

Inspector General

United States
Department of Defense



Funds Appropriated for Afghanistan and Iraq Processed
Through the Foreign Military Sales Trust Fund

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Acronyms and Abbreviations

AAA	Army Audit Agency
AECA	Arms Export and Control Act
ASFF	Afghanistan Security Forces Fund
DIFS	Defense Integrated Financial System
DSCA	Defense Security Cooperation Agency
FMF	Foreign Military Financing
FMR	Financial Management Regulation
FMS	Foreign Military Sales
GAO	Government Accountability Office
IG	Inspector General
IRRF	Iraq Relief and Reconstruction Fund
ISFF	Iraq Security Forces Fund
LOA	Letter of Offer and Acceptance
MNSTC-I	Multi-National Security Transition Command-Iraq



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-4704

March 24, 2009

MEMORANDUM FOR DIRECTOR, DEFENSE SECURITY COOPERATION AGENCY

SUBJECT: Report on Funds Appropriated for Afghanistan and Iraq Processed Through the Foreign Military Sales Trust Fund (Report No. D-2009-063)

We are providing this report for review and comment. We considered comments from the Director, Defense Security Cooperation Agency when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Security Cooperation Agency comments to Recommendation A were nonresponsive and the comments to Recommendation B were partially responsive. After reviewing management comments, we revised Recommendation B. We request additional comments on Recommendations A and B by April 24, 2009.

Please provide comments that conform to the requirements of DoD Directive 7650.3. If possible, send client comments in electronic format (Adobe Acrobat file only) to AudDBO@dodig.mil. Copies of the client comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5868. If you desire, we will provide a formal briefing on the results.

Patricia A. Marsh
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Assistant Inspector General
Defense Business Operations

March 24, 2009



Results in Brief: Funds Appropriated for Afghanistan and Iraq Processed Through the Foreign Military Sales Trust Fund

What We Did

We determined whether the Defense Security Cooperation Agency (DSCA) properly transferred appropriated funds from the Army's accounts into the Foreign Military Sales (FMS) Trust Fund, and whether DSCA was authorized to collect administrative fees on these funds.

What We Found

- The transfer by DSCA of \$6.5 billion of appropriated funds for the support of Afghanistan and Iraq military and security forces into the FMS Trust Fund did not meet the requirements of the Economy Act. It was not in the best interest of the Government, was not the most economical use of the funds, and was not in accordance the requirements in the DoD Financial Management Regulation (FMR). The FMS Trust Fund is a single Treasury account designed to manage funds received from the FMS Program and was not designed to manage expiring funds.
- DSCA improperly collected administrative fees on Iraq and Afghanistan cases funding contingency operations. From FYs 2005 through 2007, DSCA collected more than \$155 million in administrative fees to manage non-FMS cases for the Iraq Security Forces Fund (ISFF) and the Afghanistan Security Forces Fund (ASFF) processed in the FMS Trust Fund. It is DSCA policy, based on the DoD FMR, not to collect administrative expenses on funds placed in the FMS

Trust Fund for contingency operations. Because ISFF and ASFF are funding

contingency operations, DSCA should not collect administrative fees on these cases.

What We Recommend

- DSCA should directly cite the DoD appropriated funds for future purchases of support for Iraq and Afghanistan.
- DSCA should discontinue charging administrative fees on non-FMS cases funded by Iraq Security Forces Funds and Afghanistan Security Forces Funds.

Management Comments and Our Response

The DSCA Director did not concur with our recommendations. He stated that Defense Finance and Accounting Service, DSCA, and the Military Departments do not have the system infrastructure to perform the same operations through direct cite. He further stated that DSCA met all requirements of the Economy Act, and that DSCA is required to collect all the direct and indirect costs of the planned work. We disagree with DSCA comments. DSCA can control the funds with existing accounting systems designed to process appropriated funds without transferring the funds to the FMS Trust Fund and the Defense Integrated Financial System. The DoD FMR does not authorize DSCA to collect administrative fees on funds used for contingency operations. As a result of further discussion with DSCA personnel, we revised recommendation B. Please see the recommendation table on the back of the page.

March 24, 2009

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Defense Security Cooperation Agency	A. and B.	

Please provide comments by April 24, 2009.

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Introduction

Objectives

Our overall audit objective was to determine whether the Defense Security Cooperation Agency (DSCA) properly managed the funds processed through the Foreign Military Sales (FMS) Trust Fund that were appropriated for the security, reconstruction, and assistance of Afghanistan and Iraq. In this report, we will discuss:

- whether the transfers of appropriated funds into the FMS Trust Fund were properly authorized, and
- whether the collection of administrative fees on these funds was appropriate.

Background

Security Assistance is a legally authorized group of programs that allows the transfer of military articles and services to friendly foreign governments. Security Assistance transfers may be carried out through sales, grants, leases, or loans. The FMS Program is the part of Security Assistance authorized by the Arms Export Control Act (AECA). The FMS Program is conducted using formal contracts or agreements between the U.S. Government and an authorized foreign purchaser. These contracts, called Letters of Offer and Acceptance (LOAs), are signed by both the U.S. Government and the purchasing government or international organization, and provide for the sale of Defense articles and Defense services (to include training), usually from DoD stocks or through purchases under DoD-managed contracts. The FMS Program is accomplished in two basic ways:

- (1) FMS cash purchases, whereby the purchaser pays in cash (U.S. dollars) for all costs that may be associated with a sale, or
- (2) Foreign Military Financing (FMF), whereby the U.S. Government provides grants or non-repayable and repayable loans. The U.S. Government and the foreign government negotiate these credit and loan arrangements.

The FMS Trust Fund is the single account authorized to receive payments for products or services and to incur obligations and expenditures for the FMS program. The budget authority resulting from FMS orders is recognized in Treasury account 9711X8242. This is a “no-year appropriation,” meaning that funds are available until expended. DSCA assigns each country purchasing articles or services through the FMS Program a two-digit country code that is used to track and control all their funds in the FMS Trust Fund accounting system. As articles and services are requested, funds are allocated to cases established in the FMS Trust Fund accounting system based on the requirements identified in the LOA. The accounting system then tracks the funds until the final delivery and disbursement of all funds.

The Government Accountability Office (GAO) Principles of Federal Appropriations Law (Red Book) states that a trust fund is a fund that creates a fiduciary obligation on the trustee to account for the funds to the depositor (or purchaser). For FMS purchase requests, “depositor” is the requesting foreign nation. The FMS Trust Fund was

established to manage foreign funds used for purchasing goods and services on behalf of the foreign nation and to separate the funds from U.S. appropriated funds used for the same purposes.

The Economy Act provides authority for Federal agencies to order goods and services from other Federal agencies (including other Military Departments and Defense agencies) and to pay the actual costs of those goods and services. Congress passed the Economy Act in 1932 to obtain economies of scale and eliminate overlapping activities of the Federal Government. It allows the head of an agency or unit to place an order with another agency or unit if:

- funds are available;
- the head of the requesting agency or unit decides the order is in the best interest of the U.S. Government;
- the agency or unit to be asked to fill the order is able to provide the goods or services; and
- the head of the agency decides that ordered goods or services cannot be provided as conveniently or economically by a commercial enterprise.

The DoD Financial Management Regulation (FMR) states that “because of previous instances of abuse of Economy Act orders, limitations on the use of Economy Act orders have been imposed.” Agencies may not use Economy Act orders to circumvent conditions and limitations imposed on the use of funds, including extending the period of availability of the cited funds.

The Defense Security Cooperation Agency (DSCA) directs, administers, and supervises the execution of all Security Assistance programs, to include managing the FMS Trust Fund for DoD. DSCA is the focal point for government-to-government arms transfers, budgeting, legislation, projections, and forecasting.

Starting in 2003, DSCA transferred U.S. appropriated funds into the FMS Trust Fund to provide support for Afghanistan and other foreign countries. These appropriated funds are transfers subject to the AECA and are considered “non- FMS” cases by DSCA. Therefore, DSCA assigns each of these cases a “pseudo” case identifier, comprised of a “pseudo” country code and a “pseudo” case designator. DSCA and the Military Departments process these pseudo cases through the same security assistance systems and processes as the traditional FMS cases, with the exception that the LOA is not signed by the country receiving the articles or services. The LOAs for the non-FMS cases state that the funds associated with the cases are expiring funds and carry the same time, purpose, and availability restrictions associated with the funding source. Failure to obligate the funds during the period of availability will render them unavailable for new obligations.

DSCA assigns an implementing agency the responsibility of implementing a case and establishing the LOA. The implementing agency is responsible for overall management of the actions that will result in delivering the material set forth in the LOA.

Personnel at the Defense Finance and Accounting Service (DFAS) perform the accounting, billing, disbursing, and collecting functions for the Security Assistance programs, which includes the FMS Trust Fund. The Military Department (MILDEP) accounting systems forward financial data to the Defense Integrated Financial System (DIFS), which is the departmental-level central accounting system for funds in the FMS Trust Fund.

Review of Internal Controls

We determined that a material internal control weakness in the Defense Security Cooperation Agency exists as defined by DoD Instruction 5010.40, “Managers’ Internal Control (MIC) Program Procedures,” January 4, 2006. It is DSCA policy not to collect administrative fees on funds placed in the FMS Trust Fund for contingency operations. However, DSCA collected fees on Afghanistan Security Forces Fund (ASFF) and Iraqi Security Forces Fund (ISFF) cases supporting the Afghan National Army and Iraqi Armed Forces, both considered contingency operations, according to the DoD FMR. Implementing Recommendation B will correct this weakness. We will provide a copy of this report to the senior DSCA official responsible for internal controls.

Management Comments on the Background and Our Response

Defense Security Cooperation Agency Comments

The Director, Defense Security Cooperation Agency provided comments on the background section stating that some paragraphs contained inaccuracies. For complete comments, see the Management Comments section.

Our Response

We do not agree with the DSCA Director’s comments that statements in the report are inaccurate, and we responded to each of his comments. We responded to the DSCA comments and met with senior DSCA officials to further discuss the finding and recommendations in preparing the final report. Based on our discussions with DSCA, we have updated the report. For our detailed responses, see Appendix E.

Finding A. Transfer of Appropriated Funds

The transfer by the Defense Security Cooperation Agency (DSCA) of \$6.5 billion of appropriated funds for the support of Afghanistan and Iraq military and security forces into the Foreign Military Sales (FMS) Trust Fund did not meet the requirements of the Economy Act and DoD Regulations. The transfer was not in the best interest of the Government, was not the most economical use of the funds, and was not in accordance with the DoD Financial Management Regulation (FMR). The transfer of appropriated funds into the FMS Trust Fund included:

- \$5.7 billion for support of the Afghanistan armed forces, and
- \$731 million for support of the Iraq armed forces.

Citing the authority of the Economy Act and public laws, DSCA transferred the appropriated funds from various DoD accounts established for supporting Afghanistan and Iraq forces into the FMS Trust Fund. While we recognize DSCA expertise in providing goods and services to foreign governments, the commingling of appropriated funds with foreign government funds in the FMS Trust Fund is not in the best interest of the U.S. Government. The FMS Trust Fund is a single Treasury account (97X8242) designed to manage funds received from the FMS Program and was not designed to manage expiring appropriated funds. In addition, the transfer increased the costs of acquiring goods and services because DSCA collected administrative fees for funds processed in the FMS Trust Fund. The DoD FMR states that Economy Act orders may be issued as direct fund cite orders or reimbursable orders. Therefore, we believe that directly citing appropriated funds would be more advantageous for controlling and accounting for these funds.

Appropriations Transferred

In December 2002, Congress passed the Afghanistan Freedom Support Act authorizing funds to assist Afghanistan, and provided additional support in 2003 with the Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan. These laws allowed DoD to use funds appropriated for its operations and maintenance activities to train, equip, and provide other assistance to Iraq and Afghanistan armies. DSCA personnel transferred funds from various DoD appropriations to the FMS Trust Fund to be used to purchase goods and services for these military forces.

In 2005, Congress appropriated funds specifically for support of the Afghanistan and Iraq operations by establishing the Afghanistan Security Forces Fund (ASFF) and the Iraq Security Forces Fund (ISFF). The Army then transferred some of these funds to DSCA, which then disbursed them to the FMS Trust Fund to purchase goods and services. The Army received the Afghanistan appropriated funds through a Treasury appropriation warrant and then transferred the funds, through a funding authorization document, to DSCA. The Army received the Iraq appropriated funds and allocated them to the Multi-National Security Transition Command-Iraq (MNSTC-I). The military personnel

in country, the Combined Security Transition Command-Afghanistan or MNSTC-I, contacted DSCA when they needed Defense articles and services. DSCA or MNSTC-I then transferred the funds to the FMS Trust Fund. Table 1 shows the five appropriated funds for Afghanistan and Iraq that were transferred into the FMS Trust Fund.

Table 1. Breakdown of Transferred Funds into the FMS Trust Fund

	Total Amount Transferred
Presidential Drawdowns	\$ 487,690,000
Train and Equip Funds	447,191,068
Iraq Relief and Reconstruction Fund (IRRF)	49,850,570
Afghanistan Security Forces Fund (ASFF)	4,824,042,699
Iraq Security Forces Fund (ISFF)	674,266,321
Total	\$6,483,040,658

Presidential Drawdowns

In December 2002, the President signed the Afghanistan Freedom Support Act of 2002 (Public Law 107-327), which provides \$300 million in drawdown ¹ authority for Defense articles, Defense services, and training for the Afghanistan government.

Prior to Public Law 107-327, drawdowns were only for articles and services already in DoD stocks and no new procurements were authorized. The Afghanistan Freedom Support Act of 2002, section 202(a)(2), authorized the drawdown of funds by stating that the Defense articles, Defense services, other support, and military education and training support may be acquired by contract or otherwise. Based on this law, DSCA transferred funds from the Military Department (Army, Air Force, and Navy) operating funds to assist Afghanistan. Since 2002, Congress has twice increased the value of drawdown authority to its current level of \$550 million. ²

As of September 30, 2007, DSCA transferred \$488 million of this \$550 million into the FMS Trust Fund, funding 20 Afghanistan non-FMS cases, and \$7 million to Jordan to assist in its operations for Afghanistan. The remaining drawdown funds were transferred to the U.S. Agency for International Development and the Department of State Bureau of International Narcotics and Law Enforcement.

¹A drawdown is a direct transfer of on-hand DoD stock Defense articles, services, and military education and training to foreign countries and international organizations. The Foreign Assistance Act authorizes the President to drawdown.

² Public Law 108-106, “Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004 Section 2206. section 202(b) amended Public Law 107-327, “Afghanistan Freedom Support Act of, 2002” increasing the value to \$450,000,000. Public Law 108-287, “Department of Defense Appropriations Act, 2005” Section 9008, section 202(b) amended Public Law 108-106, “Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq” by striking “\$450,000,000” and inserting “550,000,000.”

Train and Equip Funds (Public Laws 108-106 and 108-287)

In November 2003, Congress authorized a transfer of \$150 million from the DoD operation and maintenance appropriation for the Afghanistan National Army and New Iraqi Army in Public Law 108-106, “Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004,” title I, chapter 1, Section 1107. The law states:

Notwithstanding any other provision of law, from funds made available in this Act to the Department of Defense under “Operation and Maintenance, Defense-Wide” not to exceed \$150,000,000 may be used by the Secretary of Defense, with concurrence from the Secretary of State, to provide assistance only to the New Iraqi Army and the Afghan National Army to enhance their capability to combat terrorism and to support U.S. military operations in Iraq and Afghanistan.

DSCA transferred the full \$150 million to the FMS Trust Fund to fund two Afghanistan non-FMS pseudo cases.

In August 2004, Congress authorized a transfer of \$500 million from the DoD operation and maintenance appropriation to provide additional assistance to the New Iraqi Army and the Afghan National Army in Public Law 108-287, “Department of Defense Appropriation Act, 2005,” title IX, Section 9006. The law states:

Notwithstanding any other provision of law, from funds made available in this title to the Department of Defense for operation and maintenance, not to exceed \$500,000,000 may be used by the Secretary of Defense, with the concurrence of the Secretary of State, to train and equip and provide related assistance only to the New Iraqi Army and the Afghan National Army to enhance their capability to combat terrorism and to support U.S. military operations in Iraq and Afghanistan.

Of the \$500 million authorized in Public Law 108-287, DSCA transferred \$293 million into the FMS Trust Fund to fund 16 Afghanistan non-FMS cases and 3 Iraq non-FMS cases. The \$293 million came from existing appropriations in DoD.

Iraq Relief and Reconstruction Funds (Public Law 108-106)

Congress appropriated funds for the Iraq Relief and Reconstruction Fund (IRRF) in Public Law 108-106, title II, chapter 2. Since FY 2004, Congress appropriated \$18.2 billion³ for needs in Iraq. DSCA transferred \$49 million to fund five non-FMS cases.

³ Public Law 108-106, “Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004,” appropriated \$18.6 billion for relief, rehabilitation, and reconstruction in Iraq. It further allocated the amount to several sectors. Public Law 108-309, “Joint Resolution,” section 133, amended the sector amounts, but the total amount remained unchanged. Public Law 109-234, “Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006,” Section 1302(b) decreased the IRRF amount to \$18.2 billion.

Afghanistan Security Forces Fund

On May 11, 2005, Congress established the Afghanistan Security Forces Fund (ASFF) with an appropriation of \$1.3 billion. This fund was authorized in Public Law 109-13, “Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005.” This fund was intended to include “the provision of equipment, supplies, services, training, facility, and infrastructure repair, renovation, and construction, and funding.” Treasury assigned appropriation symbol 21 2091 to the ASFF, Army. From FYs 2005 through 2007, Congress appropriated \$10.6 billion to the ASFF, and DSCA transferred \$4.8 billion of the appropriation into the FMS Trust Fund for 210 Afghanistan non-FMS cases. Table 2 shows the appropriated ASFF amounts and the transferred amounts into the FMS Trust Fund by authorizing public law. The Combined Security Transition Command-Afghanistan identified the requirements in-country and initiated the Letters of Request to DSCA to begin the purchases.

Table 2. Amounts Appropriated for ASFF

Public Laws	Appropriated Amounts	Pseudo Country Code	Cases Funded	Total Amount Transferred
109-13	\$ 1,285,000,000	Y8	77	\$ 994,999,235
109-234	1,908,133,000	B2	73	1,481,632,998
109-289	1,500,000,000	B6	60	2,347,410,466
110-28	5,906,400,000			
Total ASFF	\$10,599,533,000		210	\$4,824,042,699

Iraq Security Forces Fund

On May 11, 2005, Congress established the Iraq Security Forces Fund (ISFF) with an appropriation of \$5.7 billion. This fund was authorized in Public Law 109-13, “Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005.” This fund was intended “to provide assistance, with the concurrence of the Secretary of State, to the security forces of Iraq including the provision of equipment, supplies, services, training, facility, and infrastructure repair, renovation, and construction, and funding.” Treasury assigned the appropriation symbol 21 2092 to the ISFF, Army. From FYs 2005 through 2007, Congress appropriated \$14.2 billion to the ISFF, and DSCA transferred \$674 million of ISFF funds into the FMS Trust Fund to fund 46 Iraq non-FMS cases. Table 3 shows the ISFF amounts and transferred amounts into the FMS Trust Fund. The Army received the funds appropriated for Iraq and provided them to the Multi-National Security Transition Command-Iraq (MNSTC-I). MNSTC-I identified requirements for Defense articles and services and prepared Letters of Request to begin the purchases through the FMS Trust Fund. MNSTC-I then transferred funds, using the Military Interdepartmental Purchase Requests, to DSCA for deposit into the Trust Fund.

Table 3. Amounts Appropriated for ISFF

Public Law	Appropriated Amount	Pseudo Country Code	Cases Funded	Total Amount Transferred
109-13	\$5,700,000,000	Y9	23	\$432,357,494
109-234	\$3,007,000,000	B3	10	85,746,495
109-289	\$1,700,000,000	B7	13	156,162,332
110-28	\$3,842,300,000			
Total ISFF	\$14,249,300,000		46	\$674,266,321

Justification for Transfer

DSCA stated that these funds were transferred to the FMS Trust Fund “by direction of the Department of Defense pursuant to applicable legal authorities.” We gave DSCA an October 15, 2007, memorandum that questioned the legal authority to transfer funds appropriated for Iraq and Afghanistan into the FMS Trust Fund and to collect administrative fees on these funds.⁴ DSCA General Counsel responded in a December 18, 2007,⁵ memorandum, that the authority to transfer these funds to the FMS Trust Fund are in the public laws appropriating the funds and in the Economy Act (section 1535, title 31, United States Code). The memo did not specifically identify the funds in question to the laws that authorize their transfer, and we could not find any mention of transferring funds to the FMS Trust Fund in the laws DSCA had identified. However, we agree that the Economy Act does allow the transfer of funds from one Government organization to another to cover the direct cost of purchasing goods or services.

DSCA moved appropriated funds into the FMS Trust Fund, which were then commingled with other funds in the FMS Trust Fund under one appropriation symbol (97X8242). The funds were accounted for by assigning them to a sub-account (called a pseudo country code). The funds were then placed on a contract, which cited the FMS Trust Fund appropriation or provided for requisitions to reimburse the appropriations of other DoD organizations.

In its December 18, 2007, memorandum, DSCA General Counsel cited a July 26, 2005, memorandum from the Deputy Secretary of Defense that assigned the Secretary of the Army the responsibility to provide ASFF distribution and accounting support to the Combined Forces Command-Afghanistan⁶ through DSCA pursuant to authority provided in Public Law 109-13, “Emergency Supplemental Appropriation Act for Defense, the Global War on Terror and Tsunami Relief, 2005.” DSCA management stated that this memorandum assigns the respective responsibility for managing the ASFF funds. However, the memorandum did not provide clear direction for DSCA to use the FMS Trust Fund to account for these funds. DSCA manages other appropriations

⁴ See Appendix C.

⁵ See Appendix D.

⁶ The Combined Forces Command-Afghanistan (CFC-A) has become the Combined Security Transition Command-Afghanistan (CSTC-A).

without using the FMS Trust Fund, for example, the International Military Education and Training program; therefore, DSCA can also manage the non-FMS funds without using the FMS Trust Fund. However, the Deputy Secretary of Defense memorandum does state that the Secretary of the Army “is responsible for proper financial management, fiscal controls, and accountability in accordance with statute and DoD policies to include the DoD Financial Management Regulation.”

Best Interest of the Government

While we recognize DSCA expertise in providing goods and services to foreign governments, we do not believe that commingling U.S. appropriated funds with foreign government funds in the FMS Trust Fund is in the best interest of the U.S. Government. The FMS Trust Fund was established to account for cash collections, budget authority, and cash disbursements resulting from the FMS Program.

Most of the funds that Congress appropriated for the support of the Afghanistan and Iraq forces and apportioned to the Army were eventually processed by Army organizations. After DSCA received the funds from the Army appropriations, it transferred them to the FMS Trust Fund based on requests for assistance from the various U.S. commanders in Afghanistan and Iraq. DSCA then assigned the orders to the implementing agencies (Army, Navy, and Air Force organizations) to initiate contracts or requisitions for purchasing equipment, supplies, and training for Afghanistan and Iraq military and security forces, citing the FMS Trust Fund appropriation. While the implementing agency’s logistics and accounting systems then processed these purchases, DIFS did the departmental-level accounting. The Army was the implementing agency on most of the LOAs citing these funds (\$5.5 billion [95 percent] of Afghanistan funds and \$529 million [71 percent] of Iraq funds).

In addition, the Army’s financial records regarding the Afghanistan and Iraq funds were misleading. After DSCA transferred the appropriated funds from the Army’s account into the FMS Trust Fund, the Army recorded the money as disbursed, even though the funds may remain in the FMS Trust Fund for many months before actually being expended. However, the funds had not left the Treasury; DSCA simply moved the funds from one appropriation to another. For example, the September 30, 2007, SF-133 Report on Budget Execution for the Afghanistan Security Forces Fund, Army Appropriation number 21 6/7 2091, states that all but \$2 of these funds remaining in the appropriation were disbursed in FY 2007. However, more than \$719 million of these funds were still in the FMS Trust Fund as of September 30, 2007. While the Army reported these funds as disbursed, DSCA management stated that the actual obligations and expenditures for the Afghanistan and Iraq cases were made from the FMS Trust Fund appropriation. We found that, of the \$4.8 billion that Army had transferred from the ASFF for support of the Afghanistan armed forces from FYs 2005 through 2007, almost \$3 billion was still in the FMS Trust Fund.

Economical Use of Funds

The transfer of non-FMS Program funds to the FMS Trust Fund initiated an increase in the cost of purchasing the goods and services because DSCA collected \$196 million in administrative fees for processing in the FMS Trust Fund. DSCA currently collects 3.8 percent of charges for indirect costs on all FMS cases, and it used this same 3.8 percent as their “best estimate” for collecting the indirect costs to process non-FMS cases. Because DFAS charges DSCA for processing transactions in the DIFS accounting system, the cost of processing ASFF and ISFF transactions would be reduced if these funds were not transferred to the FMS Trust Fund. However, there is no way to determine the amount of saving because DFAS is paid through billing hours, and it does not track DIFS charges by country code.

DoD Regulation

The DoD Financial Management Regulation (FMR) states that on Economy Act orders the requesting organization may issue a direct fund cite to the provider or reimburse funds to the appropriation that was used to pay for the work. According to the GAO Red Book, the Economy Act authorizes the inter- and intra-departmental furnishing of material or performance of work or services as reimbursable. This reimbursement is to include all actual costs of the goods or services provided. The Economy Act authorizes two methods of payment to the organization providing the goods or services. The requesting organization can either advance the funds to the organization or reimburse the organization after the work has been completed. However, the DoD FMR 7000.14-R, volume 11A, chapter 3, states that Economy Act orders may be issued as direct fund cite orders or reimbursable orders. Because DSCA is advancing the Army funds to the FMS Trust Fund, the DoD FMR states that a direct citation of funds be used.

Management Comments on Finding A and Our Response

Defense Security Cooperation Agency Comments

The Director, Defense Security Cooperation Agency disagreed with the finding. The Director stated that referring to the funds in the FMS Trust Fund as “commingling” is incorrect because the FMS Trust Fund is a single account at the U.S. Treasury level only. Monies within the Trust Fund are segregated into more than 330 separate accounts as shown on the FMS General Ledger. The Director also stated that some paragraphs of the finding contained inaccuracies. For complete comments, see the Management Comments section.

Our Response

We disagree with the DSCA Director’s comment that the report is incorrect. Referring to the “commingling” of funds is correct because all funds transferred to the FMS Trust Fund are in a single account at Treasury and have the same designation. The report acknowledges that DSCA has established controls within the accounting system. However, other appropriations at the Treasury level carry a designation as to their

purpose (for example, Operations and Maintenance and Research, Development, Test, and Evaluation appropriations) and a fiscal year limitation that are not applicable to funds placed in the FMS Trust Fund. We are aware of no authority in any of the appropriations acts listed in this report or elsewhere that permits the commingling of U.S. appropriated funds with the funds of foreign nations in the FMS Trust Fund. We do not agree with the Director's comments that statements in the finding are inaccurate. We responded to the DSCA comments and met with senior DSCA officials to further discuss the finding and recommendations in preparing the final report. Based on our discussions with DSCA, we have updated the report to provide additional information on the DoD FMR requirements. For the detailed responses, see Appendix E.

Recommendation, Management Comments, and Our Response

A. We recommend that the Director, Defense Security Cooperation Agency discontinue transferring funds appropriated for the Afghanistan Security Forces Fund and Iraq Security Forces Fund to the Foreign Military Sales Trust Fund, and instead direct cite these appropriations on all future cases using these funds.

Defense Security Cooperation Agency Comments

The Director, Defense Security Cooperation Agency disagreed with our recommendation stating that the FMS case and financial management systems, logistical delivery systems, and case closer mechanisms connect Defense Security Cooperation Agency, DFAS, Implementing Agencies (the Military Departments), and FMS customers. Defense Security Cooperation Agency, DFAS and the Military Departments do not have the system infrastructure to perform the same operations through direct cite.

Our Response

The Defense Security Cooperation Agency Director's comment is nonresponsive. The Director did not provide any support for the statement that DSCA does not have the system infrastructure to perform the same operations through direct cite. All the accounting systems the Defense Security Cooperation Agency personnel identified to us that support the processing of the programs reviewed in this report, except the Defense Integrated Financial System, are standard systems used by the Military Departments to process DoD appropriations. The Director did not provide any documentation to show why the Defense Security Cooperation Agency cannot use these systems to control the processing of Afghanistan and Iraq Security Forces Funds without transferring the funds to the Foreign Military Sales Trust Fund accounting system. We request that Defense Security Cooperation Agency reconsider its position on the recommendation and provide comments on the final report.

Finding B. Collection of Administrative Fees

The Defense Security Cooperation Agency (DSCA) improperly collected administrative fees on Afghanistan and Iraq non-FMS cases funded with the Afghanistan Security Forces Fund (ASFF) and the Iraq Security Forces Fund (ISFF) and processed through the FMS Trust Fund. It is DSCA policy not to collect administrative fees on funds placed in the FMS Trust Fund for contingency operations based on DoD FMR, volume 12, chapter 23. However, DSCA did collect fees from funds appropriated for ASFF and ISFF, which are funding contingency operations as defined in the DoD FMR. Therefore, DSCA should not collect the administrative fees for processing ASFF and ISFF funds. As a result, from FYs 2005 through 2007, DSCA improperly collected over \$155 million in administrative fees from appropriated funds.

Administrative Fee Authority

The GAO Red Book states that the Economy Act authorizes the inter- and intra-departmental furnishing of material or performance of work or services on a reimbursable basis. It also states that this is to include all actual costs of the goods or services provided. While these actual costs can include both direct and indirect costs, DoD FMR, volume 11A, chapter 3, paragraph 030601, states that DoD activities not funded by working capital funds normally do not charge indirect costs to other DoD activities. However, DSCA currently collects 3.8 percent of charges for indirect costs on non-FMS cases, based on their estimate of the indirect costs to process FMS cases.

Contingency Operations

DSCA improperly collected administrative fees on Afghanistan and Iraq non-FMS cases funded with the Afghanistan Security Forces Fund (ASFF) and the Iraq Security Forces Fund (ISFF) and processed through the FMS Trust Fund. It is DSCA policy not to collect administrative fees on funds placed in the FMS Trust Fund for contingency operations based on DoD FMR, volume 12, chapter 23, paragraph 230107, "Allowable Contingency Operations Cost," September 2007. This paragraph states:

The funding derived from a contingency transfer account is available only for those incremental costs incurred in direct support of a contingency operation. As such, funds that are transferred into a Component's baseline appropriation are not to be used to finance activities and programs that are not directly related to the incremental cost of the contingency.

For example, DSCA executes Presidential Drawdowns (Public Law 107-327, as amended) as contingency operations. Therefore, the administrative fee of 3.8 percent is not collected on these cases, but is funded through the FMF Administrative Costs account. However, DSCA collected administrative fees on Afghanistan and Iraq non-FMS cases funded with ASFF and ISFF and processed through the FMS Trust Fund, even though they are considered as funding contingency operations. From FYs 2005 through 2007, DSCA collected over \$24 million from cases funded by ISFF, and over

\$131 million from cases funded by ASFF. DoD FMR, volume 12, chapter 23, paragraph 230406, table 23-1, states that contingency operations include “the costs to finance the training and equipping and other related assistance to Iraqi Armed forces and Afghan National Army....” Because the DoD FMR defines the operations that are being funded by ASFF and ISFF as contingency operations, DSCA should not collect administrative fees for processing ASFF and ISFF funds.

Management Comments on Finding B and Our Response

Defense Security Cooperation Agency Comments

The Director, Defense Security Cooperation Agency disagreed with the finding. He stated that the draft report confuses two sets of funding streams: (1) the appropriations for Foreign Military Financing administrative activities, and (2) the collection of the Foreign Military Sales administrative surcharges required by law to be used for administration of FMS sales. He also stated that all requirements of the Economy Act were met, and that the agency filling the orders is required to collect all the direct and indirect cost of the work to be done. He added that the administrative surcharge percentage of 3.8% was the best estimate of the indirect costs of the work performed. The Director also stated that some paragraphs of the finding contained inaccuracies. For complete comments, see the Management Comments section.

Our Response

Based on discussions with DSCA officials, we revised the report to remove the discussion of the Foreign Military Financing administrative activities. However, we do not agree that DSCA met the requirements of the Economy Act and that DSCA is required to collect administrative fees on funds used for contingency operations. We also do not agree with the Director’s comments that statements in the finding are inaccurate. We responded to the DSCA comments and met with senior DSCA officials to further discuss the finding and recommendations in preparing the final report. For the detailed responses, see Appendix E.

Recommendation, Management Comments, and Our Response

Revised Recommendation

Because of the Director’s comments and further discussions with DSCA personnel, we revised the recommendation in the final report to remove references to the Foreign Military Financing appropriation.

B. We recommend that the Director, Defense Security Cooperation Agency discontinue collecting administrative fees on non-Foreign Military Sales programs funded by Iraq Security Forces Funds and Afghanistan Security Forces Funds.

Defense Security Cooperation Agency Comments

The Director, Defense Security Cooperation Agency disagreed, stating that the recommendation requires legislative changes. The Director further stated that Congress would have to expressly authorize and appropriate Foreign Operations Appropriations and direct that such funds be used for the support of DoD programs. He also stated that the limited FMF appropriation could not support the level of funding that would be required to sustain the non-FMS programs in Iraq and Afghanistan.

Our Response

The Director's comment is partially responsive. Based on discussions with DSCA officials, we revised the recommendation to remove discussions of the Foreign Military Financing Administrative Cost account. However, we continue to recommend that DSCA not charge the administrative fee on ASFF and ISFF funded non-FMS cases due to the restrictions in the DoD FMR. We request that Defense Security Cooperation Agency reconsider its position on the recommendation and provide comments on the final report.

Appendix A. Scope and Methodology

We conducted this performance audit from June 17, 2007, through July 8, 2008, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We identified and examined eight public laws from FYs 2003 through 2007 that appropriated funds for Afghanistan and Iraq. Table 1 shows the public laws and amounts appropriated for Afghanistan and Iraq.

**Table 1. Iraq and Afghanistan Appropriations from FYs 2002 through 2007
Public Laws**

Public Law	Title	Amounts
107-327	Afghanistan Freedom Support Act of 2002, section 202	\$300,000,000 for Afghanistan. The public law was amended by PL 108-106 and PL 108-287 to a final amount of \$550,000,000.
108-106	Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004 -Title I, Chapter 1, Section 1107 -Title II, Chapter 2, Iraq Relief and Reconstructed Fund (IRRF) -Title II, Chapter 2, Section 2206, Section 202(b)	\$150,000,000 for Iraq and Afghanistan \$18,649,000,000 for Iraq. The public law allocated the funds to several sectors. This public law was amended by PL 108-309 and PL 109-234 Increased PL 107-327 to \$450,000,000
108-309	FY 2005 Continuing Resolution, section 133	Amended the sector amounts of PL 108-106, Title II
108-287	Department of Defense Appropriations Act, 2005 -Title IX, Section 9006. -Title IX, Section 9008, Section 202(b)	\$500,000,000 for Iraqi and Afghanistan Army Increased PL 107-327 to \$550,000,000

109-13	Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005, Title I	\$1,285,000,000 for the Afghanistan Security Forces Fund (ASFF) \$5,700,000,000 for the Iraq Security Forces Fund (ISFF)
109-234	Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006 -Title I, Chapter 2, ASFF and ISFF -Title I, Chapter 3, Section 1302(b)	\$1,908,133,000 for ASFF \$3,007,000,000 for ISFF Amended PL 108-106, Title II
109-289	Department of Defense Appropriations Act, 2007, Title IX	\$1,500,000 for ASFF \$1,700,000 for ISFF
110-28	U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007, Title I, Chapter 3 (supplement to PL 109-289)	\$5,906,400,000 for ASFF \$3,842,300,000 for ISFF

After compiling a list of Iraq and Afghanistan appropriated funds from FYs 2003 through 2007, we searched the Security Assistance Management Manual to identify the pseudo country codes associated with each public law. Table 2 shows the list of pseudo country codes.

Table 2. Pseudo Country Codes Related to Iraq and Afghanistan Appropriations

Public Law	Pseudo Country Code
107-327	S9 (Afghanistan)
108-106	Y2 (Afghanistan)
	Y7 (Iraq)
108-287	Y5 (Afghanistan)
	Y6 (Iraq)
109-13	Y8 (Afghanistan)
	Y9 (Iraq)
109-234	B2 (Afghanistan)
	B3 (Iraq)
109-289 & 110-28	B6 (Afghanistan)
	B7 (Iraq)

We reviewed the amounts granted to Afghanistan through the FMF program. Specifically, we examined the Apportionment and Reapportionment Schedule that apportioned funds to Afghanistan. Since FY 2002, a total of \$1,059,132,700 have been apportioned to Afghanistan. The FMF program did not provide funds for Iraq.

Defense Finance and Accounting Services personnel extracted information for each of the pseudo country codes from the Defense Integrated Financial System (DIFS), the computer system that maintains FMS financial data. The DIFS data gave us the ordered amounts in each Letter of Request.

We analyzed the data for related administrative fee charges. We received data from DIFS listing the administrative fees collected for the Afghanistan and Iraq non-FMS cases funded with appropriated funds, and for the Afghanistan FMF cases.

With the assistance of DoD Inspector General (DoD IG) General Counsel, we provided DSCA with a memorandum on October 15, 2007, which questioned the legal authority to transfer funds appropriated for Iraq and Afghanistan into the FMS Trust Fund, and to collect administrative fees on these funds.¹ The DSCA Office of General Counsel provided a response to the memorandum on December 18, 2007.²

Use of Computer-Processed Data

We used information from DIFS in performing our audit. To assess the reliability of data in the DIFS system, we compared the data reported in DIFS to hardcopy documentation. Based on this comparison, we determined that the data was sufficiently reliable for our purposes.

Use of Technical Assistance

Personnel at the DoD IG Office of General Counsel assisted with our review of the legality of the fund transfers into the FMS Trust Fund, as well as with our review of the legality of the administrative fee collection on non-FMS cases.

Management Comments on the Scope and Methodology and Our Response

Defense Security Cooperation Agency Comments

The Director, Defense Security Cooperation Agency provided comments on the scope and methodology section, stating that some paragraphs contained inaccuracies. For complete comments, see the Management Comments section.

Our Response

We do not agree with the DSCA Director's comments that statements in the report are inaccurate, and we responded to each of the Director's comments. For the detailed responses, see Appendix E.

¹ See Appendix C.

² See Appendix D.

Appendix B. Prior Coverage

During the last 5 years, the Government Accountability Office (GAO), the Department of Defense Inspector General (DoD IG), and the Army Audit Agency (AAA) have issued 11 reports discussing appropriated funds provided to Afghanistan and Iraq and the FMS Trust Fund.

GAO

GAO Report No. GAO-07-711, “DoD Cannot Ensure that U.S.-Funded Equipment has Reached Iraqi Security Forces,” July 2007

GAO Report No. GAO-07-525T, “Conditions in Iraq are Conducive to Fraud, Waste, and Abuse,” April 23, 2007

DoD IG

DoD IG Report No. D-2008-026, “Management of the Iraq Security Forces Fund in Southwest Asia – Phase III,” November 30, 2007

DoD IG Report No. D-2008-012, “Distribution of Funds and the Validity of Obligations for the Management of the Afghanistan Security Forces Fund – Phase I,” November 5, 2007

DoD IG Report No. D-2007-060, “Management of the Iraq Security Forces Fund in Southwest Asia – Phase II,” February 12, 2007

DoD IG Report No. D-2007-030, “Management of the Iraq Security Forces Fund in Southwest Asia – Phase I,” December 8, 2006

DoD IG Report No. D-2006-011, “Report on the Foreign Military Sales Trust Fund Cash Management,” November 7, 2005

DoD IG Report No. F-2005-0011-FB-1000, “Global War on Terrorism Funds Management,” June 20, 2005

Army Audit Agency

AAA Report No. A-2006-0046-ALA, “Fund Accountability for Fiscal Year 2004 Iraq Relief and Reconstruction Funds (IRRF), January 31, 2006

AAA Report No. A-2005-0194-ALA, “The Program Management in Support of Iraq Reconstruction,” May 26, 2005

AAA Report No. A-2005-0173-ALE, “The Commander’s Emergency Response Program and Quick Response Fund, Multi-National Transition Command Iraq (MNSTC-I), May 2, 2005

Appendix C. DoD Inspector General Memorandum to the Defense Security Cooperation Agency, October 18, 2007



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

OCT 18 2007

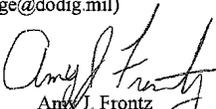
MEMORANDUM FOR DIRECTOR, DEFENSE SECURITY COOPERATION
AGENCY

SUBJECT: Audit of the Distribution of Funds and the Validity of Obligations for the Management of the Afghanistan Security Forces Fund- Phase II (D2007-D000LQ-0161 00), and Audit of the Funds Appropriated for Afghanistan and Iraq Processed Through the Foreign Military Sales Trust Fund (D2007-D000FD-0198 000)

The DoD IG is currently performing two audits related to the funds appropriated for the reconstruction and assistance of Afghanistan and Iraq. During our preliminary review of the statutory authority and policy for the operation of the Foreign Military Sales (FMS) Trust Fund, we have identified two issues that we believe do not conform to law or policy. Specifically, we do not find that the Defense Security Cooperation Agency (DSCA) has the authority to transfer the Afghanistan and Iraq appropriated funds to the FMS Trust Fund, or to collect administrative fees on these funds. Details on these issues are provided in an attachment to this memorandum.

We are providing this information prior to issuing a formal report to allow DSCA time to address our legal concerns. Once our field work is completed we will issue formal audit reports on both projects. We will incorporate this memorandum and any response provided by DSCA. We request that the DSCA provide a written response within 30 days.

If you have any questions regarding this memorandum or need additional information, please contact me at (303) 676-7392 (amy.frontz@dodig.mil) or John Barklage at (303) 676-3298 (john.barklage@dodig.mil).


Amy J. Frontz
Program Director
Defense Financial Auditing
Service

Attachment

Background. Project No. D2007-D000FD-0198 000, Audit of Funds Appropriated for Afghanistan and Iraq Processed through the Foreign Military Sales Trust Fund, began in June 2007. Our purpose is to determine whether funds appropriated for the security, reconstruction, and assistance of Afghanistan and Iraq and processed through the Foreign Military Sales Trust Fund are being properly managed. Specifically we will determine whether the transfer of appropriated funds from the Army's account in the FMS Trust fund was properly authorized, accounted for, and used for the intended purpose.

Project No. D2007-D000LQ-0161 000, Distribution of Funds and Validity of Obligations for Management of the Afghanistan Security Forces Fund, started in March 2007. The objective is to determine whether Afghanistan Security Forces Fund was obligated in accordance with legislative intent and applicable appropriation laws.

The Defense Security Cooperation Agency (DSCA) directs, administers, and supervises the execution of all Security Assistance programs for the Department of Defense. Foreign Military Sales (FMS) is one of the major types of Security Assistance programs. It includes government-to-government sales of Defense articles or Defense services from DoD stocks or through new procurements under DoD-managed contracts.

FMS Trust Fund: The Arms Export Control Act of 1976 (AECA), established in section 38, P.L. 90-629, codified as 22 U.S.C. § 2751 et seq., gives the President authority to sell Defense articles and services to eligible foreign countries, generally at no cost to the U.S. Government. This is done through the Security Assistance programs authorized by the Foreign Assistance Act of 1961, as amended; the AECA, as amended; and annual appropriations acts for Foreign Operations, Export Financing and Related Programs. The FMS Trust Fund is the single account authorized to be credited with receipts and to incur obligations and expenditures in accordance with the provisions of the AECA, and 82 Stat 1323. The budget authority resulting from FMS orders is recognized in Treasury account 97-11X8242. The "X" indicates that this is a "no-year" appropriation, and funds are available until expended.

Authority to Transfer Appropriated Funds

FMS Trust Fund was established to manage funds received under the AECA to procure Defense articles and services for foreign countries. However, the Letters of Acceptance for cases using the funds appropriated for support of Iraq and Afghanistan security forces state that these purchases are not governed by the AECA. Therefore we have found no legal authority to use the FMS Trust Fund to control and account for these funds. Specifically:

Afghanistan. The Deputy Secretary of Defense memorandum dated July 26, 2005, under authority provided by Public Law (PL) 109-13, assigned the Secretary of the Army the responsibility for providing for the Afghanistan Security Forces Fund distribution and accounting support to the Commander,

Combined Forces Command – Afghanistan (CFC-A) through the DSCA. However, the memorandum states that the Secretary of the Army is “responsible for proper financial management, fiscal, controls, and accountability in accordance with statute and DoD policies to include the Financial Management Regulation.” We see no authority for DSCA to use the FMS Trust Fund to manage and account for these appropriated funds. Specifically, DSCA, working with the CFC-A, uses the FMS Trust Fund to account for the service agency’s purchasing of defense articles and/or services (to include training) from DoD stocks or through purchases under DoD managed contracts.

In addition, we identified funds transferred into the FMS Trust Fund prior to enactment of PL 109-13 and the issuance of the Secretary of Defense memo (i.e., PL 108-106, PL 108-287), which provided for the transfer of operations and maintenance funds for use in assisting the Afghanistan army. We have found no legal authority for DSCA to process these appropriated funds through the FMS Trust Fund.

Iraq. All the appropriated Iraq funds are apportioned to the Multi-National Security Transition Command-Iraq (MNSTC-I). When MNSTC-I determines that the best way to provide defense articles and/or defense services (to include training) to the Iraq Army is through DSCA, it sends a Military Interdepartmental Purchase Request to DSCA through the Army Civil Engineering accounting system. DSCA places the funds into the FMS Trust Fund and establishes a case. While only a small portion of Iraq funds have been processed through the FMS Trust Fund to date, we have found no legal authority for DSCA to process the MNSTC-I Military Interdepartmental Purchase Request through the FMS Trust Fund.

Administrative Fees

Our preliminary review of the FY2007 end of year data provided by the Defense Finance and Accounting Service (DFAS) shows that approximately \$6.2 billion has been processed through the Foreign Military Sales (FMS) Trust Fund on behalf of the Iraq and Afghanistan war efforts. DSCA has charged approximately \$198.6 million for Administrative fees.

The purpose of the administrative fee is to recover DoD expenses related to the functions of sales, negotiations, case implementation, funds control of FMS, and related general costs of an administrative nature. The fee is based on the standard charges for letters of offer and acceptance with foreign countries. In addition, surcharges have been added to the cost of cases to collect various costs (contracting support, transportation, etc.). According to the DoD Financial Management Regulation (Volume 15, Chapter 3, Paragraph 030207A) the authority to collect these administrative fees is in the AECA. However, the cases that are funded with Afghanistan and Iraq support funds state that the AECA “does not apply” and the legal authority is public law. Of the eight public laws we reviewed, only Public Law 108-106 included any authority to collect administrative

fees. This authority is for "Other Bilateral Economic Assistance Funds," appropriated to the President for "Iraq Relief and Reconstruction Funds."

The proscribed standard rate for FMS cases is currently 3.8%. In addition, there are contract administration surcharges that may be added to the basic price for some of the items. These contract administration costs are computed as a percent surcharge on all disbursements made to contractors and reported to DFAS Denver for FMS procurements on which applicable contract administration costs have not been waived. These surcharges could be for contract administration (65%), quality assurance and inspection (65%), or contract audit (20%).

We understand that DSCA must collect fees and surcharges to pay operating expenses incurred to manage these funds. However, we find no authority to collect these expenses through the administrative fees and surcharges authorized under the AECA.

Appendix D. Defense Security Cooperation Agency's Response to DoD Inspector General Memorandum, December 18, 2007



DEFENSE SECURITY COOPERATION AGENCY

WASHINGTON, DC 20301-2800

DEC 18 2007

In reply refer to:
I-07/016070-OGC

MEMORANDUM FOR THE PROGRAM DIRECTOR, DEFENSE FINANCING AND ACCOUNTING SERVICE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit of the Disbursement of Funds and the Validity of Obligations for Afghanistan and Iraq Through the Foreign Military Sales (FMS) Trust Fund

This responds to your memorandum to the Director, DSCA concerning two audits related to the funds appropriated by the Congress to provide assistance to the security forces of Iraq and Afghanistan, including the provision of equipment, supplies, services, training, facility and infrastructure repair, renovation and construction, and funding. The authority to use such appropriations to provide assistance, was and is, in addition to any other authority to provide assistance to foreign nations.

Specifically, the audit work to date, has led to the preliminary conclusion that the Defense Security Cooperation Agency (DSCA) does not have the authority to transfer the Afghanistan and Iraq appropriated funds to the FMS Trust Fund, or to collect administrative fees on these funds. In reaching this conclusion, we believe that the auditors did not fully consider relevant information, including the language of the appropriations involved, the nature of the FMS Trust Fund, the use of the FMS Trust Fund to account for and manage the obligation and expenditure of these appropriations and the Economy Act. In that regard, we offer the following:

The FMS Trust Fund.

The FMS Trust Fund was established as an outgrowth of The Mutual Defense Assistance Act of 1949 (MDA). The MDA, as the statutory predecessor to the Arms Export Control Act, originally provided the President authority to sell defense articles to foreign countries.¹ For procurement sales, section 408(e) of the MDA required foreign countries to make funds available to the U.S. Government in advance in order to prevent the USG from incurring a financial loss.²

¹ See Arms Export Control Act of 1974, Pub. L. No. 94-329, 90 Stat. 729; Foreign Military Sales Act of 1968, Pub. L. No. 90-628, 82 Stat. 1320; Foreign Assistance Act of 1961, Pub. L. No. 87-195, 75 Stat. 424; Mutual Security Act of 1954, Pub. L. No. 83-665, 68 Stat. 832; Mutual Defense Assistance Act of 1949, 81 Pub. L. No. 329, 63 Stat. 714

² See Mutual Defense Assistance Act of 1949, § 408(e), 81 Pub. L. No. 329, 63 Stat. 714

To facilitate the management of these funds from foreign customers, by 1952, the DoD established the FMS Trust Fund under the authority in 31 U.S.C. § 725(s).³ That statutory section provided that, "moneys received by the Government as trustee analogous to the funds named in this section shall likewise be deposited into the Treasury as trust funds with appropriate title."⁴ Pursuant to this authority, by 1952, the Treasury Department established separate "trust fund receipt accounts" and "trust fund expenditure accounts" for each of the Military Departments to be used to account for sales to foreign governments.⁵ The trust fund receipt accounts were credited "with all funds received as payments for section 408(e) transactions."⁶ Since that time, DoD has continued to use the FMS Trust Fund for procurement sales and has issued numerous regulations regarding the management of the FMS Trust Fund.⁷

The DoD regulations concerning the FMS Trust Fund along with the Letters of Offer and Acceptance (LOAs), entered into pursuant to the Arms Export Control Act, set forth the fiduciary duties the United States assumes in administering the trust fund.⁸ Starting in 1952, DoD was charged with full managerial responsibilities with regard to the Trust Fund, including accounting responsibilities, special accounting responsibilities for certain transactions, reporting requirements, requirements applying to dealing with suppliers on behalf of purchasing foreign governments, interim billings, and making refunds to purchasers. Among these responsibilities are many of the most basic fiduciary duties laid out in the Restatement, including: loyalty,⁹ keeping trust property separate,¹⁰ furnishing information,¹¹ and accounting.¹² The responsibilities with regard to managing the FMS

³ 31 U.S.C. § 725(s) (originally enacted as Ch. 756, § 20(a), 48 Stat. 1233 (1934)), amended by 31 U.S.C. § 1321 (1982). See also *Matter of Procurements Involving Foreign Military Sales*, 58 Comp. Gen. 81 (1978).

Sometime prior to the publication of DoDD 2110.3 on May 16, 1952, the U.S. Treasury established trust fund accounts to be used to manage sales and assistance to foreign governments. Documentation of the exact date has not been found.

⁴ 31 U.S.C. § 725(s) supra note 3.

⁵ See Department of Defense Directive (DoDD) 2110.3 (May 16, 1952); Department of Defense Instruction (DoDI) 2110.29 (Apr. 7, 1959).

⁶ Supra note 2.

⁷ See, e.g., DoDD 2110.3 (May 16, 1952); DoDD 2110.13 (Jun. 16, 1952); DoDI 2110.29 (Apr. 7, 1959); Department of Defense Foreign Military Sales Financial Management Manual 7290.3-M (Jun. 1981); Department of Defense Financial Management Regulations, DoDD 7000.14-R (1993).

⁸ See, e.g., DoDD 2110.3 (May 16, 1952); DoDD 2110.13 (Jun. 16, 1952); DoDI 2110.29 (Apr. 7, 1959); DD Form 1513, Conditions (1969); DD Form 1513, Conditions (1973); DD Form 1513, General Conditions (1977); Department of Defense Military Assistance and Sales Manual, 5105.38-M (1978).

⁹ See Restatement (Second) Trusts § 170 (1992); See also DD Form 1513, Conditions (1969 and 1973) (providing that the DoD will procure defense articles under "the most advantageous terms and conditions available"); Arms Export Control Act of 1974, § 37(a), Pub. L. No. 94-329, 90 Stat. 729 ("Cash payments received under sections 21, 22, and 29 shall be available solely for payments to suppliers (including the military departments) and refunds to purchasers.")

¹⁰ See Restatement (Second) Trusts § 179 (1959); See also DoDD 2110.13, supra, ("Funds deposited in Trust Fund Receipt Accounts will be reported by country and category under the appropriate receipt account.")

¹¹ See Restatement (Second) Trusts § 173 (1959); See also DoDD 2110.13 supra, ("The Military Departments shall establish and maintain at all times adequate and accurate records reflecting the status of Reimbursable Military Assistance Transactions."); Department of Defense Instruction No. 2140.3 (September 6, 1979) ("FMS customers are to be provided detailed information in support of billings for Defense articles, services, and related surcharges.")

Trust Fund are clear and have been unambiguously set out in regulations for more than 55 years; DoD Directives 2110.3 and 2110.13, along with DoD Instruction 2110.29, the predecessors to the current DoD Financial Management Regulations, set out in detail the manner in which the United States was required to manage the trust fund comprehensively during the respective periods they covered.

The FMS Trust Fund is a single account only at the U.S. Treasury level. At the DoD level it consists of separate accounts (perhaps subaccounts is better for purposes of this discussion) for 206 foreign countries and international organizations and for their funds, and separate accounts for U.S. funds, consistent with the purposes and limitations for which they were appropriated or otherwise provided. A complete list of the 330-some separate accounts on the FMS General Ledger accounts is available.

Separate general ledger accounts have long been used to account for transfers to the trust fund under section 632 of the Foreign Assistance Act (FAA) of 1961, as amended (22 U.S.C. § 2392), an authority under which the President (as delegated by Executive Order to the Secretary of State) may allocate or transfer funds appropriated for carrying out the FAA to any U.S. government agency. Such separate accounts have been established and are used to manage the appropriated funds for Afghanistan and Iraq (hereinafter ASFF and ISFF for ease of discussion) which are the subject of the audits. Proper coding to ensure use of these accounts is contained in the Security Assistance Management Manual (SAMM), DoD 5105.38-M, and particularly in Chapter 5. For each of the ASFF and ISFF appropriations, attachment 1 identifies the separate and unique accounting codes, appropriation number and the Public Law cites for each appropriation.

Authority to Transfer Appropriations

Each of the Public Laws appropriating ASFF and ISFF funds have included specific authority to transfer these funds. ASFF and ISFF funds are not, however, been handled in the same way. Although they make their way to the FMS Trust Fund by different routes, they make their way by direction of the Department of Defense pursuant to applicable legal authorities.

The Economy Act (31 U.S.C. § 1535) is such an authority. It provides authority for federal agencies to order goods and services from other federal agencies (including for other Military Departments and Defense Agencies) and to pay the actual cost¹³ of those

¹² See Restatement (Second) Trusts § 172 (1959); See also DoDD 2110.3, supra, ("It is the purpose of this directive to prescribe procedures for final accounting for each such case [under Section 408(e) of the MDA] on a timely basis."); DoDI 2110.29, Section VIII(G), Final Accounting for Mutual Security Military Sales Transactions (Apr. 7, 1959) ("The accounting statement (DD Form 645, Enclosure 4) shall be in sufficient detail and content to meet the reasonable accounting requirements of the nations involved").

¹³ "Actual cost" as that term is used in the Economy Act includes all direct cost attributable to providing the goods or services ordered, as well as indirect costs funded out of the providing agency's currently available appropriations that bear a significant relationship to providing the goods or services. Comptroller General decision B-250377 (28 Jan. 1993). Agencies have some flexibility in recovery actual costs and may do so through standard costs

goods and services. Congress passed the Act in 1932 to obtain economies and efficiencies and to eliminate overlapping activities of the federal government. Within the Department of Defense, an activity within a DoD Component may place an order with another activity within the same DoD component, or with another DoD component, or with another federal agency.¹⁴ DoD activities generally use Military Interdepartmental Purchase Requests (MIPRs) for Economy Act orders.

The Project Order statutes¹⁵ provide DoD with interdepartmental authority to order goods and services separate and distinct from the Economy Act. The law applies to transactions within the DoD to include those between military departments, DoD-agencies, and other DoD-activities such as government-owned, government-operated entities for work related to authorized DoD and military projects. General regulatory guidance is in the DoD Financial Management Regulation (DoD 7000.14-R) in Volume 11A, Chapter 2. A project order is an order for specific types of goods and services and may remain open until the work is complete. Project orders require no specific form although DoD activities often use MIPRs as with Economy Act orders.

There are many similar authorities, such as section 632 of the FAA, discussed briefly above, that are applicable to various appropriations which may be used to fund assistance from the U.S. government to foreign countries.

Appropriations for Support of Iraq and Afghanistan

There have been eight (8) separate appropriations of funds for support of Iraq Security Forces (collectively referred to as ISFF) and/or Afghanistan since fiscal year 2003: (1) Pub. L. 107-327 (Dec. 4, 2002), Afghanistan Freedom Support Act of 2002¹⁶; (2) section 1107 of Pub. L. 108-106 (Nov. 4, 2003), Making emergency supplemental appropriations for defense and for reconstruction of Iraq and Afghanistan for the Fiscal Year Ending September 30, 2004, and for Other Purposes¹⁷; (3) section 9006 of Pub. L. 108-287 (Aug. 5, 2004), Making appropriations for the Department of Defense for the fiscal year ending

which are reasonably calculated to recover "all direct costs . . . and indirect costs . . . that bear a significant relationship to providing the goods or services." B-257823 (22 Jan 1998). See also, B-211953 (7 Dec 1984); 57 Comp Gen 674 (1978).

¹⁴ DoD Financial Management Regulation (FMR), DoD 7000 14-R, Volume 11A, Chapter 3, Section 030102.

¹⁵ 41 U.S.C. § 23 (DoD); 14 U.S.C. § 153 (U.S. Coast Guard).

¹⁶ The Afghanistan Freedom Support Act, at sections 103 and 107, provide authority to the President to provide assistance.

¹⁷ It provided: "Notwithstanding any other provision of law, from funds made available in this Act to the Department of Defense under "Operations and Maintenance, Defense-wide" that not to exceed \$150,000,000 may be used by the Secretary of Defense with the concurrence of the Secretary of State to provide assistance only to the New Iraq Army and the Afghan Nation Army to enhance their capability to combat terrorism and to support U.S. military operations in Iraq and Afghanistan. The Act also provided \$18,649,000 for security, relief, rehabilitation, and reconstruction in Iraq (called the Iraq Relief and Reconstruction Fund) for carrying out the purposes of the Foreign Assistance Act of 1961 [as amended]."

September 30, 2005, and for Other Purposes¹⁸; (4) Division A, Title 1 of Pub. L. 109-13 (May 11, 2005), Making Emergency Supplemental appropriations for Defense, the Global War on Terror, and Tsunami Relief for the Fiscal Year ending September 30, 2005, and for Other Purposes¹⁹; (5) section 9006 of Pub. L. 109-148 (Dec. 30, 2005), Department of Defense Emergency Supplemental Appropriations to Address Hurricanes in the Gulf of Mexico and Pandemic Influenza²⁰; (6) chapter 2 of Pub. L. 109-234 (June 15, 2006), Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006²¹; (7) Title IX of Pub. L. 109-259 (Sept. 29, 2006), Making Appropriations for the Department of Defense for the Fiscal Year Ending September 30, 2007, and for Other Purposes²²; and (8) chapter 3 of Pub. L. 110-28 (May 25, 2007), U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Act, 2007²³

ISFF Funds & Process

The process of ordering and paying for goods and services with ISFF funds is a familiar one. The ISFF funds appropriated to the Department of Defense are allocated to the Multi-national Security Transition Command – Iraq (MNSTC-I)²⁴. Funds from five (5) ISFF or ISFF-like appropriations above have been apportioned to and provided by MNSTC-I to DSCA to buy goods and services. These funds have been placed in the following separate sub-accounts for accounting and accountability purposes of ISFF: (1) Y6

¹⁸ Section 9006 of Pub. L. 108-287 provided that the Secretary of Defense (with concurrence of the Secretary of State) could use \$500,000,000 of the funds it appropriated for Defense-wide O&M for "the provision of equipment, supplies, services, training and funding" which are the same purposes as in Pub. L. 108-106 (supra). The funds were provided to the Secretary of Defense "notwithstanding any other provision of law."

¹⁹ The Act provided \$5.7 Billion for the purpose of allowing the Commander of the Multi-national Security Transition Command-Iraq, with the concurrence of the Secretary of State, to provide assistance to the security forces of Iraq to include "equipment, supplies, services, training, facility and infrastructure repair, renovation, and construction, and funding." The Act provided that the funds were to remain available until September 30, 2006, and "That such funds shall be available to the Secretary of Defense, notwithstanding any other provision of law."

²⁰ "Notwithstanding any other provision of law," this Act provided that the Secretary of Defense could use not to exceed \$500 Million of funds provided by the Act to DoD for operations and maintenance for the purposes of assistance to the security forces of Iraq and Afghanistan to include the provision of equipment, supplies, services, training, and funding.

²¹ This Act appropriated \$3,007 Billion for the purpose of allowing the Commander, MNSTC-I, or the designee of the Secretary of Defense, to provide assistance, with the concurrence of the Secretary of State, to the security forces of Iraq to include equipment, supplies, services, training, facility and infrastructure repair, renovation, and construction, and funding. To remain available until September 30, 2007, the Act further provided "That such funds shall be available to the Secretary of Defense notwithstanding any other provision of law."

²² This Act appropriated \$1.7 Billion for the purpose of allowing the Commander, MNSTC-I, or the designee of the Secretary of Defense, to provide assistance, with the concurrence of the Secretary of State, to the security forces of Iraq to include equipment, supplies, services, training, facility and infrastructure repair, renovation, and construction, and funding. To remain available until September 30, 2008, the Act further provided "That such funds shall be available to the Secretary of Defense notwithstanding any other provision of law."

²³ This Act for supplemental appropriations provided an additional \$3,842,300,000 for the Iraqi Security Forces Fund to remain available until September 30, 2008 (for the same purposes and under the same provisos as Pub. L. 109-259 (supra)).

²⁴ MNSTC-I's mission is to assist the Government of Iraq in the development, organization, training, equipping and sustainment of Iraqi Security Forces (ISF) and ministries capable of defeating terrorism and providing a stable environment in which representative government, individual freedom, the rule of law, and the free market economy can evolve and which, in time, will contribute to Iraq's external security and the security of the Gulf Region.

– funds from Pub. L. 108-287; (2) Y7 – funds from Pub. L. 108-106; (3) Y9 – funds from Pub. L. 109-13; (4) B3 – funds from 109-234; and (5) B7 – funds from Pub. L. 109-289 and 110-28.

In brief, the procedural steps are as follows: (1) MNSTC-I receives ISSF funding; (2) MNSTC-I then identifies requirements for equipment and training of Iraqi forces and communicates these requirements to the Military Departments on a Letter of Request (LOR). The MILDEP recipients of these LORs are the FMS Implementing Agency (IA) components such as USASAC, SAF/IA and Navy IPO; (3) The IA creates a Security Cooperation Program (SCP) Letter of Offer and Acceptance (LOA) based on the LOR (each LOA provides the funding and accounting references required to separately account for the ISSF funds); (4) the LOA is reviewed and approved by DSCA as part of a counter-signature approval process that requires coordination and concurrence with State; (5) MNSTC-I sends a MIPR to DSCA to fund the order; (6) DSCA prepares a DD 448-2 to accept the MIPR²⁵ and transmits a copy of the accepted/signed MIPR to MNSTC-I; (7) DSCA prepares the SF 1080 billing document and issues it to the applicable paying station (usually the Army Corps of Engineers (COE) Finance Center, Millington, TN) and sends a copy to DFAS Denver; (8) the COE uses IPAC to send the funds to DFAS; (9) DFAS records the collection into the FMS Trust Fund into separate sub-account for these funds; and (10) all expenditures are made from these FMS Trust Fund sub-account.

ASFF Funds & Process

Six (6) of the appropriations listed above have been used to provide assistance to the Afghanistan security forces and placed in separate sub-accounts for accounting and accountability purposes of ASFF: (1) S9 – funds from Pub. L. 107-322; (2) Y2 – funds from Pub. L. 108-106; (3) Y5 – funds from Pub. L. 108-287; (4) Y8 – funds from Pub. L. 109-13; (5) B2 – funds from Pub. L. 109-234; and (6) B6 – funds from Pub. L. 108-289.

Although the purposes for which assistance may be funded are virtually the same, and the Secretary of State must concur with DoD's planned use of ASFF funds, the process for ordering and paying for goods and services with ASFF is slightly different than the process for ISFF funds.

The Deputy Secretary of Defense memorandum of July 26, 2007, "Management of the Afghanistan Security Forces Fund," assigns the respective responsibilities for managing ASFF funds and the requirement to provide quarterly reports to the Congress on all ASFF apportionments, obligations and expenditures, and quarterly reports on Afghanistan security forces training and performance. The Deputy Secretary designated the Combined Forces Command – Afghanistan (CFC-A) to provide assistance to the security forces of Afghanistan and that funding will be managed by the Office of Security Cooperation Afghanistan, with direction from the CFC-A (now CSTC-A) Commander.

²⁵ DSCA internal controls resulted in the identification of a few instances where the MIPR was accepted prior to LOA approval.

He directed that the Under Secretary for Defense (Comptroller) in turn releases ASFF budget authority to the Assistant Secretary of the Army for Financial Management and Comptroller. He assigned responsibility to the Secretary of the Army for providing fund distribution and accounting support to the Commander, Combined Forces Command – Afghanistan (CFC-A) through the Defense Security Cooperation Agency (DSCA). He made the Secretary of the Army responsible for proper financial management, fiscal control, and accountability in accordance with statute and DoD policy to include the DOD FMR. He charged the Under Secretary of Defense (Comptroller) to provide additional guidance regarding the execution of ASFF.

In brief, the procedural steps are as follows: (1) the DoD Comptroller issues funds to the Army using a Standard Form 132, Apportionment and Reapportionment Schedule; (2) the Assistant Secretary of the Army for Financial Management and Comptroller issues ASFF budget authority to DSCA in Program Budget and Accounting System (PBAS) using a Funding Authorization Document (FAD), DFAS Form 1323; (3) CSTC-A sends a memorandum of request to DSCA to fund specific assistance; (4) DSCA reviews the request for consistency with the purposes for which the cited funds were appropriated and notified to Congress and assigns the order to a DoD Implementing Agency (IA) such as USASAC, Navy IPO, SAF/IA, NSA, for example; (5) the IA develops the supporting case to acquire or provide the requested assistance; (6) DSCA processes the documents to obtain concurrence from the Secretary of State; (7) DFAS processes a SF 1081 to transfer the funds from the ASFF appropriation into the appropriate FMS Trust Fund account to provide for accounting for the funded case and financial implementation in DSAMS; (8) the IA executes the case to provide the approved assistance; (9) delivery and financial execution is monitored, and reported monthly; and (10) when the case is delivery and financially complete, the IA reconciles and closes the case.

Collection of Costs for Work

For the sake of some who may read this, I hope the explanation of the process for ISFF and ASFF funded work has been helpful. It is important to understand that the ordering and funding of this assistance is a multi-step process that for the most parts mirrors the way goods and services are ordered for foreign countries under the FMS program.

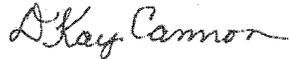
The FMS Implementing Agencies (IAs) provide defense articles and services, to include training, to Iraq and Afghanistan under the authority of the AECA (not the FAA). To the extent that ISFF and ASFF funded pseudo cases were marked as “non-AECA,” this was a mistake. The cases should have been marked “non-FMS.”

The same personnel in DSCA and the Military Departments are involved in the execution, administration and management of both FMS and non-FMS LOAs. These personnel are funded with FMS administrative funds, collected on FMS sales pursuant to section 21(e)(1) of the AECA that Congress makes available in annual Acts providing appropriations for Foreign Operations, Export Financing and Related Programs (FOAA). However, these funds are not available to pay for other than FMS-work, so a

reimbursement is required to pay for the work involved in executing and managing ISSF and ASFF orders for goods and services for Iraq and Afghanistan. There are various authorities that mandate and allow the charging of actual costs for work performed for others that cannot be funded with the appropriations of the providing entity. And those authorities, as explained above, allow for charging those costs based on an estimate calculated to recover those costs. In the case of the FMS process, the 3.8% administrative surcharge is calculated to recover the costs of doing such work. In the case of ISSF and ASFF funded work, it is used as best estimate for collecting these costs, and is not an application of the administrative surcharge mandated by section 21(e)(1) of the AECA.

In summary, the work for ISSF and ASFF, or other non-FMS programs, cannot be provided free of charge because they are non-FMS and also because doing so would result in an illegal augmentation of funds of the ordering activity.²⁶ In addition, the goods and services provided are exported under the Arms Export Control Act but are not foreign military sales under that Act.²⁷ Because of this, the funded cases that authorize and fund the ordered goods and services should all have been marked "not FMS."

Questions regarding the above may be directed to Mr. Art Hotop, Deputy for Country Financial Management (DCFM) at (703) 604-6565. Our audit liaison is Ms. Marge Webb (703) 601-3741.



D. Kay Cannon
General Counsel

²⁶ For example, when the Department of State places orders for work with the DoD and transfers funds (such as appropriations for Peacekeeping (PKO)) under section 632 of the FAA, the costs of executing and managing those orders must be charged and cannot be paid from FMS administrative funds.

²⁷ Unless otherwise specifically provided by law, all exports of defense articles and services are governed by the AECA, which requires an export license to be obtained from the Department of State, except "for carrying out any foreign assistance or sales program authorized by law and subject to the control of the President by other means." Section 38(b)(1)(B)(2) of the AECA (22 U.S.C. § 2778(b)(1)(B)(2)). Of course, USG exports to itself for its own use also do not require a license.

Appendix E. Management Comments and Our Responses

Defense Security Cooperation Agency Management Comments to the Introduction, Findings A and B, and Scope and Methodology,

On December 4, 2008, we provided the Director with our responses to his October 27, 2008, comments and asked if he would like to revise or withdraw his comments. On December 15, he provided additional comments. We respond to his comments here. All DSCA Comment paragraphs are direct quotes from the October 27, 2008, comments. For the complete October 27, 2008, comments, see the Management Comments section.

Introduction

DSCA Comment

1. The first paragraph under “Background” (page 1). The statement is made that the FMS Program is accomplished in two basic ways --- through either cash purchases or Foreign Military Financing (FMF). This is not correct. These are actually two types of funding rather than two methods of executing FMS. The method of execution is basically the same whether the case is financed with cash or with FMF. As set out in law and regulation, the two ways of executing FMS cases are (a) sales from stock, and (b) procurement by contract. At a minimum, we recommend the wording be changed to state “The FMS program is generally funded in two basic ways . . .”

In the DSCA December 15, 2008, comments, the Director upheld his original comments, stating that audit response disagrees with their statements and cites the FMS customer Financial Management Handbook. He further stated the document cited is a training guide, and it is not a policy document and should not be used as such.

Our Response

1. We disagree with the DSCA Director’s comment that the statement is incorrect. We obtained the statement from the FMS Customer Financial Management Handbook, chapter 1, “An introduction to the Foreign Military Sales Programs,” May 2004, page 1-1. The Financial Management Handbook is an official publication of the Defense Institute for Security Assistance and the Defense Finance and Accounting Service. Its purpose is to acquaint the reader with the terminology, legislation, and policies associated with the management of the FMS program. The Background section of the audit report serves that purpose for the Findings.

DSCA Comment

2. The second paragraph under “Background” (page 1).

a. The statements about the FMS Trust Fund are not correct in that they are incomplete. As explained previously, the FMS Trust is only a single account at the U.S. Treasury level. At the DoD level, it consists of over 330 separate accounts as shown on the FMS General Ledger made available by both DSCA and DFAS. For clarification, we recommend the first sentence of this paragraph be changed to read, “The FMS Trust Fund is a single account only at the U.S. Treasury level. At the DoD level, it consists of over 330 separate subaccounts that provide for the segregation and separate management of funds deposited by 206 foreign countries and international organizations and U.S. appropriations transferred to the Trust Fund.”

Our Response

a. We disagree with the DSCA Director’s comment that the statements are incorrect. The FMS Trust Fund appropriation (9711X8242) is the only appropriation used for funds in the FMS Trust Fund at the Treasury level. The subaccounts discussed in the comments are in the DIFS departmental-level accounting system. We do not feel that adding the statement about subaccounts would add any benefit to the report. In the same paragraph, we explain that DSCA assigns 2-digit country code, which DSCA uses to track and control all the funds, and making this additional statement would be redundant.

DSCA Comment

b. This paragraph inaccurately states that “As articles and services are requested, funds are allocated to cases established in the FMS Trust Fund . . .” Cases are not established in the FMS Trust Fund awaiting requests for articles and services as implied in this paragraph. What is correct: A customer’s request for articles and services prompts the creation of a Letter of Offer and Acceptance (LOA) that, when signed and implemented, creates a case. An accurate description of the process would be “When an FMS customer requests defense articles and services, a Letter of Offer and Acceptance (LOA) is written that, when signed by the customer and the United States, documents the agreement and the standard and, as appropriate, special terms and conditions under which authorized defense articles and services will be provided. A signed and implemented LOA creates obligation authority that supports requisitions against DoD stock or procurement by contract. An integral part of each LOA is a payment schedule identifying the expected amounts and timing of customer payments to the USG. A customer’s payments are deposited into the Trust Fund into sub-accounts that segregate them from the deposits of other customers and restricts the use to each individual customer. Appropriated funds are segregated in the same way, by appropriation, by country or program, and by case. The financial accounting system tracks all funding until all deliveries are completed and the case is reconciled and closed.”

In the Director’s second set of comments, he stated that cases are not established in the Trust Fund. The wording in the SAMM that we reference in the audit response deals with payments regarding “implemented” cases, which is accurate.

Our Response

b. We do not agree with the DSCA Director's comment that the paragraph "inaccurately states" the process. The purpose of the Background section was not to explain in detail the entire process of how an LOA is established, but to provide enough information for a person to understand the general basics of FMS Trust Fund operations. Although we summarized statements in the Security Assistance Management Manual (SAMM), chapter 9, we believe the intent of the statement is clear. SAMM, chapter 9, section C9.3.5 states:

The FMS Trust Fund is used for payments received from purchasers and disbursements made against implemented FMS cases. This fund is cited directly on contract for the procurement of defense articles and/or services for the purchaser, or is used to reimburse Military Department appropriations for deliveries from DoD stocks or services performed by DoD employees.

However, we revised the report to state that the cases are established in the FMS Trust Fund accounting system, not in the FMS Trust Fund.

DSCA Comment

3. Third paragraph under "Background" (page 1). Recommend the last sentence in this paragraph be amended to ". . . and has long provided for subaccounts that are used to separate foreign deposits from U.S. appropriated funds that the Congress has provided to fund foreign military and security assistance."

Our Response

3. We addressed the recommended sentence in our response to the DSCA Director's first comment to the Background. We do not feel that adding a statement about subaccounts would be of any benefit to the report. We have already explained that DSCA assigns 2-digit country code that they use to track and control all the funds in the FMS Trust Fund, and making this additional statement would be redundant.

DSCA Comment

4. Fifth paragraph under "Background" (page 2). No abuses or improprieties have been identified with regard to the use of the Economy Act to support the programs examined by this audit. We recommend deleting the three sentences beginning with the phrase "Because of previous abuses . . ." The discussion of unspecified previous abuses are not related to this report, its findings or recommendations, and thus casts an impression that is not accurate, fair, or balanced.

Our Response

4. We disagree with the DSCA Director's recommendation. This is a background statement and does not refer to specific abuses or improprieties. We took this statement verbatim from the DoD FMR, volume 11A, chapter 3, "Economy Act Orders," paragraph 030104, Limitations. For clarification, we attributed the statement to the DoD FMR and added the appropriate quotation marks.

DSCA Comment

5. Seventh paragraph under “Background” (page 2).

a. For clarity, we recommend the second sentence should be expanded to include why these cases are considered “non-FMS.” Recommend the second sentence be reworded as follows: “Because the Department of Defense is the purchaser and the transaction does not require the recipient foreign government’s agreement or funding, these DoD funded cases are designated “non-FMS” although these are transfers subject to the Arms Export Control Act (AECA).”

Our Response

a. While we feel that the sentence adequately explained the reason why these cases are considered “non-FMS,” we added wording to the paragraph for clarity.

DSCA Comment

b. The third sentence incorrectly states that the “pseudo identifier” is comprised of a “pseudo” country code and a “pseudo case designator.” There is no such thing as a pseudo case designator. We recommend the word “pseudo” be deleted when referring to the case designator.

In our December discussion with DSCA management, they agreed that the audit response correctly quotes wording currently in the SAMM, paragraph C5.4.11.1.1. regarding “pseudo” identifiers and designators. However, the SAMM wording is not accurate with regard to “pseudo” designators. The DSCA Director stated he will take action to correct that statement in the SAMM.

Our Response

b. We disagree with the DSCA Director’s comment that the statement is incorrect. The source for this statement is the Security Assistance Management Manual (SAMM), chapter 5, “Foreign Military Sales Case Development,” paragraph C5.4.11.1.1, Pseudo Country Case, which states, “A ‘pseudo’ case identifier must be created using a ‘pseudo’ country code and a ‘pseudo’ case designator....” Because we are required to use supporting documents that are current at the time of our review, we will keep the existing wording.

DSCA Comment

c. The fourth sentence in this paragraph is also incorrect. We recommend the fourth sentence in this paragraph be changed to clarify that these cases are processed using existing data systems and processes. Corrected wording should read: “DSCA and the Military Departments process these pseudo cases using the same data and financial systems and processes as FMS cases. One major exception is that the LOA is not signed by the country receiving the articles and services because the Purchaser is the United States, not a foreign government.”

Our Response

c. We disagree with the DSCA Director's comment that the statement is incorrect. The sentence already states that the foreign country does not sign the LOA. We took the statement from the SAMM, chapter 11, paragraph C11.3.3. The SAMM implies that the same systems are used to processes both FMS cases and non-FMS cases. However, for clarity, we revised the wording in the sentence to address the use of security assistance systems.

DSCA Comment

6. Eighth paragraph under "Background" (page 2). This paragraph states that once (i.e., after) an LOA is established, DSCA assigns an Implementing Agency the responsibility of implementation. This is not correct. The Implementing Agency actual provides the data needed to prepare the LOA and so is "assigned" up-front in the process --- not after the LOA is established. We recommend this paragraph be reworded as follows: "An Implementing Agency is responsible for providing data required to write the LOA. Once the LOA is offered, signed, and implemented, stock requisitions may be processed and procurement contracts may be awarded. The Implementing Agency is responsible for overall management of the actions which will result in delivering the defense articles and services specified in the LOA."

Our Response

6. We based our statement in the report on a presentation, during the audit, by a DSCA Country Finance Director, who stated that when DSCA receives a Memorandum of Request (MOR), it assigns the MOR to the Implementing Agency. For clarification, we amended the sentence to say that the Implementing Agency establishes the LOA after DSCA has assigned the work.

DSCA Comment

7. Ninth and final paragraph under "Background" (page 2). This paragraph discusses the DFAS role in performing accounting, billing, disbursing, and collecting functions. It does not acknowledge that accounting and related functions are also performed by the Military Departments using various MILDEP financial and accounting systems. These additional systems provide data to the MILDEP FMS systems which then provide the data to DIFS. For clarification, we recommend this paragraph be changed to read as follows: ". . . for the Security Assistance Programs. DFAS uses the applicable Military Department (MILDEP) accounting and financial management systems. These systems provide data to the MILDEP FMS system which then provides data to DIFS. DFAS Indianapolis uses the DIFS as the departmental-level central accounting system for billing the FMS customer and reporting the financial status of funds in the FMS Trust Fund.

Our Response

7. We acknowledge in the report the importance of the Military Departments in the execution of FMS and non-FMS cases. We took the original statement from the SAMM, paragraph C2.3.9. However, we agree that amending the paragraph to add verbiage acknowledging the MILDEP financial and accounting systems adds value to the report, and we amended the paragraph accordingly.

DSCA Comments on Finding A. Transfer of Appropriated Funds

DSCA Comment

1. Introductory Paragraphs (page 3). This section states that transfer of \$6.5 billion of appropriated funds for support of Afghanistan and Iraq military and security forces in the FMS Trust Fund did not meet the requirements of the Economy Act and that this transfer and commingling of funds was not in the best interest of the Government. DSCA non-concurs with that assessment for the following reasons:

a. DSCA did collect \$6.5 billion of appropriated funds for the support of Afghanistan and Iraq military and security forces into the FMS Trust Fund. Funding was transferred from the U.S. Army (on occasion funds were sub-allocated from any Military Department in the case of directed drawdowns) to DSCA to carry out “pseudo” cases using the FMS system. The office of the DoD General Counsel, Deputy General Counsel (Fiscal) has opined that the transactions supporting Iraq met the preconditions for the Economy Act, title 31 U.S.C. section 1535. By memo dated 26 July 2005, Gordon England directed that “ASFF distribution and accounting support to the CFC-A” be done through the Defense Security Cooperation Agency. This mandate has been repeated in subsequent directions. Because the FMS system is the only process in DSCA that is available for distribution and accounting support for defense articles and services, it was the judgment of DoD that the FMS system was an appropriate vehicle for ASFF transactions. DSCA has been provided no economic analysis in this paper or from other sources to suggest that a more economical process is available.

In his December 15, 2008, comments, the Director stated that he disagreed with our response to his initial comments regarding the cost of processing at DFAS and within the DIFS data system. He stated that DSCA pays DFAS to perform accounting services. These payments are not made on a case-by-case basis. He stated that it is not accurate to assume that the annual amount of DIFS processing costs are increased by the addition of specific numbers of cases being managed through the system.

Our Response

1. We disagree with the DSCA Director's comments.

a. The Director stated that "the DoD General Counsel, Deputy General Counsel (Fiscal) has opined that the transactions supporting Iraq met the preconditions for the Economy Act, title 31, U.S.C. section 1535." We agree; we are not stating that the Economy Act is improper for purchasing items for Iraq. We are stating that the Army should be directly citing the ISFF appropriation, as required by regulation, instead of transferring funds to the FMS Trust Fund. We agree that the July 26, 2005, memorandum directed that "ASFF distribution and accounting support to the CFC-A" be accomplished through the Defense Security Cooperation Agency. However, as we stated in the report, the memorandum did not specifically authorize the transfer of funds to the FMS Trust Fund. The DSCA Director stated that it was the judgment of DoD that the FMS system was an appropriate vehicle for ASFF transactions. In August 2008, we requested additional support for the DSCA management comments. However, DSCA was unable to provide any supporting documentation. The documents provided were memoranda from the Deputy Secretary of Defense to the Army and Military Commanders approving the reallocation of ASFF funds for execution. There was no mention of use of the FMS Trust Fund in any of the documents. While we did not provide any economic analysis concerning the cost of this process, DSCA pays DFAS a fee for processing transactions in DIFS accounting system. Therefore, by transferring these appropriated funds into the FMS Trust Fund, the cost of goods and services would increase because of the additional cost of processing in DIFS. According to DFAS personnel, an economic analysis is not available concerning the cost of processing ASFF and ISFF transactions because DFAS is paid through billing hours and does not track DIFS charges by country code. The cost of processing transactions for non-FMS cases in DIFS would have to be charged to these non-FMS cases because FMS funds cannot be used to pay for processing non-FMS cases. In addition, the 3.8% estimated cost for processing non-FMS cases is based on the 3.8% charge for FMS cases, which includes the cost of processing transactions in DIFS. There would have to be an impact on the funds used to pay DFAS for this processing.

DSCA Comment

b. The FMS Trust Fund is a single Treasury account designed to hold funds received for FMS programs. While it is true that the Trust Fund was not designed to manage expiring appropriated funds, DSCA has developed methods to segregate in separate subaccounts and ensure the appropriate management of these funds with their unique requirements. As discussed previously, DSCA has developed a series of "pseudo" country codes to identify specific funding authorization types. Unique clauses are also included in LOA documents to ensure funding restrictions are clear.

Our Response

b. We acknowledge in the report that DSCA has established separate accounts in the department-level accounting system. However, other appropriations at the Treasury level carry a designation of use (for example, Operations and Maintenance; and Research, Development, Test, and Evaluation) and a fiscal year limitation, which is not available in

the FMS Trust Fund appropriation. Segregation into separate subaccounts in the accounting system does not change the fact that the FMS Trust Fund is a single, no-year appropriation, and all funds placed in it carry the same designation. After the appropriated funds are transferred, they lose their fiscal year identity and are recognized as no-year funds at the Treasury level.

DSCA Comment

c. It is incorrect to state that the funds in the Trust Fund are “commingled.” The funds deposited into the FMS Trust Fund are controlled at several levels. There are separate subaccounts for various administrative and cost clearing accounts. Country or “pseudo” case funds are accounted for via separate subaccounts for each country or “pseudo” –type of funding. “Pseudo” case funding is separated by purpose/country benefiting from the transaction, and by funding “life.”

Our Response

c. We disagree with the DSCA Director’s comment. Our statement of “commingling” is correct. As stated in our response to comment 1.b under Finding A, because the FMS Trust Fund is a no-year appropriation, all the funds placed in it carry the same designation. DSCA management was not provided authority in any of the listed appropriations acts (the DSCA, December 18, 2007, memorandum provided a list) or elsewhere to permit the commingling of U.S. appropriated funds with the funds of foreign nations in the FMS Trust Fund. On the contrary, because Congress appropriated the funds to the Army in separate accounts for Afghanistan and Iraq, it would appear to be the intent of Congress that the subject funds be managed separately and be accounted for separately according to the specific reporting requirements in the acts.

DSCA Comment

d. This section inaccurately states, “In addition, the transfer increased the costs of acquiring goods and services because DSCA collected administrative fees for funds processed in the FMS Trust Fund.” There are two fundamental inaccuracies with this statement.

(1) First, the FMS processes and workforce are paid for by FMS customers through the assessment of the Administrative Surcharge, which is mandated by law. This FMS-funded workforce cannot acquire defense articles and services for non-FMS programs without charging and recovering the costs of that work from the DoD or USG entity ordering the non-FMS work. To do the work without charge would improperly augment the appropriations of that entity and create a potential Antideficiency Act violation. Further, administrative surcharge collections from international customers are not legally available to pay for such work.

Our Response

d. We disagree with the DSCA Director’s comment that the section is inaccurate.
(1) This report does not state that administrative surcharges collected from international customers be used to pay for other than their own expenses. We agree that under the FMS programs the services should be at no cost to the Government as the FMS

program was established specifically for foreign countries. However, as previously stated, we believe that the cost to the non-FMS cases would be reduced if the funds were not processed through the FMS Trust Fund because this would eliminate DIFS processing charges.

DSCA Comment

(2) Second, there is no analysis provided to show that the costs of acquiring these goods and services through some other means or through some other agency or component would be less expensive than using the FMS system and using the administrative surcharge percentage as the best estimate of the costs of the work. Any other means or method of support would require some recovery of the actual or estimated costs of the work – so it is very misleading to let the reader conclude that the cost of using other alternatives would be \$0.

Our Response

(2) We are not suggesting that the work would be performed at no cost by other agencies. (See Audit Response to DSCA comment 5 under Finding A and Audit Response to DSCA comment to 1.a under Finding B.) We are stating that contracts and other purchase orders should cite the ASFF and ISFF appropriation symbol instead of transferring the funds into DIFS and citing the FMS Trust Fund appropriation symbol. Because DFAS charges DSCA for processing transactions in DIFS, the cost of processing these non-FMS cases increases. There is no economic analysis on the cost of processing ASFF and ISFF transactions because DFAS is paid through billing hours and does not track DIFS charges by country code. As we previously explained, the cost of processing transactions for non-FMS cases in DIFS would have to be charged to these non-FMS cases because FMS funds cannot be used to pay for processing non-FMS cases. In addition, the 3.8% estimated cost for processing non-FMS cases is based on the 3.8% charge for FMS cases, which includes the cost of processing transactions in DIFS. There would have to be an impact on the funds used to pay DFAS for this processing.

DSCA Comment

e. The sentence regarding direct cite of appropriated funds is incorrect and should be deleted. The “pseudo” country codes and separate subaccounts ensure proper control of expiring funds. The financial systems used to execute FMS are not designed for ordering, delivering, and billing multiple appropriations using direct fund cites. Any modifications to existing Security Assistance data systems to enable direct cite of appropriated funds would require additional appropriated funds to support the system changes required.

In his December 15, 2008, comments, the Director stated that our response did not identify what “existing systems” should be used instead of DIFS.

Our Response

e. We disagree with the DSCA Director’s comment that the sentence is incorrect. We are not suggesting making any modifications or changes to the existing DIFS

accounting system. Our recommendation is that DSCA not use DIFS, but control funds using existing systems that are designed to process appropriated funds. We are referring to the MILDEP financial and accounting systems that complete the accounting and related functions, and provide data to the MILDEP FMS systems that provide data to DIFS (comment 7 to the Background section of the report and comment 4.d to Finding A).

DSCA Comment

2. Appropriations Transferred Paragraphs. The second paragraph incorrectly states that “DSCA personnel transferred funds from various DoD appropriations to the FMS Trust Fund to be used . . .” Throughout this report, the word “transferred” is used to describe DSCA actions without further clarification that these actions involved more entities than just DSCA and reflected a collection into the account for work to be provided. In this particular paragraph, we would recommend the wording be changed to state “DoD account holders sub allocated funds from DoD appropriations to DSCA, which placed them into the FMS Trust Fund to be used. . .”

Our Response

2. We disagree with the DSCA Director’s comment that the statement is incorrect. The sentence does not state that it is the sole responsibility of DSCA to transfer the funds. We are referring to the process. SAMM, chapter 11, section 11.3.4, states, “DSCA (Business Operations Directorate) issues a MIPR to transfer the funds into the FMS Trust Fund.” DSCA personnel also used the word “transfer” in their December 18, 2007, memorandum: “DFAS processes a SF 1081 to transfer the funds from the ASFF appropriation into the appropriate FMS Trust Fund account...” The word “transfer” is the correct action and terminology. The Principles of Federal Appropriations Law, volume 1, chapter 2, section 3, “Transfer and Reprogramming,” states, “Transfer is the shifting of funds between appropriations.” In this process, the funds are shifting from Army and other DoD appropriations into the FMS Trust Fund appropriation.

DSCA Comment

3. Justification for Transfer Paragraphs.

a. In response to questions from the DoDIG in regards to justification for the transfer of these funds, DSCA General Counsel submitted a December 18, 2007 memorandum. This memorandum (included in this version of the DoDIG draft report) specifically identified the funds and the laws that permitted the transfer. The transfers of funds and use of the FMS process was directed and authorized by the Deputy Secretary of Defense through the Secretary of the Army and the Commander, MNSTC-I.

Our Response

a. As stated in the report, the memorandum did not specifically state the authority to use the FMS Trust Fund, as explained in response to Finding A.1.c. We are aware of no authority in any of the listed appropriation acts (the DSCA, December 18, 2007, memorandum provided a list) or elsewhere that permit the commingling of U.S. appropriated funds with the funds of foreign nations in the FMS Trust Fund. On the contrary, it would appear to be the intent of Congress that the subject funds be managed separately and accounted for separately according to the specific reporting requirements provided in certain of the acts.

The public laws did not provide the authority to transfer the appropriated funds to the FMS Trust Fund. Likewise, the Deputy Secretary of Defense did not clearly provide authorization to transfer and use the FMS process for these funds. We agree that the Deputy Secretary of Defense provided DSCA with managerial authority, but did not provide authority to transfer appropriated funds to the FMS Trust Fund.

DSCA Comment

b. The second paragraph in this section incorrectly states that these funds were “. . . commingled with other funds in the FMS Trust Fund . . .” All funds deposited or transferred into the FMS Trust Fund are placed in separate accounts that ensure funds are not commingled.

Our Response

b. We disagree with the DSCA Director’s comment that the paragraph is incorrect. We stated that the funds are commingled because all the funds are accounted for in one appropriation symbol, 9711X8242. Standard Form 1081, the document used to transfer the funds, shows that the various DoD and Army appropriations are transferred into the FMS Trust Fund appropriation symbol. We recognize that the funds are accounted for separately in the DIFS accounting system, but they are in one account symbol at Treasury level along with funds of foreign governments.

DSCA Comment

c. A July 26, 2005 memorandum from the Deputy Secretary of Defense is cited in the draft report. The draft report states that the memorandum “. . . did not provide clear direction for DSCA to use the FMS Trust Fund to account for these funds. DSCA manages other appropriations without using the FMS Trust Fund, for example, the International Military Education and Training program; therefore, DSCA can also manage the non-FMS funds without using the FMS Trust Fund.” DSCA non-concurs with DoDIG assessment and interpretation of the DEPSECDEF memorandum and its direction. There is no basis in fact for this conclusion. The execution of the ISFF and ASFF funded programs have been regularly and frequently briefed at the highest levels in DoD.

Our Response

c. We disagree with the DSCA Director's comment. The July 26, 2005, memorandum does not state that the FMS Trust Fund should be used to manage the ASFF funds. As stated before, we agree that the Deputy Secretary of Defense memorandum provided DSCA with the authority to provide accounting support for ASFF, but it does not provide the authority to use the FMS Trust Fund. In August 2008, we requested that DSCA provide any additional support for their statements. The documents provided were memoranda from the Deputy Secretary of Defense to the Army and Military Commanders approving the reallocation of ASFF funds for execution. There was no mention of use of the FMS Trust Fund in any of the documents.

DSCA Comment

(1) The FMS process is the only process in DSCA that is available for ordering, procuring, delivering, billing, paying, and accounting for defense articles and services. It was the judgment of the Deputy Secretary and others that the FMS system would be used for ASFF transactions.

Our Response

(1) We did not receive support for the DSCA Director's statements. The ordering, procuring, delivering, billing, and paying are accomplished through the MILDEP systems, as the Director previously stated. The FMS Trust Fund accounting system (DIFS) performs the accounting based on data from MILDEP systems. As we have stated, in August 2008, we requested DSCA provide any additional support for their statements. The documents provided were memoranda from the Deputy Secretary of Defense to the Army and Military Commanders approving the reallocation of ASFF funds for execution. There was no mention of use of the FMS Trust Fund in any of the documents.

DSCA Comment

(2) Although DSCA manages other appropriations as cited (e.g., IMET), it does not and cannot manage such non-FMS funds without using the FMS Trust Fund. DSCA functions in managing the IMET program are summarily those of a fund manager. DSCA issues (allots) funds to the MILDEPs for their execution and reporting of the program.

Our Response

(2) We disagree with the DSCA Director's statements. The Director did not provide evidence to support that DSCA cannot provide a similar level of management without the use of the FMS Trust Fund. We did not state that DSCA should manage the ASFF and ISFF the same as IMET. We mentioned IMET as an example of programs using appropriated funds that DSCA personnel manage without using the FMS Trust Fund. As the Director has stated, the funds are processed through a number of Military Department systems. We believe that those systems are sufficient to control the purchasing of goods and services for ASFF and ISFF.

DSCA Comment

(3) The oversight requirement related to providing material and services utilizing ASFF and ISFF are more in-line with normal FMS activity. Having oversight of all aspects of providing the material, such as funding, logistics, and delivery information, requires use of the existing FMS program infrastructure. This infrastructure includes not only DFAS' DIFS, but also the MILDEP's logistics, contracting, and transportation legacy systems. Most, if not all, of these legacy systems are programmed to generate accounting information citing 97x8242 for all FMS activity. The 2-position country code is incorporated to identify the specific FMS customer. In the case of ASFF and ISFF, the country code not only differentiates the customer but also the legislation that appropriated the funds.

Our Response

(3) We disagree with the DSCA Director's comments. The oversight requirements may be in line with normal FMS activity, but, as we have stated, the FMS Trust Fund was designed and established to handle foreign countries funds and we see no authority for appropriated funds to be transferred into the FMS Trust Fund (9711X8242). As the Director stated, the various MILDEP systems complete the ordering, procuring, delivering, billing, and paying. The FMS accounting system (DIFS) performs the accounting based on data from the MILDEP systems. By keeping the funds within their appropriations, the Military Departments have better visibility of the funds and can give a more accurate accounting of the funds to Congress.

DSCA Comment

4. Best Interest of the Government Paragraphs.

a. In this section, the draft report again incorrectly states that "commingling" of funds occurred. As stated previously, the funds deposited into the FMS Trust Fund are accounted for in separate accounts as listed on the FMS General Ledger.

Our Response

a. We disagree with the DSCA Director's comment. Our statement regarding "commingling" is correct. As previously explained, all the funds in the FMS Trust Fund are in one appropriation symbol, 9711X8242.

DSCA Comment

b. In the second paragraph of this section it incorrectly states that ". . .it transferred them to the FMS Trust Fund based on requests for assistance from the various U.S. commanders in Afghanistan and Iraq. . ." As mentioned above, the funds are transferred into the FMS Trust Fund only after an LOA has been signed and implemented.

Our Response

b. We disagree with the DSCA Director that the statement is incorrect. The report did not state that the funds are transferred into the FMS Trust Fund before the LOA is signed and implemented. The report stated that the funds are transferred to the FMS

Trust Fund based on requests from commanders for assistance to Afghanistan and Iraq. Memorandums of Request (MOR) are received from commanders. The MORs are assigned by DSCA to Implementing Agencies who establish the LOA. When the LOA is approved, DSCA transfers the funds to the FMS Trust Fund. However, the requests for assistance are the basis for transferring the funds.

DSCA Comment

c. The draft report is not correct in questioning whether the Army should be recording the funds as expended. In doing so, it emphasizes the fact that the Army records expenditures even when funds have not left the Treasury, which is not the criteria for recording expenditures. A transfer from a general or special appropriation to a trust fund is always an expenditure transfer under U.S. Treasury rules so the Army is correct in recording the funds as expended.

Our Response

c. We disagree with the DSCA Director's comments that the report is incorrect. The draft report does not question whether the Army should be recording the funds as expended. We agree that the Army is properly recording the transfer. However, if the Army did not transfer the funds into the FMS Trust Fund, but provided a direct fund citation instead, the funds would not be recorded as expenditures until they were actually expended. Reporting the funds as expended gives the impression that the funds have been disbursed from the Treasury, when in reality they were transferred to another appropriation. Reporting the funds as expended is misleading to the public and Congress, giving the impression that the funds have actually paid for services or articles. Instead, the funds are in the FMS Trust Fund waiting to be disbursed.

DSCA Comment

d. The draft report states that “. . . DIFS did the departmental-level accounting.” This is not fully accurate. It is important to note that accounting for the Army Implementing Agencies is performed in SOMARDS, STANFINS, or the U.S.A. Corps of Engineers System (CFEMS).

Our Response

d. We disagree with the DSCA Director's comment that the sentence is not fully accurate. DIFS is the departmental-level accounting system used to process these funds. The DoD FMR, volume 15, chapter 3, paragraph 030208 states, “The Defense Integrated Financial System (DIFS) is the departmental level central accounting system used at SAAC [DFAS] to account for the FMS Trust Fund.” We do agree that there are other systems involved in processing these transactions; however, as noted, DIFS is the departmental-level central accounting system for the FMS Trust Fund.

DSCA Comment

e. In the last paragraph it states that “. . . almost \$3 billion was still in the FMS Trust Fund.” As a point of fact, funds remain in the FMS Trust fund until needed for disbursement for contracted goods and services. During this period before needed for

disbursement, those funds in the FMS Trust Fund are in the U.S. Treasury and considered assets by the Treasury in its calculation of receipts, outlays, and deficit in the Treasury statements.

Our Response

e. The DSCA Director's comment supports our response in Finding A.4.c that the funds were expended for assistance to the Afghanistan National Army. As stated, the funds in the FMS Trust Fund are in the U.S. Treasury. However, the Army's Standard Form 133 for these funds shows the funds have been expended. As stated in the report, users of the Army's Standard Form 133 for ASFF had the mistaken impression that almost \$3 billion in assistance had been provided to the Afghanistan National Army when it had not.

DSCA Comment

f. None of the information provided in this section demonstrates support for the statement that using the Trust Fund to support these programs is not in the best interest of the U.S. Government. This conclusion is without basis in fact or law.

Our Response

f. We disagree with the DSCA Director's statement. We provided factual information in this report section. As previously stated in our responses to comments 4.a-e under Finding A, we have concluded that it is not in the best interest of the U.S. Government for DSCA to process the appropriated funds for Afghanistan and Iraq through the FMS Trust Fund.

DSCA Comment

5. Economical Use of Funds Paragraphs. This paragraph states that using the FMS Trust Fund “. . . initiated an increase in the cost of purchasing the goods and services DSCA collected . . .” due to assessment of administrative fees. If the draft report is alleging that using the FMS Trust Fund to manage these funds is more expensive than other means, the report needs to identify those other Agencies/processes who could have accomplished this work for less cost. The Economy Act requires full recovery of costs to providing goods and services including indirect costs. Past investigative reports have warned that Agencies providing goods and services to other Agencies must have cost procedures in place to capture full costs of the transaction.

Our Response

5. We are not alleging that processing these funds through other agencies would be less expensive. The cost of processing these transactions increase because of the additional cost of processing the cases in DIFS (a system, not an agency). There is no economic analysis on the cost of processing ASFF and ISFF transactions because DFAS is paid through billing hours and does not track DIFS charges by country code.

Recommendation A

We recommend that the Director, Defense Security Cooperation Agency discontinue transferring funds appropriated for the Afghanistan Security Forces Fund and Iraq Security Forces fund to the Foreign Military Sales Trust Fund, and instead direct cite these appropriations on all future cases using these funds.

DSCA Comments to Recommendation A

Non-concur. The FMS case and financial management systems, logistical delivery systems, and case closure mechanisms connect DSCA, DFAS, Implementing Agencies, and customers. The financial management and logistics tracking are the keys to fiscal accountability. DSCA does not have the system infrastructure to perform the same operations through direct cite. Even if such capability were available, it is not clear what greater efficiency, cost savings, or safeguards would be obtained as the result of this change.

Our Response

The Defense Security Cooperation Agency comment is nonresponsive. The Director did not provide any support for the statement that they do not have the system infrastructure to perform the same operations through direct cite. All the accounting systems the Defense Security Cooperation Agency personnel identified that support the processing of the programs reviewed in this report, except the Defense Integrated Financial System, are standard systems used by the Military Departments to process DoD appropriations. The Director did not provide any documentation to show why the Defense Security Cooperation Agency cannot use these systems to control the processing of Afghanistan and Iraq Security Forces Funds without transferring the funds to the Foreign Military Sales Trust Fund accounting system. We believe that the report provides sufficient justification for changing the process.

Defense Security Cooperation Agency comments on Finding B. Collection of Administrative Fees

DSCA Comment

1. Introductory Paragraphs.

a. This section states that DSCA “. . . collected administrative fees from appropriated funds placed into the Foreign Military Sales (FMS) Trust Fund while also receiving appropriated funds to administer these cases.” That is incorrect. The 3.8% administrative surcharge collected on all FMS and “pseudo” cases is used to support a share of the FMS program infrastructure as well as standard case management-related execution services needed to execute these cases. The Foreign Military Financing (FMF) appropriated are separate and distinct from the Administrative Surcharge funds and are provided/used for very specific purposes which do not include execution and management of FMS or “pseudo” cases.

Our Response

a. Based on the Director's comments and further discussions with DSCA personnel, we revised this finding to remove the references to the Foreign Military Financing appropriation.

DSCA Comment

b. The second paragraph in this section states that "Administrative funds collected on FMS cases are not available to pay for non-FMS cases. DSCA collected the fee to pay for the work involved in executing and managing non-FMS orders. . ." It would be more accurate to state that "Administrative funds collected on FMS cases are not legally available to pay for work on non-FMS cases, so DSCA established a charge to pay for the work involved in executing and managing non-FMS orders. Based on historical experience, the charge for non-FMS was established at 3.8% (currently the same rate as FMS).

Our Response

b. Based on the Director's comments and further discussions with DSCA personnel, we revised this finding to remove the references to the non-FMS orders.

DSCA Comment

c. It is incorrect to state that ". . . collecting millions of dollars in administrative fees on non-FMS programs improperly augmented their appropriation. . ." As stated above, the funds collected on FMS programs are not legally available to support work on non-FMS programs. Therefore, we are required to recover costs. This is done through a 3.8% administrative surcharge. There is no appropriation to fund these administrative costs. They are funded from the surcharge. There is a Foreign Military Financing appropriation which serves a different purpose. That should not be confused with the Administrative Surcharge.

Our Response

c. Based on the Director's comments and further discussions with DSCA personnel, we revised this finding to remove the references to the Foreign Military Financing appropriation and improper augmentation of their appropriation.

DSCA Comment

d. We recommend the final paragraph in this section regarding contingency operations and fees collected be deleted. DSCA is specifically authorized to use the FMS system to support contingency operations such as the ASFF and ISFF. DoD FMR, volume 12, chapter 23, paragraph 230307 states "DSCA is responsible for providing leased equipment, using foreign military (FMS) systems and procedures, when required to support contingency operations. DSCA is also responsible for directing the implementation of those contingency operations supported under applicable sections of the Foreign Assistance Act or Title 10, United States Code, when directed by the USD(P) to provide this support. Such support may be in response to requests from the Department of State or requests from the UN [United Nations] for articles and services to

support equipment leased under Foreign Military Sales (FMS) procedures. DSCA is authorized to use the FMS system network to provide such support.”

Our Response

d. We disagree with the DSCA Director’s recommendation to delete this paragraph. The paragraph regarding contingency operations explains why DSCA does not have the authority to collect the administrative surcharge on non-FMS programs funded by appropriated funds for Afghanistan and Iraq. We do not state in the report that DSCA cannot use the FMS network for processing contingency operations related cases.

In the paragraph, we state that DSCA should not be collecting the administrative fee on contingency operations. The statement we used in the draft report is from a DSCA March 15, 2006, memorandum. Paragraph 1.b.(3) of the Administrative Surcharge and Program Management Line implementation section of DSCA memorandum I/06-000935-DBO, “Implementation Instructions for Changes to Foreign Military Sales (FMS) Administrative Surcharge Structure and Rate (3.8%) (DSCA 06-19),” March 15, 2006, states that the 3.8% administrative surcharge does not apply to cases established for Presidential Drawdowns using the S9 country code. DSCA personnel later stated that the administrative surcharge is not collected on Presidential Drawdowns because the funds are used for contingency operations. DoD FMR, volume 12, chapter 23, “Contingency Operations,” states:

The funding derived from a contingency transfer account is available only for those incremental costs incurred in direct support of contingency operation. As such, funds that are transferred into a Component’s baseline appropriation are not to be used to finance activities and programs that are not directly related to the incremental cost of the contingency.

The administrative cost for processing these Presidential Drawdowns is included in the FMF Administrative Cost account. As stated in the report, ASFF and ISFF are considered contingency operations under definitions in the FMR, volume 12, chapter 23.

DSCA Comment

2. Administrative Fee Authority Paragraphs. This section states “DSCA properly charged 2.5 percent for administrative services on FMS cases. On May 15, 2006, DSCA increased the administrative surcharge to 3.8 percent for cases that were accepted on or after August 1, 2006.” The wording of this paragraph implies that the 2.5 percent rate was “proper” but the 3.8 percent charge is not. We do not believe that was the intent of the author and recommend the wording be changed to read: “The current administrative surcharge rate is 3.8%. For cases implemented prior to August 1, 2006, the rate was 2.5% or 3.0% depending on the date of implementation.”

Our Response

2. Based on the Director’s comments and further discussions with DSCA personnel, we revised this finding.

DSCA Comment

3. Foreign Military Financing Administrative Cost Account Paragraphs.

a. In the first sentence of the first paragraph in this section, we recommend that the phrase “. . . sales for non-FMS Programs.” be changed to read “. . . sales for non-FMS Programs authorized under the AECA and FAA.” for clarity.

Our Response

a. Based on the Director’s comments and further discussions with DSCA personnel, we revised this finding to remove the references to the Foreign Military Financing Administrative Cost account.

DSCA Comment

b. The statement “We found several instances where it appears DSCA received appropriated funds and collected administrative fees for the same work.” is not supported by any analysis in the report. DSCA is not receiving appropriated funds and collecting administrative fees for the same work. A Security Assistance Organization (SAO) is authorized under the FAA and AECA and DSCA used General Costs of Administration FMF funds appropriated in the International Affairs Budget Function to support this office. Because the Iraq Security Forces Fund program is not part of the International Affairs Budget request and is not part of the FMS program, DSCA is required to collect 3.8 percent surcharge on cases processed through the FMS system for future Iraq orders. Iraq cases funded with Iraq national funds are true FMS cases and are also assessed the 3.8 percent surcharge as required by the AECA.

Our Response

b. Based on the Director’s comments and further discussions with DSCA personnel, we revised this finding to remove the references to the Foreign Military Financing appropriation.

DSCA Comment

c. The word “additional” should be deleted from the phrase “. . . DSCA collected an additional \$196 million in administrative charges directly from. . .” The \$196 million in administrative charges should not be considered together with the FMF monies received. They are for different purposes and received based on different authorities. The current wording implies that these duplicate each other --- they do not.

Our Response

c. Based on the Director’s comments and further discussions with DSCA personnel, we revised this finding to remove the references to the Foreign Military Financing appropriation.

DSCA Comment

d. DSCA is not augmenting its appropriations from outside sources as stated in the final paragraph of this section. DSCA has specific authority to collect administrative fees from cases processed for the FMS program. DSCA has no authority to use funds

from the General Costs of Administration FMF appropriation to fund work performed under programs not authorized by the AECA and FAA. Therefore, DSCA must recoup its costs of administering non-FMS cases not performed under the authority of the AECA and FAA. In order for this General Cost of Administration funding to be available for purposes other than support of AECA and FAA authorized programs, the Secretary of State would have to request that these funds be made available for Title 10 purposes as part of the annual budget process.

Our Response

d. Based on the Director's comments and further discussions with DSCA personnel, we revised this finding to remove the references to the Foreign Military Financing appropriation.

DSCA Comment

4. Contingency Operations Paragraphs. We recommend this section be deleted. See our response to 1.d. of the "Introductory Paragraph" of this section.

Our Response

4. We do not agree with the DSCA Director's recommendation to delete the section regarding contingency operations. It remains our conclusion that DSCA should not collect the administrative surcharge on non-FMS programs funded by appropriated funds for Afghanistan and Iraq. As previously stated, the report does not state that DSCA cannot use the FMS network for processing contingency operations related cases.

This paragraph states that DSCA should not be collecting the administrative fee on contingency operations. We have explained that it is DSCA policy not to collect the Administrative Surcharge on Presidential Drawdowns cases because they are for contingency operations. Because ASFF and ISFF are also for contingency operations, the surcharge should not be collected on these cases either.

Recommendation B

We recommend that the Director, Defense Security Cooperation Agency discontinue collecting administrative fees on non-Foreign Military Sales Programs and include all administrative costs for these programs as part of the budget for the Administrative Costs account in the Foreign Military Financing appropriation submitted by the Department of State.

DSCA Comments to Recommendation B

Non-concur. This recommendation requires a legislative change. This change would direct the use of Foreign Operations Appropriations to support DoD programs. We find it highly unlikely that the State Department would use its limited FMF resources to provide administrative support for programs that have been widely defended as properly funded DoD activities. The limited FMF appropriation could not support the level of

funding that would be required to sustain the non-FMS programs in Iraq and Afghanistan. The level of funding from these two programs is greater than most FMF recipients.

Our Response

The Defense Security Cooperation Agency Director's comment is partially responsive. Based on the Director's comments and further discussions with DSCA personnel, we revised this finding to remove the references to the Foreign Military Financing appropriation. However, we continue to believe that DSCA should not charge the 3.8% fee on ASFF and ISFF funded cases because the funds are for contingency operations. We request that Defense Security Cooperation Agency reconsider its position on the recommendation and provide comments on the final report.

Defense Security Cooperation Agency comments on Appendix A. Scope and Methodology

DSCA Comment

1. Review of Internal Controls Paragraph. This paragraph incorrectly states: "It is DSCA policy not to collect administrative fees on funds placed in the FMS Trust Fund for contingency operations. However, they collected fees on ASFF and ISFF cases supporting the Iraqi Armed Forces and Afghan National Army, both considered contingency operations, according to the DoD FMR." These sentences should be deleted as they are not true statements. DSCA authority to use the FMS system (which includes assessment of an administrative surcharge) to support contingency operations is in the DoD FMR, volume 12, chapter 23, paragraph 230307. In the second comment, the Director stated that it is true that DSCA does not charge 3.8% on cases established for Presidential Drawdowns using the S9 country code. He further stated that does not mean that DSCA has a policy not to collect administrative fees on funds placed in the FMS Trust Fund for contingency operations.

Our Response

1. We disagree with the DSCA Director's comment that the paragraph is incorrect. Our draft report does not state that DSCA cannot use the FMS systems for processing contingency operation related cases. The referenced statement in the draft report is from a DSCA March 15, 2006, memorandum. Paragraph 1. b. (3) of the Administrative Surcharge and Program Management Line implementation section of DSCA memorandum I/06-000935-DBO, "Implementation Instructions for Changes to Foreign Military Sales (FMS) Administrative Surcharge Structure and Rate (3.8%) (DSCA 06-19)," March 15, 2006, states that the 3.8% administrative surcharge does not apply to cases established for Presidential Drawdowns using the S9 country code. DSCA personnel later stated that the administrative surcharge is not collected on Presidential Drawdowns because the funds are used for contingency operations. As stated in the report, because ASFF and ISFF are also considered contingency operations under DoD

FMR, volume 12, chapter 23, DSCA should not be collecting the 3.8% administrative charge from ASFF and ISFF funds.

DSCA Comment

2. Use of Technical Assistance Paragraph. This sentence should be amended to add the phrase “. . . and ASFF and ISFF-funded non-FMS cases.” These cases should also have been reviewed as part of the audit.

Our Response

2. For clarification, we revised the sentence to include the words “non-FMS” cases.

Defense Security Cooperation Agency Comments, October 27, 2008



DEFENSE SECURITY COOPERATION AGENCY
2800 DEFENSE PENTAGON
WASHINGTON, DC 20301-2800

OCT 27 2008

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL,
DEFENSE BUSINESS OPERATIONS

SUBJECT: Report on Funds Appropriated for Afghanistan and Iraq Processed
Through the Foreign Military Sales Trust Fund (Project No.
D2007- D000FD-198.000)

Reference: DoD Office of Inspector General, Draft Report on Funds Appropriated
for Afghanistan and Iraq Processed Through the Foreign Military
Sales Trust Fund (Project No. D2007- D000FD-198.000), dated
August 26, 2008

Your referenced memorandum requested that we review and comment on the subject draft report. We have completed our review of the draft report. We non-concur with its findings and recommendations. Our detailed comments, identified to specific paragraphs, are attached for your use in finalizing this report. Major areas of concern include inaccuracies in the following areas:

- a. The draft refers several times to the "commingling" of funds within the FMS Trust Fund. This is incorrect. The FMS Trust Fund is a single account only at the U.S. Treasury level. Monies within this fund are segregated into more than 330 separate accounts as shown on the FMS General Ledger.
- b. The draft report confuses two sets of funding streams -- appropriations for Foreign Military Financing (FMF) administrative activities and collections of the Foreign Military Sales (FMS) administrative surcharge required by law to be used for administration of FMS sales. Such funds are provided for particular purposes. The audit report suggests using these funds for purposes for which they are not legally available.
- c. Some programs discussed in the draft report are being accomplished under the authority of the Economy Act. All the requirements of the Economy Act were met. Under the Act, the agency filling the orders is required to collect all the direct and indirect costs of the work to be done. In these cases, the administrative surcharge percentage of 3.8% was charged as the best estimate of the indirect costs of the work performed. Charging indirect costs on an estimated percentage basis is both proper and common throughout the U.S. Government

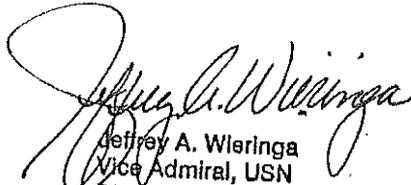
These misunderstandings are the root cause of the unsupportable findings and recommendations with which we must non-concur.

We do not concur with Finding A and B, or with the Recommendations in this draft report. Specifically:

a. DSCA Response to Recommendation A: Non-concur. The FMS case and financial management systems, logistical delivery systems, and case closure mechanisms connect DSCA, DFAS, Implementing Agencies (the Military Departments), and FMS customers. The financial management and logistics tracking are the keys to ensure financial accountability. DSCA, DFAS, and the Military Departments do not have the system infrastructure to perform the same operations through direct cite. Even if such a capability were or could be made available, it is not clear whether greater efficiency, cost savings, or enhanced safeguards would result.

b. DSCA Response to Recommendation B: Non-concur. This recommendation requires legislative changes. The Congress would have to expressly authorize and appropriate Foreign Operations Appropriations and direct that such funds be used for the support of DoD programs. We find it highly unlikely that the State Department would support using limited FMF resources to provide administrative support for programs that have been widely defended as properly funded DoD activities. The limited FMF appropriation could not support the level of funding that would be required to sustain the non-FMS programs in Iraq and Afghanistan. The level of funding from these two programs is greater than the amount of FMF provided for all but a few countries.

We request that you review our comments and incorporate our factual corrections into the final version of the report prior to publication. If you would like to meet with my staff to review these comments, please contact our audit focal point, Marge Webb, (703) 601-3741, margaret.webb@dscamil.



Jeffrey A. Wieringa
Vice Admiral, USN
Director

**DoDIG, Draft Report, Project No. D2007-D00FD00198.000,
“Funds Appropriated for Afghanistan and Iraq Processed Through the Foreign
Military Sales Trust Fund”**

This document provides the Defense Security Cooperation Agency (DSCA) response to the draft audit report referenced above. DSCA non-concurs with the findings and recommendations within this report as specified below. The response is provided in sections corresponding to those found on the draft report.

INTRODUCTION – “BACKGROUND” PARAGRAPHS

1. The first paragraph under “Background” (page 1). The statement is made that the FMS Program is accomplished in two basic ways --- through either cash purchases or Foreign Military Financing (FMF). This is not correct. These are actually two types of funding rather than two methods of executing FMS. The method of execution is basically the same whether the case is financed with cash or with FMF. As set out in law and regulation, the two ways of executing FMS cases are (a) sales from stock, and (b) procurement by contract. At a minimum, we recommend the wording be changed to state “The FMS program is generally funded in two basic ways . . .”

2. The second paragraph under “Background” (page 1).

a. The statements about the FMS Trust Fund are not correct in that they are incomplete. As explained previously, the FMS Trust is only a single account at the U.S. Treasury level. At the DoD level, it consists of over 330 separate accounts as shown on the FMS General Ledger made available by both DSCA and DFAS. For clarification, we recommend the first sentence of this paragraph be changed to read “The FMS Trust Fund is a single account only at the U.S. Treasury level. At the DoD level, it consists of over 330 separate subaccounts that provide for the segregation and separate management of funds deposited by 206 foreign countries and international organizations and U.S. appropriations transferred to the Trust Fund.”

b. This paragraph inaccurately states that “As articles and services are requested, funds are allocated to cases established in the FMS Trust Fund . . .” Cases are not established in the FMS Trust Fund awaiting requests for articles and services as implied in this paragraph. What is correct: A customer’s request for articles and services prompts the creation of a Letter of Offer and Acceptance (LOA) that, when signed and

implemented, creates a case. An accurate description of the process would be “When an FMS customer requests defense articles and services, a Letter of Offer and Acceptance (LOA) is written that, when signed by the customer and the United States, documents the agreement and the standard and, as appropriate, special terms and conditions under which authorized defense articles and services will be provided. A signed and implemented LOA creates obligation authority that supports requisitions against DoD stock or procurement by contract. An integral part of each LOA is a payment schedule identifying the expected amounts and timing of customer payments to the USG. A customer’s payments are deposited into the Trust Fund into sub-accounts that segregate them from the deposits of other customers and restricts the use to each individual customer. Appropriated funds are segregated in the same way, by appropriation, by country or program, and by case. The financial accounting system tracks all funding until all deliveries are completed and the case is reconciled and closed.”

3. Third paragraph under “Background” (page 1). Recommend the last sentence in this paragraph be amended to “. . . and has long provided for subaccounts that are used to separate foreign deposits from U.S. appropriated funds that the Congress has provided to fund foreign military and security assistance.”

Page 2

4. Fifth paragraph under “Background” (page 2). No abuses or improprieties have been identified with regard to the use of the Economy Act to support the programs examined by this audit. We recommend deleting the three sentences beginning with the phrase “Because of previous abuses . . .” The discussion of unspecified previous abuses are not related to this report, its findings or recommendations, and thus casts an impression that is not accurate, fair, or balanced.

Revised

5. Seventh paragraph under “Background” (page 2).

a. For clarity, we recommend the second sentence should be expanded to include why these cases are considered “non-FMS.” Recommend the second sentence be reworded as follows: “Because the Department of Defense is the purchaser and the transaction does not require the recipient foreign government’s agreement or funding, these DoD funded cases are designated “non-FMS” although these are transfers subject to the Arms Export Control Act (AECA).”

Revised

b. The third sentence incorrectly states that the “pseudo identifier” is comprised of a “pseudo” country code and a “pseudo case designator.” There is no such thing as a

pseudo case designator. We recommend the word “pseudo” be deleted when referring to the case designator.

c. The fourth sentence in this paragraph is also incorrect. We recommend the fourth sentence in this paragraph be changed to clarify that these cases are processed using existing data systems and processes. Corrected wording should read: “DSCA and the Military Departments process these pseudo cases using the same data and financial systems and processes as FMS cases. One major exception is that the LOA is not signed by the country receiving the articles and services because the Purchaser is the United States, not a foreign government.”

Revised

6. Eighth paragraph under “Background” (page 2). This paragraph states that once (i.e., after) an LOA is established, DSCA assigns an Implementing Agency the responsibility of implementation. This is not correct. The Implementing Agency actual provides the data needed to prepare the LOA and so is “assigned” up-front in the process --- not after the LOA is established. We recommend this paragraph be reworded as follows: “An Implementing Agency is responsible for providing data required to write the LOA. Once the LOA is offered, signed, and implemented, stock requisitions may be processed and procurement contracts may be awarded. The Implementing Agency is responsible for overall management of the actions which will result in delivering the defense articles and services specified in the LOA.”

Revised, Page 3

7. Ninth and final paragraph under “Background” (page 2). This paragraph discusses the DFAS role in performing accounting, billing, disbursing, and collecting functions. It does not acknowledge that accounting and related functions are also performed by the Military Departments using various MILDEP financial and accounting systems. These additional systems provide data to the MILDEP FMS systems which then provide the data to DIFS. For clarification, we recommend this paragraph be changed to read as follows: “. . .for the Security Assistance Programs. DFAS uses the applicable Military Department (MILDEP) accounting and financial management systems. These systems provide data to the MILDEP FMS system which then provides data to DIFS. DFAS Indianapolis uses the DIFS as the departmental-level central accounting system for billing the FMS customer and reporting the financial status of funds in the FMS Trust Fund.

Revised, Page 3

FINDING A. TRANSFER OF APPROPRIATED FUNDS

DSCA non-concurs with this finding for reasons stated below.

1. Introductory Paragraphs (page 3). This section states that transfer of \$6.5 billion of appropriated funds for support of Afghanistan and Iraq military and security forces in the FMS Trust Fund did not meet the requirements of the Economy Act and that this transfer and commingling of funds was not in the best interest of the Government. DSCA non-concurs with that assessment for the following reasons:

a. DSCA did collect \$6.5 billion of appropriated funds for the support of Afghanistan and Iraq military and security forces into the FMS Trust Fund. Funding was transferred from the U.S. Army (on occasion funds were sub-allocated from any Military Department in the case of directed drawdowns) to DSCA to carry out “pseudo” cases using the FMS system. The office of the DoD General Counsel, Deputy General Counsel (Fiscal) has opined that the transactions supporting Iraq met the preconditions for the Economy Act, title 31 U.S.C. section 1535. By memo dated 26 July 2005, Gordon England directed that “ASFF distribution and accounting support to the CFC-A” be done through the Defense Security Cooperation Agency. This mandate has been repeated in subsequent directions. Since the FMS system is the only process in DSCA that is available for distribution and accounting support for defense articles and services, it was the judgment of DoD that the FMS system was an appropriate vehicle for ASFF transactions. DSCA has been provided no economic analysis in this paper or from other sources to suggest that a more economical process is available.

b. The FMS Trust Fund is a single Treasury account designed to hold funds received for FMS programs. While it is true that the Trust Fund was not designed to manage expiring appropriated funds, DSCA has developed methods to segregate in separate subaccounts and ensure the appropriate management of these funds with their unique requirements. As discussed previously, DSCA has developed a series of “pseudo” country codes to identify specific funding authorization types. Unique clauses are also included in LOA documents to ensure funding restrictions are clear.

c. It is incorrect to state that the funds in the Trust Fund are “commingled.” The funds deposited into the FMS Trust Fund are controlled at several levels. There are separate subaccounts for various administrative and cost clearing accounts. Country or “pseudo” case funds are accounted for via separate subaccounts for each country or

“pseudo” –type of funding. “Pseudo” case funding is separated by purpose/country benefiting from the transaction, and by funding “life.”

d. This section inaccurately states “In addition, the transfer increased the costs of acquiring goods and services because DSCA collected administrative fees for funds processed in the FMS Trust Fund.” There are two fundamental inaccuracies with this statement.

(1) First, the FMS processes and workforce are paid for by FMS customers through the assessment of the Administrative Surcharge which is mandated by law. This FMS-funded workforce cannot acquire defense articles and services for non-FMS programs without charging and recovering the costs of that work from the DoD or USG entity ordering the non-FMS work. To do the work without charge would improperly augment the appropriations of that entity and create a potential Anti-deficiency Act violation. Further, administrative surcharge collections from international customers are not legally available to pay for such work.

(2) Second, there is no analysis provided to show that the costs of acquiring these goods and services through some other means or through some other agency or component would be less expensive than using the FMS system and using the administrative surcharge percentage as the best estimate of the costs of the work. Any other means or method of support would require some recovery of the actual or estimated costs of the work – so it is very misleading to let the reader conclude that the cost of using other alternatives would be \$0.

e. The sentence regarding direct cite of appropriated funds is incorrect and should be deleted. The “pseudo” country codes and separate subaccounts ensure proper control of expiring funds. The financial systems used to execute FMS are not designed for ordering, delivering, and billing multiple appropriations using direct fund cites. Any modifications to existing Security Assistance data systems to enable direct cite of appropriated funds would require additional appropriated funds to support the system changes required.

2. Appropriations Transferred Paragraphs. The second paragraph incorrectly states that “DSCA personnel transferred funds from various DoD appropriations to the FMS Trust Fund to be used . . .” Throughout this report, the word “transferred” is used to describe DSCA actions without further clarification that these actions involved more entities than

just DSCA and reflected a collection into the account for work to be provided. In this particular paragraph, we would recommend the wording be changed to state “DoD account holders suballocated funds from DoD appropriations to DSCA, which placed them into the FMS Trust Fund to be used. . .”

3. Justification for Transfer Paragraphs.

a. In response to questions from the DoDIG in regards to justification for the transfer of these funds, DSCA General Counsel submitted a December 18, 2007 memorandum. This memorandum (included in this version of the DoDIG draft report) specifically identified the funds and the laws that permitted the transfer. The transfers of funds and use of the FMS process was directed and authorized by the Deputy Secretary of Defense through the Secretary of the Army and the Commander, MNSTC-I.

b. The second paragraph in this section incorrectly states that these funds were “. . . commingled with other funds in the FMS Trust Fund . . .” All funds deposited or transferred into the FMS Trust Fund are placed in separate accounts that ensure funds are not commingled.

c. A July 26, 2005 memorandum from the Deputy Secretary of Defense is cited in the draft report. The draft report states that the memorandum “. . . did not provide clear direction for DSCA to use the FMS Trust Fund to account for these funds. DSCA manages other appropriations without using the FMS Trust Fund, for example, the International Military Education and Training program; therefore, DSCA can also manage the non-FMS funds without using the FMS Trust Fund.” DSCA non-concurs with DoDIG assessment and interpretation of the DEPSECDEF memorandum and its direction. There is no basis in fact for this conclusion. The execution of the ISFF and ASFF funded programs have been regularly and frequently briefed at the highest levels in DoD.

(1) The FMS process is the only process in DSCA that is available for ordering, procuring, delivering, billing, paying, and accounting for defense articles and services. It was the judgment of the Deputy Secretary and others that the FMS system would be used for ASFF transactions.

(2) Although DSCA manages other appropriations as cited (e.g., IMET), it does not and cannot manage such non-FMS funds without using the FMS Trust Fund.

DSCA's functions in managing the IMET program are summarily those of a fund manager. DSCA issues (allots) funds to the MILDEPs for their execution and reporting of the program.

(3) The oversight requirement related to providing material and services utilizing ASFF and ISFF are more in-line with normal FMS activity. Having oversight of all aspects of providing the material, such as funding, logistics, and delivery information, requires use of the existing FMS program infrastructure. This infrastructure includes not only DFAS' DIFS, but also the MILDEP's logistics, contracting, and transportation legacy systems. Most, if not all, of these legacy systems are programmed to generate accounting information citing 97x8242 for all FMS activity. The 2-position country code is incorporated to identify the specific FMS customer. In the case of ASFF and ISFF, the country code not only differentiates the customer but also the legislation that appropriated the funds.

4. Best Interest of the Government Paragraphs.

a. In this section, the draft report again incorrectly states that "commingling" of funds occurred. As stated previously, the funds deposited into the FMS Trust Fund are accounted for in separate accounts as listed on the FMS General Ledger.

b. In the second paragraph of this section it incorrectly states that ". . .it transferred them to the FMS Trust Fund based on requests for assistance from the various U.S. commanders in Afghanistan and Iraq. . ." As mentioned above, the funds are transferred into the FMS Trust Fund only after an LOA has been signed and implemented.

c. The draft report is not correct in questioning whether the Army should be recording the funds as expended. In doing so, it emphasizes the fact that the Army records expenditures even when funds have not left the Treasury, which is not the criteria for recording expenditures. A transfer from a general or special appropriation to a trust fund is always an expenditure transfer under U.S. Treasury rules so the Army is correct in recording the funds as expended.

d. The draft report states that ". . . DIFS did the departmental-level accounting." This is not fully accurate. It is important to note that accounting for the Army Implementing Agencies is performed in SOMARDS, STANFINS, or the U.S.A. Corps of Engineers System (CFEMS).

e. In the last paragraph it states that “. . . almost \$3billion was still in the FMS Trust Fund.” As a point of fact, funds remain in the FMS Trust fund until needed for disbursement for contracted goods and services. During this period before needed for disbursement, those funds in the FMS Trust Fund are in the U.S. Treasury and considered assets by the Treasury in its calculation of receipts, outlays and deficit in the Treasury statements.

f. None of the information provided in this section demonstrates support for the statement that using the Trust Fund to support these programs is not in the best interest of the U.S. Government. This conclusion is without basis in fact or law.

5. Economical Use of Funds Paragraphs. This paragraph states that using the FMS Trust Fund “. . . initiated an increase in the cost of purchasing the goods and services DSCA collected . . .” due to assessment of administrative fees. If the draft report is alleging that using the FMS Trust Fund to manage these funds is more expensive than other means, the report needs to identify those other Agencies/processes who could have accomplished this work for less cost. The Economy Act requires full recovery of costs to providing goods and services including indirect costs. Past investigative reports have warned that Agencies providing goods and services to other Agencies must have cost procedures in place to capture full costs of the transaction.

Recommendation A: We recommend that the Director, Defense Security Cooperation Agency discontinue transferring funds appropriated for the Afghanistan Security Forces Fund and Iraq Security Forces fund to the Foreign Military Sales Trust Fund, and instead direct cite these appropriations on all future cases using these funds.

DSCA Response to Recommendation A: Non-concur. The FMS case and financial management systems, logistical delivery systems, and case closure mechanisms connect DSCA, DFAS, Implementing Agencies, and customers. The financial management and logistics tracking are the keys to fiscal accountability. DSCA does not have the system infrastructure to perform the same operations through direct cite. Even if such capability were available, it is not clear what greater efficiency, cost savings, or safeguards would be obtained as the result of this change.

FINDING B. COLLECTION OF ADMINISTRATIVE FEES

DSCA non-concurs with this finding for the reasons stated below.

1. Introductory Paragraphs.

a. This section states that DSCA “. . . collected administrative fees from appropriated funds placed into the Foreign Military Sales (FMS) Trust Fund while also receiving appropriated funds to administer these cases.” That is incorrect. The 3.8% administrative surcharge collected on all FMS and “pseudo” cases is used to support a share of the FMS program infrastructure as well as standard case management-related execution services needed to execute these cases. The Foreign Military Financing (FMF) appropriated are separate and distinct from the Administrative Surcharge funds and are provided/used for very specific purposes which do not include execution and management of FMS or “pseudo” cases.

Revised

b. The second paragraph in this section states that “Administrative funds collected on FMS cases are not available to pay for non-FMS cases. DSCA collected the fee to pay for the work involved in executing and managing non-FMs orders. . .” It would be more accurate to state that “Administrative funds collected on FMS cases are not legally available to pay for work on non-FMS cases, so DSCA established a charge to pay for the work involved in executing and managing non-FMS orders. Based on historical experience, the charge for non-FMS was established at 3.8% (currently the same rate as FMS).

Revised

c. It is incorrect to state that “. . . collecting millions of dollars in administrative fees on non-FMS programs improperly augmented their appropriation. . .” As stated above, the funds collected on FMS programs are not legally available to support work on non-FMS programs. Therefore, we are required to recover costs. This is done through a 3.8% administrative surcharge. There is no appropriation to fund these administrative costs. They are funded from the surcharge. There is a Foreign Military Financing appropriation which serves a different purpose. That should not be confused with the Administrative Surcharge.

Revised

d. We recommend the final paragraph in this section regarding contingency operations and fees collected be deleted. DSCA is specifically authorized to use the FMS

system to support contingency operations such as the ASFF and ISFF. DoD FMR Volume 12, Chapter 23, Paragraph 230307 states “DSCA is responsible for providing leased equipment, using foreign military (FMS) systems and procedures, when required to support contingency operations. DSCA is also responsible for directing the implementation of those contingency operations supported under applicable sections of the Foreign Assistance Act or Title 10, United States Code, when directed by the USD(P) to provide this support. Such support may be in response to requests from the Department of State or requests from the UN for articles and services to support equipment leased under Foreign Military Sales (FMS) procedures. DSCA is authorized to use the FMS system network to provide such support.”

2. Administrative Fee Authority Paragraphs. This section states “DSCA properly charged 2.5 percent for administrative services on FMS cases. On May 15, 2006, DSCA increased the administrative surcharge to 3.8 percent for cases that were accepted on or after August 1, 2006.” The wording of this paragraph implies that the 2.5 percent rate was “proper” but the 3.8 percent charge is not. We do not believe that was the intent of the author and recommend the wording be changed to read: “The current administrative surcharge rate is 3.8%. For cases implemented prior to August 1, 2006, the rate was 2.5% or 3.0% depending on the date of implementation.”

3. Foreign Military Financing Administrative Cost Account Paragraphs.

a. In the first sentence of the first paragraph in this section, we recommend that the phrase “. . . sales for non-FMS Programs.” be changed to read “. . . sales for non-FMS Programs authorized under the AECA and FAA.” for clarity.

b. The statement “We found several instances where it appears DSCA received appropriated funds and collected administrative fees for the same work.” is not supported by any analysis in the report. DSCA is not receiving appropriated funds and collecting administrative fees for the same work. A Security Assistance Organization (SAO) is authorized under the FAA and AECA and DSCA used General Costs of Administration FMF funds appropriated in the International Affairs Budget Function to support this office. Because the Iraq Security Forces Fund program is not part of the International Affairs Budget request and is not part of the FMS program, DSCA is required to collect 3.8 percent surcharge on cases processed through the FMS system for future Iraq orders. Iraq cases funded with Iraq national funds are true FMS cases and are also assessed the 3.8 percent surcharge as required by the AECA.

Revised

Removed

Removed

c. The word “additional” should be deleted from the phrase “. . . DSCA collected an additional \$196 million in administrative charges directly from. . .” The \$196 million in administrative charges should not be considered together with the FMF monies received. They are for different purposes and received based on different authorities. The current wording implies that these duplicate each other --- they do not.

Removed

d. DSCA is not augmenting its appropriations from outside sources as stated in the final paragraph of this section. DSCA has specific authority to collect administrative fees from cases processed for the FMS program. DSCA has no authority to use funds from the General Costs of Administration FMF appropriation to fund work performed under programs not authorized by the AECA and FAA. Therefore DSCA must recoup its costs of administering non-FMS cases not performed under the authority of the AECA and FAA. In order for this General Cost of Administration funding to be available for purposes other than support of AECA and FAA authorized programs, the Secretary of State would have to request that these funds be made available for Title 10 purposes as part of the annual budget process.

Removed

4. Contingency Operations Paragraphs. We recommend this section be deleted. See our response to 1.d. of the “Introductory Paragraph” of this section.

Recommendation B. We recommend that the Director, Defense Security Cooperation Agency discontinue collecting administrative fees on non-Foreign Military Sales Programs and include all administrative costs for these programs as part of the budget for the Administrative costs Account in the Foreign Military Financing appropriation submitted by the Department of State.

Revised

DSCA Response to Recommendation B: Non-concur. This recommendation requires a legislative change. This change would direct the use of Foreign Operations Appropriations to support DoD programs. We find it highly unlikely that the State Department would use its limited FMF resources to provide administrative support for programs that have been widely defended as properly funded DoD activities. The limited FMF appropriation could not support the level of funding that would be required to sustain the non-FMS programs in Iraq and Afghanistan. The level of funding from these two programs is greater than most FMF recipients.

Appendix A. Scope and Methodology

1. Review of Internal Controls Paragraph. This paragraph incorrectly states: “It is DSCA policy not to collect administrative fees on funds placed in the FMS Trust Fund for contingency operations. However, they collected fees on ASFF and ISFF cases supporting the Iraqi Armed Forces and Afghan National Army, both considered contingency operations, according to the DoD FMR.” These sentences should be deleted as they are not true statements. DSCA authority to use the FMS system (which includes assessment of an administrative surcharge) to support contingency operations is in the DoD FMR, Volume 12, Chapter 23, paragraph 230307.

2. Use of Technical Assistance Paragraph. This sentence should be amended to add the phrase “. . . and ASFF and ISFF-funded non-FMS cases.” These cases should also have been reviewed as part of the audit.

Page 1

Revised

Defense Security Cooperation Agency Comments, December 15, 2008



DEFENSE SECURITY COOPERATION AGENCY
201 12TH STREET SOUTH, STE 203
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DEC 15 2008

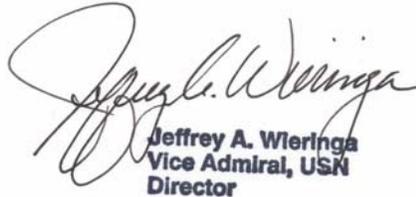
MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL,
DEFENSE BUSINESS OPERATIONS

SUBJECT: Response to Client Comments, Funds Appropriated for Afghanistan and Iraq
Processed Through the Foreign Military Sales Trust Fund

Reference: DoD Office of the Inspector General, Responses to Client Comments,
Funds Appropriated for Afghanistan and Iraq Processed Through the
Foreign Military Sales Trust Fund (Project No. D2007-D00FD-198.000),
dated December 4, 2008

Thank you for the opportunity to review and provide comment on the subject
response to our initial audit comments. I have reviewed your assessment of DSCA's
initial response and our comments are attached.

Unfortunately, DSCA still does not agree with the conclusions and
recommendations within the report. My staff is scheduled to meet with representatives
from your staff to discuss this audit and our concerns prior to your publication of the final
report.


Jeffrey A. Wieringa
Vice Admiral, USN
Director

Attachment
As stated

**DoDIG, Draft Report, Project No. D2007-D00FD00198.000,
“Funds Appropriated for Afghanistan and Iraq Processed Through the Foreign
Military Sales Trust Fund”**

INTRODUCTION – “Background” Paragraphs

1. We stand by our original comments. The audit response disagrees with our statements and cites the FMS customer Financial Management Handbook. The document cited is a training guide – it is not a policy document and should not be used as such. We have reviewed the page cited in your audit response and can not find any statements on page 3 regarding execution methods as cited in your response.

2.a. We stand by our original comments. The addition of information about the subaccounts is not redundant and makes important points regarding separation of funds and that funds are not co-mingled.

2.b. We stand by our original comments. Cases are not established in the Trust Fund. The wording in the SAMM (referenced in your audit response) is dealing with payments regarding “implemented” cases which is accurate.

3. We stand by our original comments and respectfully request that our proposed change be included in the report. Information regarding subaccounts is important in understanding separation of funds and that funds are not co-mingled.

4. We stand by our original comments. As a minimum, for accuracy, fairness, and balance, the report should be clear that none of these abuses or improprieties were found at DSCA. As currently worded, the reader might assume these problems were found as part of this audit work and they were not.

5.a. We concur with your agreement to add additional wording. We recommend you use the wording provided in our 27 October 2008 response.

5.b. The audit response correctly quotes verbiage currently in the SAMM, paragraph C5.4.11.1.1. regarding “pseudo” identifiers and designators. Unfortunately, that wording is not accurate with regard to “pseudo” designators. We will take action to correct that statement in the SAMM. Our comments provided 27 October 2008 are correct and the word “pseudo” should be deleted before the word designator.

5.c. We stand by our original comments. We concur with your agreement to add additional wording regarding use of security assistance systems. We recommend you use the wording provided in our 27 October 2008 response.

6. We stand by our original comments. DSCA does not “assign the work” on a case-by-case basis as indicated in your latest audit response. We continue to recommend you use the wording provided in our 27 October 2008 response to update this paragraph.

7. We concur with your agreement to add additional wording. We recommend you use the wording provided in our 27 October 2008 response.

Finding A. Transfer of Appropriated Funds

1.a. We stand by our original comments. DSCA/OGC memorandum 18 Dec 07 to the DoDIG explained that the Deputy Secretary of Defense directed that the Under Secretary for Defense (Comptroller) release ASFF budget authority to the Assistant Secretary of the Army for Financial Management and Comptroller. He assigned responsibility to the Secretary of the Army for providing fund distribution and accounting support to the Commander, Combined Forces Command Afghanistan (CFC-A) through DSCA. Further, we disagree with the additional comments in the latest audit response regarding cost of processing at DFAS and within the DIFS data system. DSCA pays DFAS to perform accounting services. These payments are not made on a case-by-case basis. It is not accurate to assume that the annual amount of DIFS processing costs are increased by the addition of specific numbers of cases being managed through the system.

1.b. We stand by our original comments.

1.c. We stand by our original comments. It is incorrect to state that the funds in the Trust Fund are “commingled.” They are controlled at several levels as discussed in our comments provided 27 Oct 08.

1.d. (1). We stand by our original comments. The report continues to confuse two sets of funding streams. Activities funded using FMF Administrative monies are not the same as those funded by the FMS Administrative Surcharge.

1.d.(2). We stand by our original comments. We do not pay DFAS on a transaction-by-transaction basis. It is not accurate to assume that the annual amount of DIFS processing costs are increased by the addition of specific numbers of cases being managed through the system. Again, there is no data or analysis in the report showing either (1) specific additive costs incurred by using the FMS system or (2) specific costs and/or savings that would be achieved if some other system were used to execute these programs.

1.e. We stand by our original comments. The latest audit response does not identify what “existing systems” should be used instead of DIFS.

2. We stand by our original comments. These funds were not DSCA funds and we did not transfer them to ourselves. We continue to recommend the wording provided in our 27 Oct 08 response be used to clarify this paragraph.

3.a. We stand by our original comments.

3.b. We stand by our original comments. Funds are not commingled with other funds in the Trust Fund. They are placed in separate accounts that ensure funds integrity.

3.c. We stand by our original comments.

3.c.(1). We stand by our original comments. "FMS system" in the context of our response was not referring to a data system, but rather to the FMS process and procedures which include ordering, procuring, delivering, billing, paying, and accounting.

3.c.(2). We stand by our original comments. There is no empirical, qualitative, or quantitative analysis included in this audit report that would support using other than Trust Fund to manage these programs.

3.c.(3). We stand by our original comments.

4.a. We stand by our original comments. Funds are not commingled with other funds in the Trust Fund. They are placed in separate accounts that ensure funds integrity.

4.b. We stand by our original comments. The latest audit response does provide a clearer explanation of how requests are made (e.g., from Memorandums of Request to implemented LOAs). That information should be included within the report itself for clarity.

4.c. We stand by our original comments.

4.d. We stand by our original comments. There are many data systems that perform accounting functions and feed information into DIFS.

4.e. We stand by our original comments.

4.f. We stand by our original comments. There is no empirical, qualitative, or quantitative analysis included in this audit report that would support using other than Trust Fund to manage these programs.

5. We stand by our original comments. The words in the draft audit specifically state that using the Trust Fund ". . . initiated an increase in the cost. . ." Again, there is no data or analysis in the report showing either (1) specific additive costs incurred by using

the FMS system or (2) specific costs and/or savings that would be achieved if some other system were used to execute these programs. We do not pay DFAS on a transaction-by-transaction basis. It is not accurate to assume that the annual amount of DIFS processing costs are increased by the addition of specific numbers of cases being managed through the system.

Recommendation A. We continue to non-concur with this recommendation.

Finding B. Collection of Administrative Fees

1.a. We stand by our original comments. The FMS Administrative Surcharge is collected and used for different activities from those provided using FMF Administrative funds. The wording in the Congressional Budget Justification regarding “non-FMS segments” is referring to non-case related activities and activities under the FAA. These are not the same activities performed in executing FMS and FMS-like cases.

1.b. We stand by our original comments. We continue to recommend the wording provided in our 27 Oct 08 response be used to clarify this paragraph.

1.c. We stand by our original comments. The audit continues to confuse activities supported through collection of the FMS Administrative Surcharge and those supported using FMF Administrative monies. We are permitted by law and regulation to recover our best estimate of actual costs and we do so using the 3.8% estimate.

1.d. We stand by our original comments.

2. We agree with your recommended change to the report to delete the word “properly.”

3.a. We agree with your recommended change to add the phrase “authorized under the AECA and FAA.”

3.b. We stand by our original comments. The audit continues to confuse activities supported through collection of the FMS Administrative Surcharge and those supported using FMF Administrative monies.

3.c. We stand by our original comments. The audit continues to confuse activities supported through collection of the FMS Administrative Surcharge and those supported using FMF Administrative monies. The word “additional” should be deleted as requested in our original response.

3.d. We stand by our original comments.

4. We stand by our original comments. We continue to recommend deletion of this section.

Recommendation B. We continue to non-concur with this recommendation.

Appendix A. Scope and Methodology

1. We stand by our original comments. It is true that DSCA does not charge 3.8% on cases established for Presidential Drawdowns using the S9 country code. That does not mean that DSCA has a policy not to collect administrative fees on funds placed in the FMS Trust Fund for contingency operations. These statements should be deleted as requested in our original comments on 27 Oct 08.

2. We agree with your recommendation to add “non-FMS” to the sentence discussed in this paragraph.



Inspector General Department of Defense

