



DEPARTMENT OF DEFENSE

# AUDIT REPORT

PRICING AND BILLING OF TECHNICAL ASSISTANCE  
SOLD TO FOREIGN MILITARY SALES CUSTOMERS

No. 90-106

September 5, 1990

*Office of the  
Inspector General*





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

September 5, 1990

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL  
MANAGEMENT)  
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL  
MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on the Audit of Pricing and Billing of Technical  
Assistance Sold to Foreign Military Sales Customers  
(Report No. 90-106)

This is our final report on the Audit of Pricing and Billing of Technical Assistance Sold to Foreign Military Sales Customers for your information and use. Comments on a draft of this report were considered in preparing the final report. We made the audit from November 1989 through February 1990. The objectives of the audit were to determine whether the Military Departments accurately identified, priced, and billed appropriate costs to foreign customers for sales of technical assistance, and whether the internal controls that related to the pricing and billing of technical assistance were adequate. The audit also included a follow-up review of recommendations applicable to the recovery of Component Improvement Program costs, which were presented in Assistant Inspector General for Auditing, DoD, Report No. 85-006, October 19, 1984. During calendar years 1987 through 1989, the Military Departments had 2,233 foreign military sales cases that included technical assistance. The technical assistance on these cases had an ordered value of \$2.4 billion.

The audit showed, that except for costs associated with Aircraft Engine Component Improvement programs, the Military Departments properly priced and billed technical assistance in accordance with existing regulations. For two of seven aircraft engines, research and development costs for Component Improvement Programs were not recouped in accordance with DoD directives or Military Department regulations. The results of the audit are summarized in the following paragraph, and the details, audit recommendations, and management comments are in Part II of this report.

The Navy and, to a lesser degree, the Air Force, did not properly recoup research and development costs for Component Improvement programs for the Navy's F-404 engine and the Air Force's J-79 engine. Excluding and improperly computing the charges associated with the Component Improvement programs will result in underrecoupments of \$51.1 million in the Navy and \$0.7 million in the Air Force. We recommended that the Navy revise the recoupment rate for the F-404 aircraft engine and use

the new rate in future billings. We also recommended that the Air Force bill the Federal Republic of Germany for Component Improvement Program costs for reentering the Component Improvement Program for the J-79 engine (page 3).

The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Controls were not established to ensure that research and development costs associated with aircraft engine component improvement programs are properly identified, computed, and recouped as part of new engine sales to foreign customers. Therefore, a copy of the final report will be provided to the senior officials responsible for internal controls within your Departments. All recommendations in this report, if implemented, will correct these weaknesses. We have determined that monetary benefits of \$51.8 million can be realized by implementing the recommendations (Appendix F).

The management responses to a draft of this report conformed to the provisions of DoD Directive 7650.3. No unresolved issues existed on the audit recommendations or internal control deficiencies. The Assistant Secretary of the Navy for Research, Development and Acquisition disagreed with the amount of potential monetary benefits of Recommendation 1.a. We believe that these benefits are valid, for reasons discussed in Part II of the report; therefore, we ask that the Navy provide final comments on the estimated monetary benefits of \$51.1 million for its F-404 engine. On the basis of the comments of the Assistant Secretary of the Army for Financial Management, we have deleted Recommendations 2.a. and 2.b. in the draft report, which addressed the nonrecurring cost rate for the T-700 engine. Recommendation 3. in the draft report, therefore, has been renumbered Recommendation 2. in the final report. The Assistant Secretary of the Air Force for Accounting, Banking and Finance has requested direction from the Defense Security Assistance Agency before concurring with the amount of monetary benefits of Recommendation 2. We believe that these benefits are valid, for reasons discussed in Part II of the report; therefore, we ask that the Air Force provide final comments on the estimated monetary benefits of \$744,000 for its J-79 engine. DoD Directive 7650.3 requires prompt resolution of audit issues. Accordingly, final comments on the unresolved issues in this report should be provided within 60 days of the date of this memorandum.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit, please contact Mr. David R. Stoker at (202) 694-1692 (AUTOVON 224-1692) or Mr. Nicholas E. Como at (202) 693-0355 (AUTOVON 223-0355). We will give you a formal briefing on the results of the audit

within 15 days of the date of this memorandum, should you desire it. A list of audit team members is in Appendix H. Copies of this report will be provided to the activities listed in Appendix I.



Edward R. Jones  
Deputy Assistant Inspector General  
for Auditing

cc:

Secretary of the Army  
Secretary of the Navy  
Secretary of the Air Force  
Comptroller of the Department of Defense  
Director, Defense Security Assistance Agency



REPORT ON THE AUDIT OF PRICING AND BILLING  
OF TECHNICAL ASSISTANCE SOLD TO  
FOREIGN MILITARY SALES CUSTOMERS

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Prepared by:  
Financial Management Directorate  
Project No. OFA-0021



REPORT ON THE AUDIT OF PRICING AND  
BILLING OF TECHNICAL ASSISTANCE SOLD TO  
FOREIGN MILITARY SALES CUSTOMERS

PART I - INTRODUCTION

Background

Technical assistance is defined as services in the form of technical advice or actions that require the expertise of a specialist. Technical assistance can include processes such as: determining the economy, feasibility, nature, and level of item repair; analyzing the feasibility of updating item configuration; establishing failure rates; developing technical data packages; conducting site and system surveys and training programs; and installing and testing major defense equipment. The Component Improvement Program (CIP) is a type of technical assistance. The CIP is designed to continuously improve the safety, reliability, availability, and maintainability of an end item or major component over the projected life of the item.

The Military Departments are responsible for the pricing and billing of technical assistance to the foreign military sales customer. DoD directives and Military Department regulations require that each country participating in the CIP share on a pro rata basis all costs generated in the design, development, and testing of technical assistance. DoD directives further require that each customer pay a pro rata share of nonrecurring costs incurred in the development and production of major defense equipment.

Objectives and Scope

Our overall objective was to determine whether the Military Departments accurately identified, priced, and billed appropriate costs for sales of technical assistance to foreign customers. We evaluated the adequacy of internal controls that related to the pricing and billing of technical assistance. The audit also included a follow-up review of recommendations applicable to the issuance of specific guidance for pricing and billing CIP costs, depot maintenance costs, and missile target and range costs.

The audit universe consisted of 2,233 foreign military sales cases that included technical assistance transactions, valued at \$2.4 billion, for calendar years 1987 through 1989. We compiled the universe data from the Defense Security Assistance Agency (DSAA) Foreign Military Sales Financial Information System (DSAA 1200 System). We reviewed 187 technical assistance cases valued at \$1 billion of which 90 cases, valued at \$825.5 million did not involve CIP for aircraft engines. We also reviewed cost calculations supporting the recoupment of CIP costs for 7 aircraft engines.

This program results audit was made from November 1989 through February 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 the internal controls as were considered necessary. A list of activities visited or contacted in Appendix G.

### Internal Controls

We reviewed internal controls related to the Military Departments' compliance with DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of USG Products and Technology." We also reviewed internal controls related to the inclusion of this Directive in the Military Departments' regulations. We reviewed internal controls governing the implementation of the guidance by operating and budget personnel for seven aircraft engines, as detailed in Part II of this report. For technical assistance sold to foreign military sales customers that did not include aircraft engines, we tested internal controls that related to ensuring that all costs identified as technical assistance were properly indentified, priced, and billed to foreign customers.

### Prior Audit Coverage

The Office of the Inspector General, DoD, previously performed an audit of technical assistance sold through foreign military sales. Audit Report No. 85-006, "Pricing of Technical Assistance to Foreign Military Sales Customers," October 19, 1984, recommended the issuance of clarifying guidance for pricing and billing component improvement costs. On July 27, 1987, the Assistant Secretary of Defense (Comptroller) (now the Comptroller of the Department of Defense) revised DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of U.S. Products and Technology." The revised guidance required that all research, development, test and evaluation, and production costs be recovered through the application of a charge for nonrecurring costs. We followed up on 6 of the 14 recommendations made in this report (see Appendix C).

## PART II - FINDING AND RECOMMENDATIONS

### Recoupment of Research and Development Costs for Component Improvement Programs

#### FINDING

The Navy and Air Force did not properly collect Component Improvement Program costs for aircraft engines sold to foreign military sales customers. The Navy did not include Component Improvement Program costs in the recoupment rate for nonrecurring costs of research, development, test and evaluation, and production of the F-404 aircraft engine. The Air Force did not charge the Federal Republic of Germany appropriate Component Improvement Program costs when Germany reentered the J-79 aircraft engine program. Understatement of the recoupment rate will result in the Navy undercharging foreign customers \$51.1 million on future sales. The Air Force underbilled the Federal Republic of Germany by \$744,600 for the J-79 engine.

#### DISCUSSION OF DETAILS

Background. The Arms Export Control Act requires that the U.S. Government recoup a proportionate amount of any nonrecurring costs of research and development and production of major defense equipment (MDE) from foreign military sales (FMS) customers. DoD policy for determining appropriate charges is provided in DoD Directive 2140.2, "Recoupment of Nonrecurring Costs on Sales of USG Products and Technology." Nonrecurring research, development, test, and evaluation (RDT&E) costs are those costs funded by an RDT&E appropriation to develop or improve a product or technology. These costs are accumulated in a nonrecurring cost pool to determine the nonrecurring cost recoupment rate for an MDE item. The pool also includes nonrecurring production costs and estimated future RDT&E costs. The estimated costs are prorated against estimated production quantities to establish a nonrecurring cost recoupment rate.

Aircraft engine component improvement programs are follow-on engineering efforts designed to improve the safety, reliability, availability, and maintainability of an end item or major component over the projected life of the item or component. The Component Improvement Program (CIP) is not intended to expand the basic performance of the engine. Costs for the engine CIP are funded with RDT&E appropriations. Therefore, they are considered nonrecurring RDT&E costs.

Navy's F-404 Engine. The F-404 engine powers the F/A-18 aircraft, and under the criteria in DoD Directive 2140.2, the engine is an MDE item. Naval Air Systems Command Instruction 13700.14 contains the Navy's implementing guidance on the aircraft engine CIP for FMS customers.

As of October 1989, four FMS countries participated in the CIP for the F-404 engine. Each country participating in the CIP is required to share in the annual costs. The participants share costs on a pro rata basis, based on ownership as of October 1 of each year. From inception of CIP for the F-404 engine through September 30, 1989, the U.S. Navy had paid 80 percent of the total cost of the CIP, but the Navy owned only 66 percent of the engines.

The Navy did not implement the provisions of DoD Directive 2140.2 to include CIP in the computation of the recoupment rate for nonrecurring costs for the F-404 engine. The Navy did not include CIP costs of \$378.3 million in the cost pool used to compute the recoupment rate, which caused the nonrecurring charge for the F-404 engine to be understated.

We computed the recoupment rate for the F-404 engine according to the criteria in DoD Directive 2140.2 and found that the FMS participants may potentially underpay CIP costs of the F-404 by as much as \$51.1 million, depending on future sales of the engine (see Appendix A).

DoD Directive 2140.2 provides three criteria for submitting a revised recoupment rate for approval. The Directive defines a significant change as:

- a change of more than 30 percent of the current charge for nonrecurring costs; or
- an increase or decrease of \$50,000 or more in the unit charge; or
- the potential for a \$5 million projected change in future recoupments for an MDE item.

In August 1989, the F/A-18 Project Office recomputed the nonrecurring recoupment rate for the F-404 engine. The rate approved by the Defense Security Assistance Agency was \$63,840. The recomputed rate was \$74,276. The Project Office did not submit the new rate for approval, because the rate did not change by more than 30 percent.

The Navy's new rate would have increased projected recoupments by \$17.9 million. Therefore, the F-404 engine qualified for a new recoupment rate under the third criterion above. When the Navy

properly recomputes the recoupment rate for nonrecurring costs to include CIP costs on the F-404 engine, the rate should be submitted to the Defense Security Assistance Agency for approval.

Our rate computation includes actual and projected CIP costs for the F-404 engine. The Naval Air Systems Command's Propulsion Division estimated that 580 engines will be sold between FY's 1990 and 1999. The F/A-18 Program Office has estimated that 1,715 engines will be sold to FMS customers; however, the Navy could not estimate the year of delivery of the additional 1,135 engines. Therefore, we limited our estimate of savings, \$51.1 million, to that attainable on the 580 engines estimated by Naval Air Systems Command.

Air Force J-79 Engine. DoD Directive 2140.2 provides for mandatory cost sharing of CIP costs on new aircraft engines. The J-79 engine was introduced into the supply system in 1964, before DoD had begun its component improvement programs. For these older engines, the Air Force allows purchasing countries to participate in a CIP on a voluntary basis.

By 1981, the Federal Republic of Germany had received 639 J-79 engines. From 1980 through 1983, Germany participated in the J-79 CIP. From 1984 through 1988, Germany declined to participate in the program due to the anticipated delivery of a new European model of fighter aircraft. Because production of the European fighter was delayed and there was an immediate need to upgrade the J-79 engine to meet the North Atlantic Treaty Organization requirements, Germany reentered the CIP in 1989.

Air Force Regulation 130-1, "Security Assistance Management," provides that a one-time assessment will be charged to FMS countries reentering the CIP. The assessment will be based on when the customer was first offered participation.

Existing records and our discussions with responsible personnel disclosed that the Air Force did not charge Germany the one-time assessment or officially waive the assessment. Personnel of the Office of the Deputy Chief of Staff for Programs and Resources stated that Germany might not have returned to the CIP if the fee was excessive and that other members of the J-79 CIP had not expressed concern about the assessment.

Between 1984 and 1988, CIP costs for 605 J-79 engines totaled \$9.0 million. Appendix B shows that Germany's share of CIP costs for the 5-year period totaled \$744,150.

## RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Assistant Secretary of the Navy (Financial Management):

a. Recompute the nonrecurring cost recoupment rate for the F-404 aircraft engine to include the costs of the Component Improvement Program, submit the revised rate to the Defense Security Assistance Agency for approval, and apply the revised rate to future sales of the engine.

b. Monitor nonrecurring cost recoupment rates annually in accordance with DoD Directive 2140.2 and submit revised rates for approval when any one of the three criteria for a significant change of the rate has been met.

2. We recommend that the Comptroller of the Air Force bill \$744,150 to the Federal Republic of Germany for a pro rata share of Component Improvement Program costs for the J-79 engine for FY's 1984-1988.

## MANAGEMENT COMMENTS

The Assistant Secretary of the Navy for Research, Development and Acquisition concurred with Recommendation 1.a. and stated that it would, as of October 1, 1990, revise cost-sharing calculations based on the actual and projected F-404 engine inventory of each CIP participant. However, the Navy disagreed with our estimated engine production quantity and the inclusion of \$111 million of actual and projected CIP costs in the nonrecurring cost pool. The Navy stated that it will seek clarification from the Deputy Comptroller of the Department of Defense (Management Systems) before submitting a revised F-404 rate to the Defense Security Assistance Agency (Appendix D).

The Assistant Secretary of the Navy for Research, Development and Acquisition concurred with Recommendation 1.b. and stated that the request for clarification will be submitted to the Deputy Comptroller of the Department of Defense (Management Systems) by July 25, 1990, and the revised rates will be submitted to the Defense Security Assistance Agency 30 days after receiving a response.

The Assistant Secretary of the Air Force for Accounting, Finance and Banking concurred with Recommendation 2. but wished to conduct a further investigation to determine the appropriate responses to our audit. The estimated completion date of this investigation is September 20, 1990. The Air Force also expressed concern that political ramifications may dictate that recoupment is unwise. The Air Force stated that, if directed by the Defense Security Assistance Agency, it will bill the Federal

Republic of Germany for \$744,150 as payment for a pro rata share of the J-79 engine CIP costs for FY's 1984-1988 (Appendix E).

#### AUDIT RESPONSE TO MANAGEMENT COMMENTS

The estimated production quantity of 7,323 engines was obtained from Navy records as of August 30, 1989. This is the most current estimate of future production of the F-404 engine. The Navy contends that the correct estimated production of the engine will be 8,520. The estimate, approved by the Defense Security Assistance Agency, was prepared by the Navy in March 1987.

The Navy also contends that the \$111 million of foreign CIP costs should be excluded from the cost pool when computing the revised nonrecurring cost rate for the F-404 engine. These costs consist of actual CIP costs incurred by the foreign customers and estimated CIP costs that will be incurred by them in future sales of the engine. It is true that the inclusion of total CIP costs in the cost pool would result in charging existing foreign customers a portion of CIP costs that they paid when they purchased the engine. However, the foreign customers began sharing CIP costs the year they purchased the engine. Deliveries of the engine to foreign customers began in FY 1983. At that time, the Navy had already incurred over \$45.3 million of CIP costs that were not shared with foreign customers. Existing foreign purchasers will not be overcharged until the Navy recoups the pro rata share of all CIP costs for the engine. In addition, excluding the total foreign customer portion of CIP costs would result in undercharging new foreign purchasers of the engine.

The Defense Security Assistance Agency did not issue any waiver, either expressed or implied, of costs that the Republic of Germany would incur when it elected to reenter the CIP program for the J-79 engine. Because the Defense Security Assistance Agency did not approve a waiver to the Federal Republic of Germany for these costs, we do not see the merit in the Air Force's response that it will obtain direction from the Defense Security Assistance Agency to initiate billing for the CIP costs.



ANALYSIS OF UNDERRECOUPMENT OF NONRECURRING COSTS FOR THE F-404 ENGINE

F-404 Engine Component Improvement Program (CIP) Costs  
 (\$ in Millions)

<u>User</u>	Actual Costs	Estimated Costs	Total Program Costs
	FY 1980-1989	FY 1990-1999	Costs
U.S. Navy	\$136.871	\$130.463	\$267.334
Foreign Military Sales (FMS)	<u>31.026</u>	<u>79.984</u>	<u>111.010</u>
	<u>\$167.897</u>	<u>\$210.447</u>	<u>\$378.344</u>

<u>Revised Nonrecurring Cost Recoupment (NRC) Rate Computation</u>	<u>Potential Underrecoupment on Projected Sales</u>
Total Current NRC Cost Pool	\$ 125,941
Add: CIP Costs	<u>63,840</u>
Total NRC Cost Pool	\$ 62,101
Divided By Production Quantity	<u>x 1,715</u>
Revised NRC Rate	\$106,503,215
	<u>55,412,000 *</u>
	<u>\$ 51,091,215</u>

\* The estimate was based on the projected annual inventory of F-404 engines, which the Navy used to determine the FMS share of CIP costs through FY 1999. The estimate followed the procedures the Navy uses to allocate CIP costs to FMS customers. This figure included costs for future deliveries of 580 engines. The Navy did not estimate delivery dates for the remaining projected sales of 1,135 engines; therefore, we did not include them in the estimated recoupment. We included the 1,135 engines in the projected sales in determining the potential underrecoupment from FMS customers, because the sales were included in the Navy's computation of the nonrecurring cost recoupment rate. If these engines are not sold, the estimated underrecoupment is overstated and our revised NRC rate is overstated.



CALCULATION OF GERMANY'S ONE-TIME  
ASSESSMENT FOR REENTEEING THE J-79  
COMPONENT IMPROVEMENT PROGRAM

Comparison of Component Improvement Program (CIP)  
Costs to CIP Members with  
and Without (W/O) Germany as a Member  
1984 Through 1988

<u>Calendar Year</u>	<u>Amount of CIP Contract (\$ in millions)</u>	<u>Total J-79 Engines W/O Germany</u>	<u>CIP Cost per Engine W/O Germany</u>	<u>Total J-79 Engines with Germany</u>	<u>CIP Cost per Engine with Germany</u>
1984	\$2.355	7,912	\$298	8,517	\$277
1985	\$2.086	6,865	\$304	7,470	\$279
1986	\$2.000	6,656	\$300	7,261	\$275
1987	\$1.600	6,115	\$262	6,720	\$238
1988	\$1.000	5,606	\$178	6,211	\$161

Estimate of Germany's Cost for CIP Participation  
1984 Through 1988

<u>Calendar Year</u>	<u>No. of J-79 Engines</u>	<u>CIP Cost per Engine</u>	<u>CIP Cost to Germany</u>
1984	605	\$277	\$167,585
1985	605	\$279	168,795
1986	605	\$275	166,375
1987	605	\$238	143,990
1988	605	\$161	97,405
			<u>\$744,150</u>



FOLLOWUP OF ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD, REPORT NO. 85-006,  
"PRICING OF TECHNICAL ASSISTANCE SOLD TO FOREIGN MILITARY SALES CUSTOMERS,"  
OCTOBER 19, 1984

Finding A. Allocation of Costs for Aircraft Engine Component Improvement Programs

Audit Recommendation

The Assistant Secretary of Defense, (Comptroller) issue specific guidance for the Military Departments to price and bill Component Improvement Program (CIP) costs and to handle recoupments for component improvement programs.

Corrective Action Taken

DOD 2140.2, "Recoupment of Nonrecurring Costs on Sales of U.S. Products and Technology," was revised on July 27, 1987. The revision provided for including all research and development costs in the nonrecurring cost pool. The Navy did not compute all costs for the F-404 engine for the life of the engine and CIP program. This issue is addressed in Part II of the current report. The Air Force and Army, however, complied with the revised DOD Directive in computing the nonrecurring cost rate for the Air Force's F-100 and PW-1120 engines and the Army's T-700 engine.

Finding B. Recovery of Costs for Component Improvement Programs for the T-56 Engine

Audit Recommendation

The Commander, Air Force Logistics Command issue written procedures for accumulating and billing for costs for voluntary participation in component improvement programs.

Corrective Action Taken

All technical assistance (CIP) costs were included in the calculation of the recovery of CIP costs for the J-85 and T-56 engines.

FOLLOWUP OF ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD, REPORT NO. 85-006,  
"PRICING OF TECHNICAL ASSISTANCE SOLD TO FOREIGN MILITARY SALES CUSTOMERS,"  
OCTOBER 19, 1984

Finding C. Billing of Conversion and Overhaul Costs for the F-111

Audit Recommendation

The Commander, Air Force Logistics Command (AFLC) issue detailed procedures for billing depot maintenance costs to foreign military sales customers.

Corrective Action Taken

Headquarters, AFLC, implemented written procedures for the billing of depot maintenance costs to foreign military sales customers. AFLC memorandum, "Standard Billing Procedures," dated July 21, 1989, provides adequate and detailed instructions for the recovery and reimbursement of in-house depot maintenance charges.

Finding D. Billing of Targets used in Missile Testing

Audit Recommendation

The Commander, U.S. Army Missile Command (MICOM), establish local procedures for billing, and funding costs of missile targets used on foreign military sales cases.

Corrective Action Taken

MICOM implemented procedures to properly bill target costs for foreign military sales transactions. MICOM incorporated a modified price and availability sheet that highlights actual charges of target costs after the targets have been used for foreign customers.

FOLLOWUP OF ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD, REPORT NO. 85-006,  
"PRICING OF TECHNICAL ASSISTANCE SOLD TO FOREIGN MILITARY SALES CUSTOMERS,"  
OCTOBER 19, 1984

Finding E. Billing of Missile Range Support Costs

Audit Recommendation

The Under Secretary of Defense for Research and Engineering revise DoD Directive 3200.11, "Major Range and Test Facility Base," to provide for billing the cost of test range services for foreign governments in accordance with DoD Manual 7290.3-M.

Corrective Action Taken

DoD Directive 3200.11 was revised on September 23, 1985, to incorporate guidance for billing user charges to foreign military sales customers for test range services. Implementation of this recommendation was verified in the followup of the following recommendation.

Finding E. Billing of Missile Range Support Costs

Audit Recommendation

Commander, U.S. Army Materiel Development and Readiness Command, provide detailed guidance to the U.S. Army Missile Command (MICOM) and the White Sands Missile Range (WSMR), on their respective responsibilities for costing and billing range costs.

Corrective Action Taken

MICOM identified and resubmitted expenditure orders for the costing of test range service costs for foreign customers. WSMR repriced the appropriate range charges and subsequently resubmitted these expenditures to MICOM for rebilling.



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R&D PROG & BUDG

THE ASSISTANT SECRETARY OF THE NAVY

(Research, Development and Acquisition)

WASHINGTON, D.C. 20350-1000

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JUL 24 1990

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR  
GENERAL FOR AUDITING

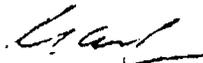
Subj: DRAFT REPORT ON THE AUDIT OF PRICING AND BILLING OF  
TECHNICAL ASSISTANCE SOLD TO FOREIGN MILITARY SALES  
CUSTOMERS (PROJECT NO. OFA-0021)

Ref: (a) DODIG Memo of 26 April 90

Encl: (1) DON Response to Draft Audit Report

I am responding to the draft audit report forwarded by  
reference (a) concerning the calculation of nonrecurring cost  
(NC) recoupment charges for the F-404 engine.

The Department of the Navy response is provided at enclosure  
(1). We agree, in principal, with the draft report findings and  
recommendations; however, we plan to seek clarification of policy  
contained in DODD 2140.2 in regard to the method of calculation.  
After clarification is obtained we will recalculate the F-404  
rate and submit our revision to DSAA. Accordingly, comments on  
monetary savings are withheld pending decision on method of  
calculation.

  
Gerald A. Cann

Department of the Navy Response

to

DODIG Draft Report of April 26, 1990

on

Pricing and Billing of Technical Assistance Sold to  
Foreign Military Sales Customers

Finding A:

The Military Departments did not properly collect Component Improvement Program costs for aircraft engines sold to foreign military sales customers. The Navy did not include Component Improvement Program costs in the recoupment rate for nonrecurring costs of research, development, test and evaluation, and production of the F-404 aircraft engine. Understatement of the recoupment rates will result in the Navy and Army undercharging foreign customers \$57.1 million on future sales.

Recommendation:

1. We recommend that the Assistant Secretary of the Navy (Financial Management):

a. Recompute the nonrecurring cost recoupment rate for the F-404 aircraft engine to include the costs of the Component Improvement Program, submit the revised rate to the Defense Security Assistance Agency for Approval, and apply the revised rate to future sales of the engine.

b. Monitor nonrecurring cost recoupment rates annually in accordance with DOD Directive 2140.2 and submit revised rates for approval when any one of the three criteria for a significant change of the rate has been met.

DON Position:

Recommendation 1a.

Concur with recommendation to revise CIP cost sharing calculations. As of 1 October 1990 cost sharing will be based on actual/projected F-404 inventory of each CIP participant.

Concur, in part, with recommendation to revise F-404 recoupment charge. Engine production quantities approved by DSAA in March 1987 were 8520 and not 7323 as indicated in Appendix A, page 15, of the audit. We do not agree that the \$111 million foreign CIP should be added to the cost pool. Using the approved production quantities and deleting foreign CIP payments results in the following calculation:

(1)	Total current cost pool	\$543,921,000
	Add CIP costs	<u>267,334,000</u>
	Total NRC cost pool	\$811,255,000
	Production Quantity	8520
	Revised Rate (unit charge)	\$ 95,217.00

DON will seek policy clarification from DOD Deputy Comptroller (MS) on two issues before submitting a revised F-404 rate to DSAA. The first clarification concerns which of the two calculation methods specified in DODD 2140.2 should be used in the case of the F-404. Calculating a NC rate using the "new item procedure" would result in a revised charge of about \$87,000 while a calculation using the "existing item procedure" would result in a charge of about \$80,000. In both cases the revised rate would not be equitable to current F-404 users. Therefore, the second issue concerns our proposal for multiple recoupment rates wherein one rate would be set for existing customers and a second higher rate for new customers. A request for clarification will be submitted to DOD by 25 July 1990 and revised rates submitted to DSAA 30 days after receiving a response.

Recommendation 1b.

Concur.





DEPARTMENT OF THE AIR FORCE  
WASHINGTON DC 20330-1000

20 JUN 1990

OFFICE OF THE ASSISTANT SECRETARY

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

SUBJECT: Draft Report on the Audit of Pricing and Billing of  
Technical Assistance Sold to Foreign Military Sales  
Customers (Project No. OFA-0021) - INFORMATION MEMORANDUM

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.

FINDING: "The Air Force did not charge the Federal Republic of Germany appropriate Component Improvement Program (CIP) costs when Germany reentered the J-79 aircraft engine program. The Air Force underbilled the Federal Republic of Germany \$744,150 for the J-79 engine."

COMMENT: Concur.

RECOMMENDATION: "That the Comptroller of the Air Force bill \$744,150 to the Federal Republic of Germany for a pro-rata share of Component Improvement Program costs for the J-79 engine for the period Fy 1984 through Fy 1988."

COMMENT: Further investigation of the files and records of the J-79 engine CIP during the time frame involved is warranted to determine all appropriate actions to adequately respond to this audit. An investigation is being conducted by representatives from SAF/FMA, AF/PRI and AFLC/MI. Estimated completion date of this investigation should be approximately 90 days from the date of this memorandum. If we find that recoupment is technically required in accordance with DoD policy, political ramifications may dictate that recoupment is unwise. If directed to do so by the Defense Security Assistance Agency (DSAA), the Assistant Secretary of the Air Force (Financial Management and Comptroller) will direct the Comptroller of HQ Air Force Logistic Command (AFLC) to initiate a bill to the Federal Republic of Germany for \$744,150 as payment for a pro-rata share of the J-79 engine CIP costs for the period FY 1984 through FY 1988.

GARY W. AMLIN  
Acting Deputy Assistant Secretary  
(Accounting, Finance and Banking)



**SUMMARY OF POTENTIAL MONETARY AND OTHER  
BENEFITS RESULTING FROM AUDIT**

<u>Recommendation Reference</u>	<u>Description of Benefit</u>	<u>Benefit Type</u>	<u>Benefit Amount (\$ in Millions)</u>
1.a.	Compliance with regulations and laws; this is the foreign customers' share of the reimbursement to "Miscellaneous Receipts of Treasury" of nonrecurring costs for future sales of the F-404 aircraft engine.	Collections	\$51.1
1.b.	Internal control and compliance with regulations and laws; review of nonrecurring cost recoupment rates and submission of revised rates are requirements of DoD Directive 2140.2.	Nonmonetary	
2.	Compliance with regulations and laws; this is a one-time collection from the Federal Republic of Germany for reentering the J-79 engine Component Improvement Program. This reimbursement to the Air Force's Research, Development, Test and Evaluation appropriation is prescribed in Air Force Regulation 130-1.	Collections	\$0.7



## ACTIVITIES VISITED OR CONTACTED

### Department of the Army

Army Aviation Systems Command, St. Louis, MO  
Army Missile Command, Huntsville, AL  
Army Security Affairs Command, New Cumberland, PA

### Department of the Air Force

Hsdaqarters, Air Force Systems Command, Washington DC  
Aeronautical Systems Division, Wright-Patterson Air Force Base,  
Dayton, OH  
Air Force Logistics Command, Wright-Patterson Air Force Base,  
Dayton, OH  
Kelly Air Logistics Center, San Antonio, TX  
Oklahoma City Air Logistics Center, Oklahoma City, OK

### Department of the Navy

Naval Air Systems Command, Washington, DC  
Naval Office of Technology Transfer and Security Assistance,  
Washington, DC  
Naval Sea Systems Command, Washington, DC  
Space and Naval Warfare Systems Command, Washington, DC

### Defense Agencies

Defense Security Assistance Agency, Washington, DC



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Secretary of the Navy  
Assistant Secretary of the Navy (Financial Management)  
Director, Office of Technology Transfer and Security Assistance

### Department of the Air Force

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

### Defense Agencies

Director, Defense Security Assistance Agency

### Non-DoD

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