425-01-024-9982	$ 11,440.00	$156.20	$ 781.00
		2	8	1425-01-024-9982	18,304.00	156.19	1,249.52
		3	5	1427-01-024-9967	9,945.00	156.19	780.95
		4	16	1427-01-024-9967	31,824.00	156.19	2,499.04
					71,513.00		5,310.51
GY-VXD	A003	1	2	1427-01-024-9967	3,554.00	99.71	199.42
		2	3	1427-01-024-9982	7,857.00	114.43	343.29
					11,411.00		542.71
IT-XKE	A088	1	4	1427-01-024-9982	9,152.00	156.20	624.80
		2	8	1427-01-024-9967	15,640.00	156.19	1,249.52
					24,792.00		1,874.32
JA-VFV	A003	1	3	1427-01-024-9967	4,226.13	99.71	299.13
		2	14	1425-01-024-9982	4,655.95	114.43	1,602.02
					8,882.08		1,901.15
JA-VFW	A003	1	1	1427-01-024-9967	1,636.00	99.71	99.71
		2	6	1425-01-024-9982	11,922.00	114.43	686.58
					13,558.00		786.29
JA-VHW	A055	1	9	1427-01-024-9967	13,505.13	233.00	2,097.00
		2	30	1425-01-024-9982	66,840.00	326.00	9,780.00
					80,345.13		11,877.00
JA-VHZ	A055	1	2	1427-01-024-9967	3,020.18	233.00	466.00
		2	35	1425-01-024-9982	77,980.00	326.00	11,410.00
					81,000.18		11,876.00

SUMMARY OF FACILITY ASSET USE AND RENTAL CHARGES (continued)

Procurement Cases (continued)

Case	Contract Number	Line No.	Quantity Purchased	National Stock Number	Facility Asset Use Charges	Rental Charge Per Unit	Total
JA-VKH	A088	1	12	1425-01-024-9982	$ 35,844.00	$156.19	$ 1,874.28
		2	2	1427-01-024-9967	5,576.00	156.19	312.38
					41,420.00		2,186.66
JA-VKX	A088	1	35	1425-01-024-9982	104,545.00	156.19	5,466.65
		2	4	1427-01-024-9967	11,152.00	156.19	624.76
					115,697.00		6,091.41
JA-VNC	A100	1	24	1425-01-024-9982	61,944.00	137.66	3,303.84
		2	3	1427-01-024-9967	6,594.00	118.75	356.25
					68,538.00		3,660.09
JA-VND	A100	1	26	1425-01-024-9982	67,106.00	137.66	3,579.16
		2	3	1427-01-024-9967	6,594.00	118.75	356.25
					73,700.00		3,935.41
NE-VLH	A003	1	464	1425-01-024-9982	773,488.00	114.43	53,095.52
		2	182	1427-01-024-9967	274,820.00	99.71	18,147.22
					1,048,308.00		71,242.74
UK-VSH	A088	1	52	1427-01-024-9967	105,404.00	156.19	8,121.88
		2	8	1425-01-024-9982	17,824.00	156.19	1,249.52
					123,228.00		9,371.00
UK-VTJ	A088	2	6	1425-01-024-9982	15,654.00	156.19	937.14
		2	12	1427-01-024-9967	27,876.00	156.19	1,874.28
					43,530.00		2,811.42
Totals					$1,805,922.39		$133,467.11

SUMMARY OF FACILITY ASSET USE AND RENTAL CHARGES
(continued)

SDAF Cases

Case	Contract Number	Line No.	Quantity Purchased	National Stock Number	Facility Asset Use Charges	Rental Charge Per Unit	Total	Variance (Asset) - (Rental)
BA-JUQ	A088	1	16	1427-01-219-7116	$ 28,752.00	$156.00	$ 2,496.00	$ 26,256.00
		3	54	1427-01-024-9967	96,012.00	156.19	8,434,26	87,577.74
					124,764.00		10,930.26	113,833.74
CD-JUU	A088	1	10	1427-01-219-7116	17,970.00	156.00	1,560.00	16,410.00
		3	20	1427-01-024-9967	35,560.00	156.19	3,123.80	32,436.20
					53,530.00		4,683.80	48,846.20
FR-UYP	A088	1	7	1427-01-219-7116	11,732.00	156.00	1,092.00	10,640.00
		3	12	1427-01-024-9967	19,896.00	156.19	1,874.28	18,021.72
					31,628.00		2,966.28	28,661.72
FR-JAA	A088	1	6	1427-01-219-7116	12,378.00	156.00	936.00	11,442.00
		4	12	1427-01-024-9967	21,648.00	156.19	1,874.28	19,773.72
					34,026.00		2,810.28	31,215.72
FR-JWB	A088	1	10	1427-01-024-9967	17,780.00	156.19	1,561.90	16,218.10
JA-JEP	A088	1	27	1427-01-024-9982	50,166.00	156.19	4,217.13	45,948.87
			7	1427-01-024-9967	11,207.00	156.19	1,093.33	10,113.67
					61,373.00		5,310.46	56,062.54
JA-JFX	A088	1	24	1427-01-024-9982	44,592.00	156.19	3,748.56	40,843.44
		2	4	1427-01-024-9967	6,404.00	156.19	624.76	5,779.24
					50,996.00		4,373.32	46,622.68
PK-VFD	A088	1	60	1427-01-024-9982	110,640.00	156.19	9,371.40	40,843.44
	A088	2	27	1427-01-024-9967	42,093.00	156.19	4,217.13	37,875.87
	A055		33	1427-01-024-9967	51,447.00	233.00	7,689.00	43,758.00
					204,180.00		21,277.53	182,902.47
SR-VHB	A055	1	200	1425-01-024-9982	525,000.00	326.00	65,200.00	459,800.00
		2	200	1425-01-024-9967	447,200.00	233.00	46,600.00	400,600.00
					972,200.00		111,800.00	860,400.00
Total					$1,550,477.00		$165,713.83	$1,384,763.17

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

OCT 15 1990

(Management Systems)

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DODIG

SUBJECT: Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales Customers (Project No. 0FA-0004)

Your memorandum of August 3, 1990, requested our comments on the "Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales Customers," draft report. Our comments address only the recommendations to the DoD Comptroller. We also commented on the monetary benefits outlined in Appendix B of the draft report.

We appreciate the opportunity to provide comment on this report. Should you need to discuss any of our comments further, Mr. Robert Florence is our point of contact. Mr. Florence may be reached on 697-3192.

Alvin Tucker
Deputy Comptroller
(Management Systems)

Attachment

DoD Comptroller Comments
on
DoDIG Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales Customers
(Project No. 0FA-0004)

RECOMMENDATION A.1.: We recommend that the Comptroller of the Department of Defense direct the Army to rebill packing, crating, and handling charges on Stinger missiles shipped from Army stocks using a rate of $12 a missile instead of 3.5 percent of the selling price.

DoD Comptroller Comment: Nonconcur. We recognize that the PC&H surcharge may result in individual billings which are greater or less than actual costs. However, our objective is to recover costs incurred by the U. S. Government in performing packing, crating and handling (PC&H) services in the aggregate and not necessarily on each transaction. To achieve that objective, we apply an approved surcharge, without regard to the precise actual costs for specific shipments. To selectively use actual costs, or to bill at the recommended $12 rate, whenever actual costs are lower, and bill at the surcharge amount when actual costs are higher, would negate the overall equity of the rate and result in DoD subsidizing the FMS program. Unless actual costs are required to be billed on all transactions, some degree of inaccuracy, i.e., over and under billing, should be anticipated on all transactions.

DoD policy requires that the surcharge be used for specified delivery source codes unless the DoD Component requests an exception with supporting justification prior to the performance of PC&H. The Army acted within the policy contained in DoD 7290.3-M, Foreign Military Sales Financial Management Manual, by reporting the delivery with the PC&H surcharge applicable.

We concur that the monetary amount of the difference between amounts collected and actual costs in this instance were $1.7 million. The amount is not a recurring amount. The missiles were priced in accordance with existing policy.

RECOMMENDATION B.2.: We recommend that the Comptroller of the Department of Defense reevaluate the requirement to apply a 10 percent force rearrangement factor to all items replaced with an improved models.

DoD Comptroller Comment: Concur. We intend to review a number of Foreign Military Sales (FMS) surcharges including the force rearrangement factor in the near future. If the review results in modification to FMS pricing policy, the resultant policy will be published both in chapter 26 of DoD 7220.9-M, "DoD Accounting Manual," and in chapter 7 of DoD 7290.3-M, "Foreign Military Sales Financial Management Manual." The review is expected to be completed by December 31, 1990.

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
WASHINGTON, DC 20310-0103

17 OCT 1990

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING, OFFICE OF THE INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE

SUBJECT: Response to DOD Inspector General (DODIG) Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales (FMS) Customers (Project No. OFA-0004)

Enclosed is our response to the subject DODIG draft report as requested in your 6 August 90 memorandum.

We concur with the recommendation that the Army establish policies and procedures to monitor the timeliness of FMS delivery reporting. We also concur that the Army erroneously charged asset use when rental charges were included on FMS procurement cases. The related overcharges total $1.7 million, not $3.1 million as stated in the report. Additionally, we concur that the Army omitted charging a non-DOD agency for packing, crating, and handling and for overhead cost totaling $982,000, according to the report. Therefore, we agree to a net reimbursement of about $720,000 ($1.7 million in overcharges less $982,000 in undercharges). Although we concur with the intent of the remaining findings and recommendations, we do not believe that reimbursement is appropriate.

The other findings on the pricing of Stinger missiles indicate that alternative pricing methods would have produced a lower price. This is true. However, we followed DOD guidance in pricing the missiles and applying the standard add-on rates. Application of this frequently results in individual overcharges or undercharges, when compared to actual costs. We believe that DOD established this policy to simplify the billing process, expedite the final billing, and break even on aggregate sales. It was not the intent that individual shipments would be precisely billed. If we were to concur with your recommendations to bill actual add-on costs associated with the Stinger missile, we also would be required to perform similar actual cost reviews for all FMS and Economy Act billings, and that is not feasible.

Our point of contact is Mr. Thomas L. Leonard, Office of the Deputy Assistant Secretary of the Army for Finance and Accounting, SAFM-FAP-S, Indianapolis, IN 46249-1046, AUTOVON 699-3059 or commercial (317) 542-3059.

Neil R. Gennetti
for Douglas A. Brook
Assistant Secretary of the Army
(Financial Management)

Enclosure

Copy Furnished:
The Inspector General, OSA, ATTN: SAIG-PA

ARMY RESPONSE

DOD Inspector General Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales (FMS) Customers (Project No. OFA-0004)

FAR A - Packing, Crating, and Handling Costs.

Finding: Foreign Military Sales customers were overcharged for packing, crating, and handling (PC&H) costs on shipments of Stinger missiles from Red River Army Depot. The overcharges occurred because the existing method for calculating PC&H costs did not reasonably approximate actual effort expended by the depot. As a result, PC&H billings to FMS customers and reimbursements to the U.S. Army Missile Command (MICOM) were overstated by about $1.7 million.

Recommendation A-1: We recommend that the Comptroller of the Department of Defense direct the Army to rebill packing, crating, and handling charges on Stinger missiles shipped from Army stocks using a rate of $12 a missile instead of 3.5% of the selling rice.

Comments: While not directed to Army, we submit the following comments for consideration.

MICOM priced the Stinger missiles in compliance with paragraph 70402 of DOD 7290.3-M. This FMS manual directs the standard 3.5% PC&H charge be billed for items $50,000 or less, and an additional one percent of the selling price over $50,000. MICOM followed guidance in applying the standard 3.5% PC&H costs to the FMS of Stinger missiles.

Any use of these standard rates will result in an overcharge or an undercharge, when compared to the estimated actual cost. We believe that DOD's purpose in developing the rates was to apply an equitable charge to all items in the aggregate--not on an individual basis. We strongly believe that this was the proper approach.

In the case of the Stinger missiles, it appears that application of the standard rate may have produced a charge higher than estimated actual PC&H cost. However, we do not agree that MICOM should refund PC&H charges on past sales of Stinger and other missiles. Collections were deposited, as required, and subsequently used to fund approved operations. Instead, we will ask DOD to reevaluate the existing standard rates. If determined appropriate, a new standard rate should be mandated for future (but not past) FMS of all military items. However, we do not favor separate rates for individual items. Army commands do not have cost accounting systems to accumulate and classify expenses, nor the funds to build them.

Further, applying estimated actual PC&H costs to all items sold would result in the same overall net result as does the standard rates.

Recommendation A-2: We recommend that the Commander, U.S. Army Missile Command initiate a joint effort with the Army depots to establish PC&H rates for FMS customers based on actual costs for the Stinger and other missile systems.

Comments:
We nonconcur with this recommendation as currently worded. As mentioned above, Army systems are not capable of gathering and classifying costs to establish individual PC&H rates for each missile system. Instead, we will request that DOD reevaluate the current rates and, if appropriate, issue new standard rates. However, we do not favor the establishment of multiple rates. Like the existing standard rates, new rates should apply across-the-board to produce the necessary reimbursement over all sales.

Monetary Benefit: Nonconcur. As stated above, MICOM priced the Stinger missiles according to DOD guidance. Therefore, an adjustment of $1.7 million is not appropriate. Also, while a change to actual PC&H costs may result in a savings to the customer on Stinger missiles, the overall effect for all FMS would, in theory, be zero.

ARMY RESPONSE

DOD Inspector General Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales (FMS) Customers (Project No. OFA-0004)

FAR B - Pricing of Economy Act Sales.

Finding: MICOM did not accurately price Stinger missiles sold to a non-DOD activity under the Economy Act. This condition occurred because the MICOM Stinger Project Manager's Office did not comply with DOD guidance and priced the sales using the standard price instead of replacement cost. In addition, the Project Manager's Office added a 10% force rearrangement factor to cover the costs of putting an improved missile in the Army's inventory, but excluded packing, crating, and handling (PC&H) and overhead costs. As a result, MICOM overcharged $4.0 million on the sales of 1,606 Stinger missiles and undercharged $982,000 for the PC&H and overhead costs. Also, MICOM used the force rearrangement funds to increase the Army's Stinger inventory by about 160 more missiles than were sold to the customer.

(Please note that the Stinger Project Manager's (PM) Office is under the purview of the Program Executive Officer, Air Defense, and not the Commander, MICOM.)

Recommendation B-1: We recommend that the Commander, Army Missile Command:

a. Reprice the Stinger missiles sold to a non-DOD activity under the Economy Act from March 1987 to July 1988, using the appropriate pricing elements, and reimburse the activity for $3.1 million in overcharges.

b. Comply with DOD 7220.9-M to ensure that applicable costs are recovered on future Economy Act sales.

Response: We concur in part.

The various pricing guidance in effect at the time for this type of sale was both confusing and contradictory. In pricing the Economy Act sales, the PM used what was believed to be the appropriate policy at the time. As noted in the audit, Paragraph F.4.b.(1)(b) of DOD 7220.9-M (dated September 18, 1989) does state that items to be replaced with an improved item should be sold to other Federal agencies at the estimated replacement cost. We believe that this was the DODIG's basis for the finding. This is understandable, but, in our opinion, there are other criteria to be considered.

During most of the period in question, the PM relied on an Army memorandum dated March 25, 1987. The memorandum subject was "New Guidance for Pricing Sales to Non-DOD Federal Agencies Under the Economy Act, 31 U.S.C. 1535." It was issued in advance of a change to Army Regulation (AR) 37-60. This memorandum stated that the replacement price should be used for Economy Act sales, subject to FMS criteria, when a procurement action for replacement is required. This memorandum resulted from a verbal concurrence with similar wording from the Comptroller of the Department of Defense (DOD(C)) and assurance that DOD 7220.9-M would be changed accordingly. Paragraph B.3. of the DOD manual was modified with the following: "Requisitioning DOD activities ...shall disclose to both DOD and non-DOD suppliers whether any goods or services are for the benefit of non-DOD or non-Federal Government activities, so that proper amounts may be billed and collected." Since the goods in this case were for the benefit of a foreign country (a non-Federal Government activity), it followed that FMS pricing rules should be used. The PM priced the missiles using FMS rules from AR 37-60. Paragraph 4-1.a.(6) of the AR states that items to be replaced will reflect the higher of estimated replacement price or standard price. Under this criteria, the PM priced the missiles at the standard Army Master Data File price, which was higher than the replacement cost. We believe it was proper to use the higher of the two prices, since this same rule applied to DOD and other U.S. Government customers. In one celebrated case, the General Accounting Office was highly critical of the Army for not charging the higher of the standard or replacement cost in a sale to another U.S. Government agency for the benefit of a non-Federal Government activity. This, too, was a missile sales case.

We will request that the DOD(C) clarify the policy for Economy Act sales of items to be replaced.

The force rearrangement factor was added as required by paragraph 26F.4.b.(1)(b) of DOD 7220.9-M for the sale of an item to be replaced with an improved item. This cost was not added with the intent to procure more missiles than were sold.

We concur that Army improperly excluded the Overhead and Packing, Crating, and Handling costs from the price of the missiles sold under the Economy Act.

Recommendation B-2: We recommend that the Comptroller of the Department of Defense reevaluate the requirement to apply a 10 percent force rearrangement factor to all items replaced with an improved model.

Comments: While not directed to the Army, we submit the following comments for DOD consideration. The Army followed DOD guidance in applying the force rearrangement factor. Any change to this guidance, should not be applied retroactively.

Monetary Benefit: Concur in part. As stated above, the Army priced the Stinger missiles according to what we believed to be DOD guidance at the time. Therefore, an adjustment for a $4.0 million overcharge is not appropriate. Further, to reimburse this amount would not benefit the other non-DOD agency. In most cases it would be credited to merged funds. We concur with the undercharge of $982,000 for overhead and packing, crating, and handling.

ARMY RESPONSE

DOD Inspector General Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales (FMS) Customers (Project No. OFA-0004)

FAR C - Transportation Costs.

Note: This finding and recommendation is directed to the Security Assistance Accounting Center. Therefore, we are not addressing this issue.

ARMY RESPONSE

DOD Inspector General Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales (FMS) Customers (Project No. OFA-0004)

FAR D - Asset Use Charges for DOD-owned Facilities.

Finding: MICOM improperly charged asset use costs to FMS customers for DOD-owned facilities and equipment used to produce basic Stinger missiles. In addition, sales of missiles procured through the Special Defense Acquisition Fund (SDAF) were not charged the applicable rental fee, but instead, were charged a substantially higher amount for asset use. These conditions occurred because MICOM did not have adequate internal controls to properly process price and availability worksheets between the organizational elements responsible for FMS pricing. As a result, 25 of 28 basic Stinger FMS cases had an improper or inflated cost for asset use that resulted in overcharges of $4.5 million to FMS customers.

Recommendation D-1: We recommend that the Commander, U.S. Army Missile Command reprice all basic Stinger FMS procurement cases by deleting the asset use charge when an appropriate rental fee was included in the contract cost of the missile.

Comments: Concur. A review will be made of all open FMS cases to delete invalid asset use costs, if an appropriate rental charge was incurred through procurement action. This action will be completed by March 30, 1991.

Recommendation D-2: We recommend that the Commander, U.S. Army Missile Command adjust the basic Stinger sales prices on SDAF cases by substituting the appropriate rental fee for the 4-percent asset use charge.

Comments: We concur in part. MICOM followed the guidance in Paragraph 71806 of DOD 7290.3-M for charging a 4 percent asset use charge on SDAF sales. The SDAF contract price excluded rental fees, as specifically required by paragraph 71802 A. 2. of the same DOD guidance. While application of this policy may have resulted in a higher price to FMS customers, MICOM had no basis for deviating from this written policy. However, Army will request the DOD(C) reevaluate the requirement to exclude rental fees and include the 4 percent asset use charge on SDAF sales. We will ask that any change made by the Comptroller be effective on future sales of SDAF items, not on past sales.

Monetary Benefit: Concur with part of the monetary benefit stated. According to the report, the total overcharges were

$4.5 million. Of this total, $3.1 million was listed for procurement cases. However, only $1.7 million (of the $3.1 million) was actually billed to customers. Differences exist on several of the cases listed in the report because the estimated costs on the DD Form 1513 were different than the amount actually billed to the customer. The largest difference relates to FMS case IT-B-XKS. The report shows asset use charges in excess of $1 million. However, a 1986 amendment deleted the charges and the country was never billed for this amount. The MICOM billing office has initiated action to refund the $1.7 million to the cases improperly billed. The remaining $1.4 million (of the $4.5 million total) relates to SDAF cases. Since MICOM priced the SDAF sales according to DOD guidance, we do not believe that an adjustment of $1.4 million is appropriate.

ARMY RESPONSE

DOD Inspector General Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales (FMS) Customers (Project No. OFA-0004)

FAR E - Delivery Reporting of Stinger Missiles.

Finding: MICOM took over 60 days to report shipments of Stinger missiles to FMS customers on 62 of 82 missile deliveries. This condition occurred because MICOM did not have adequate internal controls to monitor the reporting of shipments diverted from Army stock and shipments from contractor or depot facilities to customers. These reporting delays slowed billings of $115.9 million of missile deliveries. Also, these delays understated the level of deliveries reported to the individual FMS countries in the quarterly billing statements.

Recommendation E: We recommend that the Commander, U.S. Army Missile Command establish policies and procedures to monitor and report all shipments from contractors and depots to ensure prompt billing to Foreign Military Sales customers, including diversions of Army stocks.

Comments: Concur in principle. A detailed description of the problems and planned actions by MICOM is attached. MICOM will complete its efforts by October 31, 1990.

Monetary Benefit: Not applicable.

Command Comments

DODIG Draft Report on the Audit of
Pricing, Billing, and Inventory Controls of
STINGER Missiles Sold to Foreign Military Sales Customers
(Project OFA-0004)

FAR E - Delivery Reporting of Stinger Missiles.

FINDING: "MICOM took over 60 days to report shipments of Stinger missiles to FMS customers on 62 of 82 missile deliveries. This condition occurred because MICOM did not have adequate internal controls to monitor the reporting of shipments diverted from Army stock and shipments from contractor or depot facilities to customers. These reporting delays slowed billings of $115.9 million of missile deliveries. Also, these delays understated the level of deliveries reported to the individual FMS countries in the quarterly billing statements."

ADDITIONAL FACTS: Commodity Command Standard Systems (CCSS) procedures are in place to process and control all shipments from contractors and depots. There are extenuating circumstances, however, which preclude billing all actions within prescribed timeframes, as explained below.

(1) In order to report physical delivery, the Document Control File (DCF) must be updated in a timely manner. Shipments from U.S. Army Depots, (shipments from stock), are recorded based upon the receipt of a confirmation of shipment from the depot. Shipments from procurement (direct delivery) are recorded in the DCF based upon receipt of a Shipment Performance Notice (SPN).

(2) If either transaction in paragraph one above rejects upon input into the system, billing action will be affected. Finance and Accounting Division personnel are aware of this problem and are currently working with MICOM Missile Logistics to clear all rejects.

(3) Army inventory items being diverted from stock to satisfy FMS requirements require special handling. The Finance and Accounting Billing Office cannot process billings to FMS customers unless Project Office personnel take prompt action to generate wash post transactions to indicate shipment. Subject audit report stated that billings were not reported until receipt of the replacement items.

(4) DOD 7290.3-M, requires billing action within 30 days of shipment. It is generally felt that compliance with this rule is impossible due to the complexity of DCASR's, Depots, NICP and Financial systems.

(5) Some commands are billing estimated prices in an attempt to satisfy the 30-day billing requirement. One command is reporting billings by utilizing a USASAC management report that reports shipping status. Neither of these commands are fully utilizing the CCSS. MICOM has continued to process all FMS actions through CCSS. Due to rejects and ADP system run schedules, the 30-day billing timeframe will be impossible to meet.

(6) The alternatives for meeting the 30-day billing requirement are loss of control, reversing and re-billing all estimated bills when the shipments finally post and eliminate CCSS as part of the billing process. The alternatives are considered manpower intensive and do not solve the true problems. MICOM will continue to use these ADP systems and seek more timely updates of shipment actions through system changes.

RECOMMENDATION E-1: "We recommend that the Commander, U.S. Army Missile Command establish policies and procedures to monitor and report all shipments from contractors and depots to ensure prompt billing to Foreign Military Sales customers, including diversions of Army stocks."

ACTION TAKEN: Concur in principle. Internal control procedures will be strengthened to ensure that MICOM Foreign Military Sales (FMS) Program Managers explore every possibility to enhance earlier reporting and billing. The new guidance will require FMS Program Managers to initiate requirements for wash post actions whenever the manager becomes aware of actual shipments via DD Form 250, DD Form 1149, DD Form 1348, or information from any other sources, and timely billing has not been accomplished. Normally, wash post actions are required when materiel is shipped from a contractor (vendor) facility directly to a customer and the direct delivery data was not properly recorded in the automated systems. All wash post actions require manual preparation of the receipt and requisition documents. These actions will update an automated program which will notify Resource Management Directorate of all diversion actions for necessary financial transactions. Procedures will be issued NLT 31 Oct 90.

ARMY RESPONSE
SUMMARY OF PRICING FINDINGS

DOD Inspector General Draft Report on the Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales (FMS) Customers (Project No. OFA-0004)

FAR	DESCRIPTION		IN $ MILLIONS AUDIT TOTAL	CONCUR	NON-CONCUR
A*	PACKING, CRATING AND HANDLING (PC&H)		1.7		1.7
B*	ECONOMY ACT SALES				
	--PRICING MISSILES	4.0			4.0
	--PC&H AND OVERHEAD	-.9		-.9	
	--SUBTOTAL	3.1	3.1		
D*	ASSET USE CHARGES				
	--PROCUREMENT CASES	3.1		1.7	1.4
	--SDAF CASES	1.4			1.4
	--SUBTOTAL	4.5	4.5		
	TOTALS		9.3	.8	8.5
	ROUNDED TOTALS		9.3	.7	8.6

* - See footnotes below.

Footnotes:

FAR A - PC&H.

FINDING: Should have used the actual cost (about $12 each, according to the auditors) instead of the standard percentage (3.5% and 1%, which amounted to about $1,800 each). This resulted in total overcharges to FMS customers of about $1.7 million.

COMMENT: Although DOD guidance permits alternate methods of charging PC&H, individual waivers must be obtained and we felt the standard DOD percentages were appropriate.

ARMY RESPONSE
SUMMARY OF PRICING FINDINGS (Continued)

FAR B - ECONOMY ACT SALES.

PRICING MISSILES.

FINDING: Should have used the replacement cost (about $60,000 each) instead of the inventory cost (about $62,000 each). Therefore, Economy Act customers were overcharged a total of about $4.0 million.

COMMENT: Followed DOD guidance in pricing at higher of two costs.

PC&H AND OVERHEAD.

FINDING: Did not charge appropriate PC&H (about $12 each, according to the auditors' calculations) and overhead costs (about $600 each, as calculated by the auditors), thereby undercharging Economy Act customers a total of about $982,000.

COMMENT: Concur, undercharged about $982,000, according to the auditors' calculations.

FAR D - ASSET USE CHARGES.

PROCUREMENT CASES.

FINDING: Erroneously charged asset use (4%, or about $1,900 each) of about $3.1 million to FMS customers in addition to correctly charging rental fees (about $130 each).

COMMENT: Concur, but only about $1.7 million of the $3.1 million was overcharged, since only this portion was actually billed to customers.

SDAF CASES.

FINDING: Should have charged rental fees (about $290 each) instead of the standard percentage (4%, which amounted to about $2,100 each). Therefore, FMS customers were overcharged a total of about $1.4 million.

COMMENT: Although DOD guidance permits alternate methods of charging asset use, individual waivers must be obtained and we felt standard DOD percentages were appropriate.

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

10 OCT 1990

OFFICE OF THE ASSISTANT SECRETARY
(Financial Management)

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING OFFICE OF THE INSPECTOR GENERAL DEPARTMENT OF DEFENSE

SUBJECT: Management Comments, DoDIG Draft Report of Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to Foreign Military Sales Customers (Project No. OFA-0004)

This is in reply to your memorandum for Assistant Secretary of the Air Force (Financial Management and Comptroller) requesting comments on the findings and recommendations made in subject report. Air Force comments are attached. Point of contact is John Williams, SAF/FMABC, extension 76410.

C. RONALD HOVELL
Acting Deputy Assistant Secretary
(Accounting, Finance and Banking)

Attachment

DOD(IG) DRAFT REPORT ON THE PRICING, BILLING, AND INVENTORY CONTROLS OF STINGER MISSILES SOLD TO FOREIGN MILITARY SALES CUSTOMERS PROJECT NO. 0FA-0004

RECOMMENDATIONS AND MANAGEMENT COMMENTS

SECTION C: TRANSPORTATION COSTS

FINDING

Management Comment. Concur with the facts and figures as presented in the finding.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Director, Security Assistance Accounting Center:

1. Correct the transportation charges for the cases listed in Appendix D by the amounts shown.

Management Comment. Concur. Based on a review of each case listed in Appendix D of the draft audit report, SAAC will adjust the transportation charges to ensure the Foreign Military Sales (FMS) customer is charged correctly. It is estimated that these reviews will be completed by November 30, 1990.

2. Revalidate transportation charges on deliveries of other FMS articles subject to look-up table rates, and take action to correct any erroneous charges disclosed.

Management Comment. Concur. The transportation charges on deliveries of FMS articles subject to look-up table rates will be validated. Due to the large number of transactions that have been processed against the look-up tables, statistical sampling techniques will be used to evaluate the accuracy of transportation charges applied by SAAC. Once the scope of erroneous transportation charges has been determined, a methodology will be developed to correct these erroneous charges. This evaluation should be completed by December 31, 1990.

DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

In reply refer to:
I-064656/90
September 24, 1990

MEMORANDUM FOR THE DIRECTOR, FINANCIAL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL, DOD

SUBJECT: Draft Report on the DoDIG Audit of Pricing, Billing, and Inventory Controls of Stinger Missiles Sold to FMS Customers (Project OFA-0004); DSAA/Plans/SDAF Comments

REFERENCE: DoDIG Memorandum, 3 August 1990, Subject as above

This memorandum forwards the comments of the Defense Security Assistance Agency, SDAF Division, to the referenced draft report. The Point of Contact (POC) for this response is Gregory D. Cleva, DSAA/Plans/SDAF, extension 695-4448.

John T. Tyler, Jr.
Director, Plans

Attachment

DODIG DRAFT REPORT ON THE AUDIT OF PRICING, BILLING, AND INVENTORY CONTROLS OF STINGER MISSILES SOLD TO FOREIGN MILITARY SALES CUSTOMERS (PROJECT OFA-0004)

D. Asset Use Charges for DOD-owned Facilities (section of this finding relating to SDAF cases)

FINDING

MICOM improperly charged asset use costs to FMS customers for DOD-owned facilities and equipment used to produce Basic Stinger missiles. In addition, sales of missiles procured through the Special Defense Acquisition Fund (SDAF) were not charged the applicable rental fee, but instead were charged a substantially higher amount for asset use.

DISCUSSION OF DETAILS

For items procured through the SDAF in anticipation of future FMS cases, DoD 7290.3-M, "Foreign Military Sales Financial Manual," states that contracts awarded shall not provide for rental charges under provisions of the FAR. This manual further specifies that the DoD Component with custody of the SDAF asset being purchased will be responsible for tracking the related unfunded costs until the asset is sold to an FMS customer...Inflated asset use charges of $1.4 million were assessed on 9 of 11 SDAF cases.

RECOMMENDATION FOR CORRECTIVE ACTION

D(2). We recommend that the Commander, U.S. Army Missile Command adjust the Basic Stinger sales prices on SDAF cases by substituting the appropriate rental fee for the 4 percent asset use charge.

DSAA/PLANS/SDAF COMMENTS

Nonconcur with Finding D relative to SDAF cases.
Nonconcur with Recommendation D2.

Major Points:

DSAA's major objection to this finding is that it is contrary to the existing policy of quoting stablized prices on SDAF cases. The use of stabilized pricing is a basic element of the effective management of the SDAF. It insures that the price of major end items remains the same from the time of country acceptance of the Letter of Offer and Acceptance (LOA) to delivery reporting and case closure. Paragraph 71803 of DoD 7290.3-M states that: "Sales of SDAF items will be quoted as **firm prices** and DD Form 1513 annotated accordingly." The provision of firm prices, coupled with accelerated deliveries of end items, largely accounts for the widespread FMS customer satisfaction the

SDAF has enjoyed. Hence, the DoDIG finding, and its associated recommendation to reprice 9 SDAF cases, undermines the principle of stablized pricing which is integral to SDAF operations.

It should be noted that stablized pricing is followed uniformly on SDAF cases. Prices on SDAF cases are not adjusted even if it is later discovered that specific sales have resulted in earnings or losses to the Fund. Paragraph 71803 futher states that: "The DSAA is responsible for reviewing SDAF prices to assure full cost recovery and for changing any proposed SDAF prices to achieve that objective." Therefore, it is incumbent on DSAA to insure that the assumptions on which SDAF prices are based are correct --i.e., that they insure full cost recovery--prior to their quotation as **firm prices** on SDAF cases. Explicitly, this entails not adjusting prices on SDAF cases once they are cited as firm prices.

It should also be noted that the DoDIG expressly supported the concept of stabilized pricing, as outlined above, in its omnibus report of the Defense Security Assistance Program (Draft Report issued 25 January 1990). The DoDIG report called for expanding the SDAF concept within security assistance as a way of eliminating inaccurate price estimates, and frequent, unilateral price changes. Specifically, the DoDIG report states: "If the principle of 'no-loss, no-gain' was revised to a system of **stable**, annually revised prices, then increases in efficiency and customer satisfaction would result at nearly every step of the FMS process. At the same time, the principle of the customer paying for all articles and services would remain satisfied on a long-term break-even position for the U.S.government."

In light of the above policy, we do not agree that MICOM should reprice the referenced SDAF cases. Such a recommendation is at odds with stabilized pricing and its uniform application on SDAF cases.

Subordinate Points:

The DODIG Finding correctly cites Para 71802(A)(2) of DoD 7290.3-M to the effect that contractor rental costs will not be charged for sales to the SDAF. However, Para 71806 of DoD 7290.3-M states explicitly that a 4 percent asset use charge (not contractor rental charges) shall be applied to items procured for the SDAF which are being sold to an FMS customer. Similarly, TABLE 718-1, "SDAF Price Computation Examples" specifically includes a 4 percent asset use charge for SDAF-FMS sales, and excludes any reference to contractor rental charges.

As confirmation of this view, Para 71802(A)(2) of the DOD

7290.3-M originally drew the relationship between unfunded contractor rental charges on the buy-in side of SDAF and the application of asset use charges on SDAF FMS sales more directly. Specifically, this paragraph (which was in effect at the time the Basic Stingers were procured into the SDAF in FY 1984) read as follows: "Contracts awarded to meet SDAF requirements will not provide for rental charges under provision of the Federal Acquisition Regulation(FAR), in which case the 4 percent asset use charge will be identified as an unfunded cost and charged at the time of a sale to an FMS customer."

The DODIG Finding also indicates that FMS customers were overcharged $1.4 million on 9 SDAF cases because of the inappropriate application of asset use charges. While we have addressed the policy aspects of this Finding above, it is important to realize that the FMS customers addressed in this Finding benefited from the SDAF stabilized pricing concept in terms of the overall pricing of these cases. The Basic Stingers at issue were procured by SDAF in FY 1983 and FY 1984 (MIPRs 3011.01 and 4017.01). The sales cases, cited in Appendix E, were implemented during the period FY 1984-89. As a consequence, the pricing employed on these cases would have been the higher of the SDAF buy-in price or the latest DoD contract price. In either instance, the FMS customer most likely would have benefited when compared to prices derived from new procurement, and, additionally, would have received an abbreviated leadtime on physical delivery of the missiles.

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1. and A.2.	Program: Align packing, crating, and handling charges with actual costs, and eliminate overcharges to Foreign Military Sales (FMS) customers.	Nonmonetary.
B.1.a. and b. and B.2.	Compliance: Ensure proper pricing and recovery of all applicable costs on Economy Act sales, in accordance with DoD Manual 7220.9-M.	Nonmonetary.
C.1. and C.2.	Compliance: Correct erroneous transportation costs to FMS customers by applying look-up table rates as required by DoD regulations.	Collections to the FMS Trust Fund of $935,000. Nonrecurring benefit.
D.1. and D.2.	Program: Eliminate improper or inflated asset use charges billed to FMS customers.	Collections to the FMS Trust Fund of $3.2 million. Nonrecurring benefit.
E.	Program: Improve accuracy of delivery performance reported in FMS case status reports and customer billing statements.	Nonmonetary.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Comptroller of the Department of Defense

Department of the Army

Army Materiel Command, Alexandria, VA
Army Security Affairs Command, New Cumberland, PA
Army Missile Command, Redstone Arsenal, AL
Red River Army Depot, Texarkana, TX

Department of the Navy

Naval Plant Representative Office, Ontario, CA

Defense Agencies

Defense Security Assistance Agency, Washington, DC
Security Assistance Accounting Center, Denver, CO

Non-Government Activities

General Dynamics, Valley Systems Division, Ontario, CA
General Dynamics, Sycamore Annex, San Diego, CA

AUDIT TEAM MEMBERS

Nancy L. Butler, Director, Financial Management Directorate
David R. Stoker, Program Director
Ronald C. Tarlaian, Project Manager
Annella F. Chamblee, Team Leader
Clarence E. Knight, Team Leader
Con Noriega, Team Leader
Pamella W. Biggs, Auditor
Averel E. Gregg, Auditor
Susanne B. Allen, Editor

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U.S. Army Materiel Command
U.S. Army Security Affairs Command

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Assistant Secretary of the Air Force (Financial Management and Comptroller)
Director, Security Assistance Accounting Center

Other Defense Activities

Director, Defense Security Assistance Agency

Non-DoD Activities

Office of Management and Budget
U.S. General Accounting Office, NSIAD Technical Information Center

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
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House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Committee on Legislation and National Security, Committee on Government Operations