Audit Report

OFFICE OF THE INSPECTOR GENERAL

QUICK-REACTION REPORT ON THE F-16 MULTINATIONAL FIGHTER PROGRAM CASE CLOSURE PROCESS

Report No. 95-304

September 11, 1995

Department of Defense

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Acronyms

AFR	Air Force Regulation
ASC	Aeronautical Systems Center
DCAA	Defense Contract Audit Agency
DSAA	Defense Security Assistance Agency
EPG	European Participating Governments
FMS	Foreign Military Sales
LOA	Letter of Offer and Acceptance
MNFP	Multinational Fighter Program
SPO	System Program Office

INSPECTOR GENERAL
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September 11, 1995

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

SUBJECT: Quick-Reaction Report on the F-16 Multinational Fighter Program Case Closure Process (Report No. 95-304)

We are providing this quick-reaction report for review and comment. Management comments on a draft were considered in preparing the final report. We performed the audit in response to a request from the Supreme Audit Institutions of Belgium, Denmark, the Netherlands, and Norway. We are providing this quick-reaction report because the Office of the Deputy Under Secretary of the Air Force (International Affairs) and the F-16 System Program Office will not be able to close the F-16 Multinational Fighter Program cases for the European Participating Governments by December 1997. The current U.S. commitment to case closure by that date needs to be reconsidered before an upcoming conference with the participating countries in September 1995.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments, we deleted draft Recommendation 1.a. and redirected draft Recommendation 3.a. Therefore, we request that the Air Force provide additional comments on the unresolved recommendation by November 13, 1995.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Evelyn R. Klemstine, Audit Program Director, at (703) 604-9172 (DSN 664-9172) or Mr. Robert W. Otten, Audit Project Manager, at (703) 604-9177 (DSN 664-9177). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 95-304
(Project No. 5LG-0015)

September 11, 1995

Quick-Reaction Report on the F-16 Multinational Fighter Program Case Closure Process

Executive Summary

Introduction. This quick-reaction report is the first of two reports resulting from the Audit of Contract Prices for the F-16 Multinational Fighter Program. The European Participating Governments of Belgium, Denmark, the Netherlands, and Norway participated in the F-16 Multinational Fighter Program, a foreign military sales cooperative program with the U.S. Air Force, to procure and produce 998 F-16 aircraft, 650 for the U.S. Air Force and 348 for the European Participating Governments. This report is being provided because the Air Force, based on the premise of contractual financial closure prior to case closure, will not be able to close the 4 European Participating Governments cases and 172 subcases, initiated in 1975 and valued at about $5.4 billion, by December 1997, the date to which the United States is currently committed.

Audit Objectives. The primary audit objective was to determine whether the European Participating Governments paid equitable prices for the F-16 airframes and engines based on the provisions of the memorandum of understanding. In addition, the audit reviewed the management control program to ensure that all provisions of the memorandum of understanding were met. The specific objective for this segment of the audit was to determine whether adequate planning and coordination existed to complete case closure by the December 1997 commitment date. The primary audit objective will be discussed in a subsequent report.

Audit Results. The Office of the Deputy Under Secretary of the Air Force (International Affairs) and the F-16 System Program Office have not put sufficient emphasis on closing the four European Participating Governments cases for the F-16 Multinational Fighter Program buy. The F-16 SPO took the position that all contracts must be completely closed before case closure. Additionally, the case manager assigned to the Deputy Under Secretary's office did not prepare a case master plan. As a result, the U.S. Air Force cannot meet the case closure commitment date of December 1997.

Review of the management control program disclosed material weaknesses in the Air Force implementation of contract and case closure procedures (Appendix A). Implementation of the recommendations will increase management oversight, improve planning, and expedite the case closure process for the F-16 Multinational Fighter Program. See Part I for a discussion of the audit results and Appendix B for a summary of the potential benefits resulting from the audit.

Summary of Recommendations. We recommend that the Air Force develop additional procedures, plans, and management controls to improve case closure oversight and improve the case closure process for the F-16 Multinational Fighter Program and propose the use of accelerated case closure procedures at the

September 1995 Supreme Audit Institutions conference. We also recommend that the F-16 System Program Office develop milestones for case, subcase, and contract closure.

Management Comments. The Air Force provided a consolidated Air Force response reflecting comments from the Assistant Secretary of the Air Force (Acquisition), Deputy Under Secretary of the Air Force (International Affairs), and F-16 System Program Office. The Air Force concurred with all but two recommendations. The Air Force nonconcurred with the recommendation to assign a case manager, stating that the Deputy Under Secretary of the Air Force (International Affairs) had already designated a case manager for the F-16 Multinational Fighter Program. Although the Air Force nonconcurred with the recommendation for the F-16 System Program Office to prepare a case master plan, it concurred with the intent of the recommendation. The Air Force believed the recommendation should be readdressed to the Deputy Under Secretary of the Air Force (International Affairs) because the case manager is responsible for preparing the case master plan. A complete discussion of management comments and audit responses is in Part I and the complete text of the managements' comments is in Part III.

Audit Response. The Air Force comments were responsive. As a result of the Air Force comments, we deleted the recommendation to assign a case manager and redirected the recommendation on preparing the case master plan to the Deputy Under Secretary of the Air Force (International Affairs). We request that the Air Force provide comments on the redirected recommendation and provide an implementation date for all proposed actions by November 13, 1995.

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Part I - Audit Results

Audit Background

F-16 Multinational Fighter Program. This audit was requested by the Supreme Audit Institutions of Belgium, Denmark, the Netherlands, and Norway. In 1975, the U.S. Air Force entered into a foreign military sales (FMS) arrangement with the European Participating Governments (EPG) of Belgium, Denmark, the Netherlands, and Norway to procure and produce F-16 aircraft under the cooperative program known as the F-16 Multinational Fighter Program (MNFP). Under the program, the U.S. Air Force procured 650 F-16 aircraft and the EPG procured 348 F-16 aircraft. Governed by a June 10, 1975, memorandum of understanding, the F-16 MNFP involves a cost-sharing, pricing, and coproducing arrangement between the U.S. Air Force and the EPG. The memorandum of understanding provides the framework for implementing the Letter of Offer and Acceptance (LOA)[1] signed by the U.S. Air Force and the EPG. The F-16 MNFP for the EPG nations consists of four LOA cases, one each for Belgium, Denmark, the Netherlands, and Norway.

Case Closure Commitment Date. The F-16 System Program Office (SPO) has committed to closing the four LOA cases by December 1997. At the Supreme Audit Institutions conference[2] in 1985, representatives of the F-16 SPO stated that the F-16 MNFP cases would be closed in 1992. However, that date was changed in subsequent years, first to 1993, then to 1995, and most recently to the current commitment date of 1997. The last F-16 aircraft was delivered in 1985 and the EPG are dissatisfied that it will have taken 12 years between delivery of the last F-16 aircraft and closure of the F-16 MNFP cases.

Management of the F-16 MNFP Buy. The Office of the Deputy Under Secretary of the Air Force (International Affairs) is responsible for signing the Case Closure Certificates for the F-16 MNFP cases. The Aeronautical Systems Center (ASC), specifically the F-16 SPO and the Propulsion SPO located at Wright-Patterson Air Force Base, is responsible for providing documentation to the Office of the Deputy Under Secretary of the Air Force (International Affairs) to support the Case Closure Certificates. The F-16 SPO procured the F-16 airframe and supporting equipment; however, the engines were procured by the Propulsion SPO. In addition to Air Force management of the F-16 MNFP, the memorandum of understanding requires the establishment of committees to implement, oversee, and monitor the program.

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[1]An LOA is a contract between the U.S. Government and a foreign government, whereby the foreign government agrees to allow U.S. Government representatives to act on its behalf to procure defense articles and services. The LOA provides the basic information and authority for an FMS case and lists the articles and services, estimated costs, and the terms and conditions of the sale.

[2]A conference held by representatives of the Auditors General of the United States and EPG to exchange experiences in auditing the F-16 MNFP.

F-16 MNFP Steering Committee. The F-16 MNFP Steering Committee is responsible for broad policy matters, advice, and counsel to the Commander, F-16 SPO. The Steering Committee is tasked with monitoring the performance of all contractors under the F-16 MNFP but is not involved in the day-to-day aspects of the case closure process.

F-16 MNFP Contractual and Financial Subcommittee. In 1975, the F-16 MNFP Steering Committee established the F-16 Contractual and Financial Subcommittee to identify and take action on any contractual, legal, or financial problems arising under the F-16 MNFP. The F-16 MNFP Contractual and Financial Subcommittee briefs the Steering Committee at least semiannually on issues, including case closure status, but the subcommittee is not involved in the day-to-day operations of the case closure process.

Case Closure Working Group. To expedite the case closure process, the F-16 SPO established a Case Closure Working Group in October 1988. The purpose of the Case Closure Working Group is to instill a spirit of cooperation, establish focal points, develop "work smart" methods, organize a discussion forum, and track case closure status. The Case Closure Working Group monitors contract closure activities and reports on those activities to the F-16 Contractual and Financial Subcommittee. However, the Case Closure Working Group has no formal authority outside the SPO and cannot direct other Air Force and DoD organizations to close related F-16 MNFP contracts.

Audit Objectives

The primary audit objective was to determine whether the EPG paid equitable prices for the F-16 airframes and engines based on the provisions of the memorandum of understanding. In addition, the audit reviewed the management control program to ensure that all provisions of the memorandum of understanding were met.

The specific objective for this segment of the audit was to determine whether adequate planning and coordination existed to complete case closure by the December 1997 commitment date. See Appendix A for a discussion of the audit scope, methodology, and prior coverage related to the audit objective. See the finding for a discussion of the material management control weaknesses identified and Appendix A for the details of our review of the management control program.

Closing the European Participating Governments F-16 Cases

The Office of the Deputy Under Secretary of the Air Force (International Affairs) and the F-16 SPO have not put sufficient emphasis on closing the four cases of the EPG for the F-16 MNFP buy, valued at about $5.4 billion. The F-16 SPO took the position that all contracts must be completely closed before any case can be closed under standard case closure procedures and the case manager assigned to the Deputy Under Secretary's office did not prepare a case master plan. Additionally, the ASC and other DoD organizations that issued contracts in support of the F-16 MNFP did not retain all financial records needed for case closure. As a result, the U.S. Air Force cannot meet the case closure commitment date of December 1997.

Policies and Procedures for the Case Closure Process

DoD Policies and Procedures. DoD Manual 5105.38-M, "Security Assistance Management Manual," October 1, 1988 (the Security Assistance Manual), does not preclude an FMS case from being closed before contracts issued in support of the case are closed. The Security Assistance Manual states, "It is no longer necessary that cases remain unclosed on active files for years after full delivery of articles and services because contract overhead, renegotiating of profit, and similar costs are not finalized." Although the guidance states, under standard case closure procedures, that cases can be closed after full delivery but before final costs are determined; this guidance has not been consistently disseminated. A DSAA message, "Update on Revised Case Closure Procedures," March 26, 1992, states:

> Currently, FMS cases cannot be closed until all costs have been determined and charged to the customer. When FMS cases are supported with contracts, final costs are not known until the supporting contract(s) are closed, even though a specific FMS may have been supply complete (all material and services provided to the customer) long before. The revised procedures [accelerated case closure procedures] are intended primarily for FMS cases supported by long running contracts. Contracts typically support both U.S. forces and FMS customer requirements and contract closure cannot begin until the final ordered material/service has been delivered/performed by the contractor, the Defense Contract Audit Agency has performed the final audit, and the contract administration office has negotiated the final contract price. These negotiations are normally for the general and administrative (overhead) rates of the contractor. When this process is completed, which can take five or more years, the final contract price is determined and distributed among all customers of the contract. Only at this time can the FMS case be closed.

The Security Assistance Manual requires that all costs be reimbursed by the FMS customers to the U.S. Government. The DSAA maintains that final costs to the FMS customers cannot be known until the contracts are closed.

The Security Assistance Manual requires the implementing agency[3] to assign a case manager to each LOA no later than the LOA implementation date. The case manager is responsible for all management aspects of the LOA, including preparing the case master plan, developing a financial and logistics management plan, maintaining a complete chronological history of the case, ensuring that Defense Finance and Accounting Service and implementing agency records are in agreement, ensuring that case records are maintained, and ensuring that schedules are accurate and timely. The case manager is also responsible for ensuring that all articles and services are provided on schedule within the stated case value and the case is closed out as planned.

Air Force Regulations. Air Force Regulation (AFR) 130-1, "Security Assistance Management," December 16, 1991, sets FMS policy for the Air Force. That regulation states that all contracts must be financially closed before an FMS case can be closed. AFR 130-1 also provides procedures to close FMS cases when there are contracts that are still open. AFR 130-1 states that a case closure certificate is prepared, "After the line is supply/service complete, financially complete, reconciled, and all outstanding RODs [reports of discrepancies] processed . . . ." AFR 130-1 also requires that case line managers perform reviews of open contract lines to ensure timely closure and deobligation of unused funds. It states:

> For FMS cases on which final deliveries of material and services has occurred, yet the contract remains open, line managers should contact the contracting officer to examine the possibility of contract closure or re-evaluation of funds obligations. If a case is ready for closure with the exception of an open contract, and the only unresolved issues are unquantified final overhead costs; i.e., profit, general, and administrative charges, which have not been billed or paid, or final audited and there is no outstanding litigation on the case, the line manager should solicit a best final estimate of the contract cost from the contracting officer. The contracting officer should be requested to deobligate any excess funds.

Although AFR 130-1 provides procedures to close a case with an open contract, implementation is apparently left to the discretion of the line manager. An official in the Office of the Deputy Under Secretary of the Air Force (International Affairs) stated, "We cannot finalize contract costs until the contract itself is closed."

AFR 130-1 states that the Office of the Deputy Under Secretary of the Air Force (International Affairs) is the office primarily responsible for the central management, direction, guidance, and supervision of most FMS programs

[3]The implementing agency for the F-16 MNFP is the U.S. Air Force.

assigned to the Air Force to include the case closure process. Case managers are assigned to the Office of the Deputy Under Secretary of the Air Force (International Affairs).

Managing the Case Closure Process

The Office of the Deputy Under Secretary of the Air Force (International Affairs) and the F-16 SPO have not put sufficient emphasis on closing the four cases of the EPG for the F-16 MNFP buy. The Office of the Deputy Under Secretary of the Air Force (International Affairs) was ultimately responsible for closure of the four LOA cases for the F-16 MNFP buy. The case manager assigned to the Deputy Under Secretary's office did not prepare a case master plan specifically addressing case closure. Rather, the case manager relied on the ASC for subcase management and the F-16 SPO for contract closeout management and for performing all functions necessary to close the four cases. The F-16 SPO took the position that all contracts must be completely closed before case closure.

ASC Management of the Subcases of the EPG. Although the Office of the Deputy Under Secretary of the Air Force (International Affairs) was relying on the ASC and the F-16 SPO to perform all functions necessary for closure of the four LOA cases of the EPG, the ASC did not have the necessary authority to direct other Air Force and DoD organizations to complete the work necessary to close the four cases. The 4 cases comprised 172 subcases.[4] The ASC is responsible for managing and completing the work necessary to close 100 of those subcases. Other Air Force organizations (Air Force Security Assistance Center, Air Force Security Assistance Training [Group], Air Force Contract Management Division, and Air Combat Command, formerly Tactical Air Command) were responsible for managing and completing the work necessary to close the remaining 72 subcases. To close a case or subcase, all articles and services ordered must be delivered and paid for, financial accounting balances must be reconciled, and all discrepancy reports must be resolved.

ASC Management of EPG Contracts. The F-16 SPO has identified 415 contracts that were funded either fully or in part with funds from the EPG for the F-16 MNFP buy. To satisfy a subcase deliverable, the Air Force may issue or modify one or more contracts. The F-16 SPO asserted that those contracts must be closed before the F-16 MNFP cases and subcases can be closed. Of those 415 contracts, organizations at ASC issued 165 contracts, other Air Force organizations issued 226 contracts, various other DoD organizations issued 17 contracts, and 7 contracts could not be identified to any DoD or non-DoD organization. Each DoD organization is responsible for closing the contracts it issued. As of June 1995, the F-16 SPO could provide the status of only the 165 contracts issued by ASC. The F-16 SPO was unable

[4]A subcase is a category of deliverables, for example, aircraft, spare engines, spare parts, special equipment, or technical improvements.

to provide the status of the remaining 250 contracts because those contracts were issued by other Air Force and DoD organizations. We contacted the various organizations that issued the 415 contracts related to the EPG and found that 113 contracts were open as of June 1995. Of those 113 open contracts, 4 had scheduled deliverables in FY 1997 or later, and 2 had been issued by the Department of the Navy.

Scheduled Deliverables. Four fixed-price incentive contracts partially funded with funds from the EPG have scheduled deliverables in FY 1997 or later as shown in the table below.

Future Deliverables

Item	Contract Number	Dollars[1] (millions)	EPG Dollars[2] (millions)	Delivery Schedule
Engine	F33657-84-C-2014	$5,200	Unknown	1st qtr[3] FY 1997
Airframe	F33657-84-C-0192	$2,200	$12	4th qtr[3] FY 1997
Engine	F33657-84-C-2011	$5,300	Unknown	4th qtr[3] FY 1998
Airframe	F33657-82-C-2120	$4,500	$11	1st qtr[3] FY 1999

[1]Total value of contract.
[2]Total EPG dollars on contract.
[3]Quarter.

Although the deliverables are not to the EPG, the four contracts cannot be closed by December 1997, if as the F-16 SPO asserted, all articles and services ordered must be delivered and paid for, and accounting balances reconciled before the contract can be closed.

Department of the Navy Contracts. Naval Supply Systems Command Publication 541, "Security Assistance Manual," June 12, 1985, sets FMS policy for the Navy. The publication does not require that contracts be closed before an FMS case is closed. Rather, it allows cases to be closed prior to the negotiation of the final contract overhead rates. The Naval Air Systems Command issued two contracts for radar warning receivers for about $10.6 million. As of May 1995, the administrative contracting officer expected one contract, N00019-88-C-0269, to be closed by September 1995. The administrative contracting officer stated that the other contract, N00019-80-C-0147, was sent to the Defense Finance and Accounting Service-Columbus Center for financial reconciliation; however, the contracting officer did not know when the financial reconciliation would be completed. The administrative contracting officer did not have an estimated time frame for contract closure and stated other impediments to closing contract N00019-80-C-0147 were: the contractor not submitting final cost proposals, customers other than the EPG ordering equipment and spares under the contract, and current year funding needed to pay one of the contract line items.

Preparing a Case Master Plan

The case manager did not prepare a case master plan. The Security Assistance Manual requires the case manager to prepare a case master plan at the initiation of an LOA. The plan is required to separate the LOA into management components, indicate significant activities requiring coordination, and establish a time-sequence schedule for case closure implementation. The case master plan also specifies those organizations required to participate and their assigned responsibilities. Because all deliverables had been received, the F-16 SPO was working on closing the cases; therefore, a complete case master plan for the F-16 MNFP was not needed. However, to effectively plan for the closure of the remaining 113 open contracts, a plan was needed to monitor and control the closure of the contracts. The case manager should have prepared that portion of the case master plan specifically addressing case closure. However, neither the Office of the Deputy Under Secretary of the Air Force (International Affairs) nor the F-16 SPO was able to provide a case master plan that outlined a time-sequence schedule for case closure implementation.

Closing F-16 Airframe and Engine Contracts

The EPG purchased, through the ASC, about $2.2 billion in airframes and $1.1 billion in engines (about 61 percent of total program costs) under the $5.4 billion F-16 MNFP buy. If all contracts must be completely closed before supply complete cases can be closed, the following actions are required to close the airframe contract (F33657-75-C-0310) and the five engine contracts.[5] They are:

- o Defense Contract Audit Agency (DCAA) audits and final overhead rate negotiation,
- o final price determination,
- o resolution of defective pricing claims,
- o modification of existing F-16 contracts, and
- o financial reconciliations.

DCAA Audits and Final Overhead Rate Negotiations. Federal Acquisition Regulation part 4.804-5, "Detailed procedures for closing out contract files," 1990 edition, requires that contractor overhead rates be settled before the contracts can be closed. The DCAA audit reports on incurred costs are used to reach settlement of contractor overhead rates, whether the settlements are

[5]The engine contracts were F33657-75-C-0377, F33657-79-C-0739, F33657-80-C-0218, F33657-80-C-0333, and F33657-82-C-0258.

negotiated by the administrative contracting officer or determined by an audit. The DCAA has audited rates for the airframe and engine contracts through calendar year 1991. However, as of July 1995, the administrative contracting officers had negotiated the rates only through calendar year 1988 for the airframe and engine contracts. Additionally, DCAA had estimated that the audits of the overhead rates for the Lockheed Fort Worth Company (Lockheed), the prime airframe contractor, for calendar years 1992 and 1993 would not be completed until the second quarter of FY 1996. As of June 1995, the audits for overhead rates for calendar year 1994 were not scheduled. Neither the F-16 SPO nor the Propulsion SPO had timetables for the administrative contracting officers to negotiate the rates for calendar years 1989 through 1994.

Final Price Determinations. Federal Acquisition Regulation part 4.804-5 requires that price revision be completed before a contract is closed. Before the fixed-price incentive contracts can be closed, the F-16 SPO, Propulsion SPO, and contractors must negotiate final price incentive determinations after the contractors submit and the DCAA audits the final cost proposals. The contractors cannot submit the final cost proposals until open audit issues are settled, purchase orders are closed, final price determinations for subcontractors are received and reviewed, reconciliations of material to subcontracts are completed, property disposition is accomplished, and work orders are closed.

Neither the F-16 SPO nor the Propulsion SPO had an overall plan in place to work with the contractors to obtain the final cost proposals and negotiate the final contract price determinations for the airframe and engine contracts. In addition, the Propulsion SPO did not know whether all items ordered under the five engine contracts had been delivered. As of May 1995, Pratt and Whitney, the prime engine contractor, had submitted a final cost proposal and negotiated the final price determination on F33657-75-C-0377, one of the five open engine contracts awarded under the F-16 MNFP. However, no estimated dates were available for the remaining four contracts, and the F-16 SPO was unable to identify an estimated date for the submission of a final cost proposal or the negotiation of a final price determination for the Lockheed airframe contract, F33657-75-C-0310.

Resolution of Defective Pricing Claims. Federal Acquisition Regulation part 4.804, "Closeout of contract files," 1990 edition, states that a contract shall not be closed if it is in litigation or under appeal. Defective pricing can occur during the negotiation of an initial contract or a modification and can cause a delay in contract closure. If a contractor submits cost or pricing data that are inaccurate, incomplete, or outdated at the time of the price negotiation, the Government is entitled to a price adjustment of any significant amount by which the price on that initial contract or modification was increased because of the defective data. The defective data can be discovered during future negotiations with a contractor or during a DCAA audit of the contractor's incurred costs or final cost proposal.

As of July 1995, the Propulsion SPO had five open defective pricing claims against four engine contracts[6] for about $15 million. Of those five claims, two were in litigation for about $4.5 million. The F-16 SPO believes that all defective pricing claims, including those in litigation, can be settled before December 1997. Those four engine contracts may or may not be closed until the defective pricing claims are resolved.

Modification of Existing F-16 Contracts. The case closure process is further complicated because customers other than the EPG purchased F-16 airframes and engines under the F-16 buy contracts by contract modification instead of issuance of a new contract. As a result, the period of performance for those contracts was extended from FY 1985 to FY 1997. For example, an FMS customer was added to contract F33657-75-C-0310 in 1979 and received its final delivery of technical data in 1994. The F-16 SPO stated that modifying the existing contracts to add customers or to purchase more equipment was more cost-effective than issuing new contracts. However, that policy has a significant effect on the timelines for closing out contracts and retaining financial and logistical documentation.

Financial Reconciliations. In accordance with AFR 130-1, all contracts must be financially closed before an FMS case can be closed. Before a contract can be closed, it must be financially reconciled, which includes a complete review of contract disbursements against contract requirements and a review of required deliveries. The F-16 SPO has been attempting to reconcile and close airframe contract F33657-75-C-0310 since FY 1988. At the Case Closure Working Group meeting of June 1990, the F-16 SPO estimated that the airframe contract would be financially reconciled by July 1990 and closed by March 1992. The F-16 SPO informed the EPG on June 13, 1990, that the financial reconciliation was complete. However, in a March 1991 meeting, the F-16 SPO, the Defense Plant Representative Office, DCAA, and Lockheed agreed to delay closure of the airframe contract because DCAA was concerned that major contract tasks were incomplete and unresolved. The DCAA determined that final cost proposals submitted by Lockheed were unauditable for contract closure. The F-16 SPO then estimated that the issues could be resolved and the contract closed by February 1993. As of May 1995, the airframe contract was not completely financially reconciled, and Lockheed had not resubmitted a final cost proposal. The F-16 SPO did not know when Lockheed would resubmit the final cost proposal.

Records Retention

Federal Acquisition Regulation part 4.805, "Disposal of contract files," 1990 edition, and Defense Federal Acquisition Regulation Supplement part 204.805, "Disposal of contract files," 1991 edition, prescribe the procedures for

[6]The affected engine contracts were F33657-75-C-0377, F33657-79-C-0739, F33657-80-C-0333, and F33657-82-C-0258.

handling, storing, and disposing of contract files. Documentation for contracts more than $25,000 must be retained for 6 years and 3 months after final payment. Documentation for contracts of $25,000 or less must be retained for 3 years after final payment. Although the regulations do not specifically address record retention requirements for contracts issued in support of FMS cases, the Security Assistance Manual requires that documentation supporting expenditures on FMS cases must be retained indefinitely. That documentation supports the use of funds and provides the audit trail necessary to reconcile the FMS cases in preparation for case closure and ensures that customer funds have been accounted for.

DoD organizations that issued contracts in support of the F-16 MNFP buy, including the ASC, did not retain contract files supporting obligations and expenditures in accordance with the Security Assistance Manual. Those DoD organizations stated that documentation was maintained in accordance with the Federal Acquisition Regulation. Of the 415 contracts related to the EPG, 295 were closed, and 204 contract files had been destroyed. Additionally, the F-16 SPO was unable to provide records for the seven contracts that could not be identified to any DoD or non-DoD organization. Without that documentation, the Air Force will not be able to completely reconcile the F-16 MNFP buy cases for closure.

Meeting the December 1997 Commitment Date

The Office of the Deputy Under Secretary of the Air Force (International Affairs) will not be able to meet the case closure commitment date of December 1997 if all contracts must be completely closed before supply complete FMS cases can be closed. The F-16 SPO committed to closing the four LOA cases first by 1992, then 1993, 1995, and now by December 1997. It will have been 12 years between the last delivery of an F-16 aircraft under the F-16 MNFP and the current commitment date for closure of the cases.

The DSAA implemented accelerated case closure procedures DoD-wide in June 1992 to alleviate the lengthy closure process associated with large contracts supporting FMS cases. Accelerated case closure procedures allow a case to be closed and funds to be released to the FMS customer before contracts issued in support of the case are closed. Under the accelerated case closure procedures, the delivered value of an item is adjusted to equal the estimated final contract price. The difference is collected from the customer and held in a suspense account until the contracts are closed and the final contract price known. From the customer's point of view, the case is closed even though contracts are still open. In 1991 and 1992, the EPG were briefed on accelerated case closure procedures at F-16 MNFP Steering Committee meetings. The governments of Denmark and Norway elected to use accelerated case closure procedures for their FMS cases; however, Belgium and the Netherlands did not. Thus, the EPG, as a group, stated that accelerated case closure procedures were not acceptable for the four F-16 MNFP cases. As a result, accelerated case closure

procedures were not in effect for the EPG buys. Use of accelerated case closure procedures would reduce the remaining time needed to close the F-16 MNFP cases.

Recommendations, Management Comments, and Audit Responses

Deleted, Redirected, and Renumbered Recommendations. As a result of management comments, we deleted draft Recommendation 1.a. and redirected draft Recommendation 3.a.. We also renumbered draft Recommendations 3.b. and 3.c. to Recommendations 3.a. and 3.b.

1. We recommend that the Deputy Under Secretary of the Air Force (International Affairs):

a. Prepare a case master plan specifically addressing case closure to include a time-sequence schedule for case, subcase, and contract closure taking into account tasks that must be performed by Air Force and other DoD organizations to close the F-16 Multinational Fighter Program cases, subcases, and contracts. The case master plan should include options for closing the cases under either standard case closure procedures or accelerated case closure procedures.

Air Force Comments. The Air Force nonconcurred, stating that the idea was valid; however, the case manager assigned to the Office of the Deputy Under Secretary of the Air Force (International Affairs), not the F-16 System Program Office, should prepare the case master plan.

Audit Response. We consider the Air Force comments to be partially responsive. The recommendation was redirected from the F-16 System Program Office to the case manager assigned to the Office of Deputy Under Secretary of the Air Force (International Affairs), who has the responsibility for preparing the case master plan. We understand that a complete case master plan covers all aspects of a case from implementation through closure. However, the F-16 MNFP is in the case closure stage; therefore, preparing a complete case master plan would be counterproductive. We recommended preparing that portion of a case master plan specifically addressing case closure because the case closure process for the program has not been effectively managed. A case master plan with a time sequence schedule to close the EPG portions of the contracts is needed if the F-16 System Program Office is to meet the case closure commitment date. Preparing and adhering to a case master plan for closure of the F-16 MNFP cases will allow the case manager to monitor and control all DoD and Air Force organizations included in the case closure process. We request that the Air Force reconsider its position and provide a case master plan specifically outlining how the Air Force will achieve the case closure commitment date. Additionally, we request an implementation date in response to this final report.

b. Establish a revised case closure date for the F-16 System Program Office to present to the European Participating Governments for the F-16 Multinational Fighter Program at the Supreme Audit Institutions conference in September 1995.

Air Force Comments. The Air Force concurred, stating that the date can be influenced by a decision of the EPG Supreme Audit Institutes to use accelerated case closure procedures.

Audit Response. We consider the comments to be responsive and request that the Deputy Under Secretary of the Air Force (International Affairs) provide an implementation date in response to this final report.

c. Propose and recommend the use of accelerated case closure procedures to the European Participating Governments for the F-16 Multinational Fighter Program cases and subcases.

Air Force Comments. The Air Force concurred with the recommendation.

Audit Response. We consider the comments to be responsive and request that the Deputy Under Secretary of the Air Force (International Affairs) provide an implementation date in response to this final report.

2. We recommend that the Commander, Air Force Materiel Command, direct Air Force acquisition and logistics organizations to retain foreign military sales records in accordance with DoD Manual 5105.38-M, "Security Assistance Management Manual," and to assist the F-16 System Program Office in closing contracts awarded by the air logistics centers.

Air Force Comments. The Air Force concurred with the recommendation.

Audit Response. We consider the comments to be responsive and request that the Air Force Materiel Command provide an implementation date in response to this final report.

3. We recommend that the Commander, F-16 System Program Office:

a. Contact all DoD organizations that issued contracts in support of the F-16 Multinational Fighter Program cases and request that they retain all contracts and related documents not yet destroyed in accordance with DoD Manual 5105.38-M, "Security Assistance Management Manual."

Air Force Comments. The Air Force concurred, stating that any DoD guidance should be issued by the Defense Security Assistance Agency. In this case, the Air Force Materiel Command should reiterate this to its commands.

Audit Response. We consider the comments to be responsive and request that the F-16 System Program Office provide an implementation date in response to this final report.

b. Issue new contracts for foreign military sales customer orders rather than adding orders to existing contracts.

Department of the Air Force Comments. The Air Force concurred, stating that the F-16 System Program Office contracts division is definitizing foreign military sales Letters of Offer and Acceptance orders on separate contracts.

Audit Response. We consider the comments to be responsive and request that the F-16 System Program Office provide an implementation date in response to this final report.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We reviewed plans and procedures for closing LOA cases and contracts under the F-16 MNFP buys of airframes and engines for the EPG. We visited or contacted each DoD organization that either issued contracts or was involved in the contract closure process for the F-16 MNFP cases. We reviewed contract closure documentation from October 1988 through July 1995. We reviewed working group and committee meeting minutes from October 1988 through March 1995 and F-16 SPO worksheets for reconciling financial and logistical data. Additionally, the Office of the Auditor General of Denmark provided an audit report, "Report to the Public Accounts Committee concerning the completion of the purchase of 59 F-16 aircraft etc," February 1995. The results of that audit pertaining to the case closure process were incorporated in this report. See Appendix C for a list of organizations visited or contacted.

Use of Computer-Processed Data. We did not evaluate the general and application controls of the Air Force General Accounting and Finance System that processes contract obligation and expenditure data, although we relied on data produced by that system to conduct the audit. Not evaluating the controls did not affect the results of the audit.

Audit Period, Standards, and Location. We performed this program audit from March through July 1995 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. We did not use statistical sampling procedures for this audit.

Methodology

We evaluated the work to be performed to close the F-16 MNFP cases, subcases, and contracts related to the procurement of airframes and engines for the EPG. The ASC issued one airframe contract, valued at about $5.8 billion, and five engine contracts, valued at about $7.4 billion. We assessed the tasks yet to be performed to close those six contracts. In addition, the F-16 SPO provided a listing of 409 other contracts issued in support of the F-16 MNFP airframe and engine procurements that they maintain must be closed before the F-16 MNFP cases can be closed. We obtained listings of contracts with deliveries outstanding, unsettled defective pricing cases, and DCAA reports of audited contractor overhead rates. We contacted the air logistics centers as well as other DoD organizations to determine whether those 409 contracts were open or closed and whether the supporting documentation was still available to

support case closure and to reconcile financial and logistical records. We also reviewed the regulations that the air logistics centers followed for closing out FMS cases and retaining records.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of the Deputy Under Secretary of the Air Force (International Affairs) and F-16 SPO management controls over contract and case closure for the F-16 MNFP. Specifically, we reviewed DoD and Air Force regulations on the contract and case closure process and management controls over maintaining documentation needed to support decisions made in contract and case closure for the airframe and engine contracts. We also reviewed DoD and Air Force guidance on records retention requirements. We also reviewed the results of any self-evaluation of those management controls.

Adequacy of Management Controls. We identified material management control weaknesses as defined by DoD Directive 5010.38 for the Deputy Under Secretary of the Air Force (International Affairs) and the F-16 SPO. The case manager assigned to the Office of the Deputy Under Secretary of the Air Force (International Affairs) did not prepare a case master plan for the F-16 MNFP. The F-16 SPO management controls were not adequate to ensure that contracts were closed in a timely manner. In addition, the F-16 SPO and the air logistics centers did not adhere to the Security Assistance Management Manual on records retention requirements for FMS documentation. Recommendation 1.a., if implemented, will improve the Deputy Under Secretary of the Air Force (International Affairs) oversight of the F-16 MNFP. Recommendations 2. and 3., if implemented, will improve F-16 SPO case closure procedures. Although we could not quantify the potential monetary benefits associated with management's implementation of the recommendations, we did identify other potential benefits. See Appendix B for a summary of the potential benefits resulting from the audit. A copy of the report will be provided to the senior official in charge of management controls in the Office of the Deputy Under Secretary of the Air Force (International Affairs) and at the Air Force Materiel Command.

Adequacy of Air Force Self-Evaluation. F-16 SPO officials did not designate case closure or contract closure as assessable units and, therefore, did not identify or report the material management control weaknesses identified by the audit. However, an Air Force Process Action Team identified several internal control weaknesses in the assessment of case closure procedures. Specifically, it found that case closure has no formal priority within the ASC, no centralized

case closure policy exists, and organizations were not retaining records needed for case closure. The Process Action Team made recommendations to various DoD organizations to correct the problems.

Prior Audits and Other Reviews

Process Action Team to the Under Secretary of Defense for Acquisition and Technology report on "Contract Administration Reform," February 1995. The Process Action Team found that contract closeout within DoD needed improvement. The report recommended:

o issuing a policy letter to allow interim settlement of the final indirect cost rates;

o raising the quick-closeout thresholds to $1 million;

o using an advance overhead memorandum of agreement;

o establishing and maintaining a comprehensive data base to measure the process of establishing overhead rates;

o providing additional training for Defense Finance and Accounting Center personnel;

o prevalidating the DD 250, "Material Inspection and Receiving Report," electronically against a data base;

o standardizing contract data tracking; and

o expanding the Mechanization of Contract Administration Services system to generate more notices.

The Inspector General, DoD, concurred with the recommendations. A review to assess progress and ensure compliance with the report is planned for 6 months from the date of the report.

Appendix B. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.a.	Management Controls. Improves effectiveness and efficiency by ensuring that the closure of F-16 MNFP cases, subcases, and contracts have management oversight.	Nonmonetary.
1.b.	Program Results. Increases effectiveness and efficiency by providing realistic milestones for closure of the F-16 MNFP cases, subcases, and contracts.	Nonmonetary.
1.c.	Economy and Efficiency. Increases effectiveness and efficiency by closing the F-16 MNFP cases and subcases as soon as possible rather than waiting for closure of all contracts.	Nonmonetary.
2. 3.a.	Compliance With Regulations or Laws. Improves effectiveness and efficiency by maintaining documentation needed to reconcile and close the F-16 MNFP cases and subcases.	Nonmonetary.
3.b.	Program Results. Improves effectiveness and efficiency by reducing the effort needed to close contracts in a timely manner.	Nonmonetary.

Appendix C. Organizations Visited or Contacted

Department of the Army

U.S. Army Communications-Electronics Command, Fort Monmouth, NJ
Armament and Chemical Acquisition and Logistics Activity, Rock Island, IL
U.S. Army Corps of Engineers, Huntsville, AL

Department of the Navy

Naval Air Systems Command, Arlington, VA
  International Programs Office
Naval Supply Systems Command, Arlington, VA
  Security Assistance Directorate

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
  Director, Budget Investment, Washington, DC
Assistant Secretary of the Air Force (Acquisition), Washington, DC
  Air Force Program Executive Office Organization, Tactical and Airlift Programs, Washington, DC
  Director of Fighter, Command and Control, and Weapons Programs, Washington, DC
Deputy Under Secretary of the Air Force (International Affairs), Washington, DC
  Europe/NATO/Eurasia Division, Washington, DC
Air Force Materiel Command, Wright-Patterson Air Force Base (AFB), OH
  Aeronautical Systems Center, Wright-Patterson AFB, OH
    F-16 System Program Office, Wright-Patterson AFB, OH
    Propulsion System Program Office, Wright-Patterson AFB, OH
  Oklahoma City Air Logistics Center, Tinker AFB, OK
  Ogden Air Logistics Center, Hill AFB, UT
  Sacramento Air Logistics Center, McClellan AFB, CA
  San Antonio Air Logistics Center, Kelly AFB, TX
  Warner Robins Air Logistics Center, Robins AFB, GA

Other Defense Organizations

Defense Contract Audit Agency, Arlington, VA
  Northeastern Regional Office, Boston, MA
  United Technologies Eastern Regional Resident Office, Palm Beach Gardens, FL
  Lockheed Fort Worth Company Central Regional Resident Office, Dallas-Fort Worth, TX
Defense Finance and Accounting Service-Columbus Center, Columbus, OH

Other Defense Organizations (cont'd)

Defense Security Assistance Agency, Arlington, VA
Defense Logistics Agency, Alexandria, VA
- Defense Contract Management Area Office, Chicago, IL
- Defense Plant Representative Office, Lockheed Fort Worth Company, Dallas-Fort Worth, TX
- Defense Plant Representative Office, Pratt and Whitney Company, Palm Beach Gardens, FL

Virginia Contracting Activity, Washington, DC

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Economic Security)
Assistant Secretary of Defense (International Security Affairs)
Director, Defense Procurement
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Deputy Under Secretary of the Air Force (International Affairs)
Commander, Air Force Materiel Command
  Commander, Aeronautical Systems Center
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, Defense Security Assistance Agency
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations

Office of Management and Budget
General Accounting Office
- National Security and International Affairs Division, Technical Information Center
- National Security and International Affairs Division, Defense and National Aeronautics and Space Administration Management Issues
- National Security and International Affairs Division, Military Operations and Capabilities Issues

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Part III - Management Comments

Department of the Air Force Comments

Final Report Reference

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

OFFICE OF THE ASSISTANT SECRETARY

8 AUG 1995

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

FROM: SAF/AQCS

SUBJECT: DoD IG Draft Quick-Reaction Report on F-16 Multinational Fighter Program Case Closure Process, July 20, 1995, Project No. 5LG-0015

This is in reply to your request for Air Force comments on the subject report. The following is a consolidated response from SAF/IA, ASC/YP, and SAF/AQCS.

Recommendation 1. – The audit recommends that the Deputy Under Secretary of the Air Force (International Affairs):

Deleted

a. Designate a case manager with the authority to direct other Air Force organizations and negotiate with other DoD organizations to complete actions necessary to close the F-16 Multinational Fighter Program cases, subcases, and contracts.

Non Concur – SAF/IAE has already designated a case manager for these cases who has the authority to direct other Air Force organizations. See ADDITIONAL RESPONSES comment on page three of this response relative to the report's first paragraph of page 5.

b. Establish a revised case closure date to present to the European Participating Governments (EPG) for the F-16 Multinational Fighter Program at the Supreme Audit Institutions conference in September 1995.

Concur – The Secretariat and ASC/YP agree with providing a revised closure date. The date can be influenced by a decision by the EPG Supreme Audit Institute to accept the DSAA accelerated case closure procedures for these cases.

It should be understood that the date given is just an estimate and not a commitment to close by a certain date. The greatest obstacle to the SPO is negotiation of overhead rates, which is outside their control.

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c. Propose and recommend the use of accelerated case closure procedures to the European Participating Governments for the F-16 Multinational Fighter Program cases and subcases.

Concur.

Recommendation 2 -- We recommend that the Commander, Air Force Material Command, direct Air Force acquisition and logistics organizations to retain foreign military sales records in accordance with DoD Manual 5105.38-M, "Security assistance Management Manual," and to assist the F-16 System Program Office in closing contracts awarded by the air logistics centers.

Concur -- However, these are not FMS, but security assistance records.

Recommendation 3 -- The audit recommends that the Commander, F-16 System Program Office:

a. Prepare a case closure master plan to include a time-sequence schedule for case, subcase, and contract closure taking into account tasks that must be performed by Air Force and other DoD organizations to close the F-16 Multinational Fighter Program cases, subcases, and contracts.

Redirected and Renumbered as Recommendation 1.a.

Non Concur -- The idea is valid, however, it should be noted, the SAF/IA case manager, and not the SPO, should develop the case master plan. The F-16 SPO and AFMC/IA should be working with them in developing the plan.

b. Contact all DoD organizations that issued contracts in support of the F-16 Multinational Fighter Program cases and request that they retain all contracts and related documents not yet destroyed in accordance with DoD Manual 5105.38-M, "Security Assistance Management Manual."

Renumbered as Recommendation 3.a.

Concur -- Any DoD guidance should be issued by DSAA. In this case, AFMC/IA should reiterate this to their command.

c. Issue new contracts for foreign military sales customer orders rather than adding orders to existing contracts.

Renumbered as Recommendation 3.b.

Concur -- The F-16 SPO contracts division is definitizing FMS LOA orders on separate contracts.

ADDITIONAL RESPONSES

The audit in several instances cites AF noncompliance with DoD 5105.38-M, Security Assistance Management Manual (SAMM) and other regulations. The

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sections cited, however, deal largely with FMS case procedures. The EPG cases being audited are not FMS cases, but are partnership arrangements which have been handled outside normal procedures at our partners' request. For example, these documents are not written using the Letter of Offer and Acceptance (LOA) format -- they are written using a unique "plain bond" approach which emphases our unique arrangements with these countries. These arrangements are also being handled using "non-participating" case closure procedures even though two of the countries are participating in the accelerated procedures for all other cases. It is not appropriate to penalize the US Air Force for not using FMS procedures when these procedures often do not apply to the EPG cases.

Page 4

Page 5. First Paragraph: This paragraph states that SAF/IA and the F-16 SPO have not put "sufficient emphasis" on closing the EPG cases. Since these cases are designated as "non-participating" (at the request of the four countries involved), they have a low case closure priority. These priorities have been established by DSAA and are well publicized.

Revised Page 4

Page 5. First Paragraph: This paragraph also implies that SAF/IA has been remiss in not assigning a case manager to provide oversight of the case closure process. SAMM paragraph 70501 assigns case closure responsibility to the case manager as follows: "...manager is defined as that individual who is designated to accomplish the task of integrating functional and inter- and intra-organizational efforts directed toward the successful performance of an FMS case including closure after supply complete." Case closure is the responsibility of the case manager of the case. We do not assign a separate case manager to deal only with case closure.

Page 6

Page 6. Managing the Case Closure Process. Paragraph 1: This paragraph states that SAF/IA "did not establish an overall case manager to oversee the closure of the F-16 MNFP cases. Rather the Deputy Under Secretary's office relied on the ASC for subcase management and the F-16 SPO for contract closeout management..." SAF/IA has always had a case manager assigned to these cases within the Europe/NATO division. While this person's responsibilities include overseeing the entire program, the managers for individual line items have been delegated responsibility for working their particular lines--including contract closeout. The SAF/IA case manager cannot close the case until a Statement for Certificate of Closure has been issued by the line managers for every line on the case. For non-participating cases, these statements cannot be issued for a line until all contracts involved in that line have been closed. (See AFR 130-1, Security Assistance Management, paragraph 8-35).

Revised Page 8

Page 8. Preparing a Case Closure Master Plan: This paragraph indicates that a "case closure master plan" is required for each case. The actual SAMM requirement is for a case master plan of which case closure is a part.

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Page 11

Page 12. Meeting the December 1997 Commitment Date. Paragraph 2: The use of the accelerated case closure procedures (ACC) would reduce the time needed to close EPG cases. By using the ACC process, the AF could estimate remaining obligations due on contracts and could close these cases before the contracts actually close.

If you require any additional information, or have any questions, please call Maj Les Clark at 703-695-1997 or DSN 225-1997.

Stephen P. Busch

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