Audit Report

OFFICE OF THE INSPECTOR GENERAL

ISRAELI USE OF OFFSHORE PROCUREMENT FUNDS

Report No. 97-028

November 22, 1996

This special version of the report has been revised to omit Government of Israel proprietary information.

Department of Defense

Additional Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

CY	Calendar Year
DSAA	Defense Security Assistance Agency
FMF	Foreign Military Financing
MoD	Ministry of Defense

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

November 22, 1996

MEMORANDUM FOR DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY

SUBJECT: Audit Report on Israeli Use of Offshore Procurement Funds (Report No. 97-028)

We are providing this final report for review and comment. Management comments on a draft of this report were generally responsive and were considered in preparing the final report. It is the first of two reports to be issued as a result of the Audit of Foreign Military Financing Grants for Israel.

We request that management provide details on its proposed streamlining actions and specify a planned implementation date for Recommendation 3. by January 22, 1997.

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 Ms. Catherine M. Schneiter, Acting Audit Project Manager, at (703) 604-9609 (DSN 664-9609). See Appendix E for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

This special version of the report has been revised to omit Government of Israel proprietary information.

Office of the Inspector General, DoD

Report No. 97-028
(Project No. 5LG-0069)

November 22, 1996

Israeli Use of Offshore Procurement Funds

Executive Summary

Introduction. Foreign military financing (FMF) is a program to carry out the provisions of Public Law 90-629, "Arms Export Control Act," section 23, "Credit Sales." The FMF program is a program of nonrepayable grants and of repayable and nonrepayable loans and credits to enable U.S. Allies to improve their defense capabilities through the acquisition of Defense articles and services. Each year since 1988, Congress has appropriated $1.8 billion for Israel as nonrepayable FMF grants, which it uses to procure Defense articles and services through direct commercial contracts with U.S. contractors; foreign military sales that are government to government agreements; and procurements in Israel, commonly referred to as offshore procurements. Each year since FY 1991, $475 million of the $1.8 billion annual FMF grants has been designated for offshore procurements, specifically, "not less than $475 million shall be available for the [offshore] procurement in Israel . . . ."

Audit Objectives. The primary audit objective was to review the policies and procedures related to the execution of the FMF program for Israel. The specific objective for this report was to evaluate the adequacy of support for Israeli requests for offshore procurement fund disbursements. We reviewed the management control program as applicable to the specific audit objective.

Audit Results. The Israeli Ministry of Defense was not required to, and did not, maintain an adequate audit trail to allow verification of production costs for the Merkava tank and depot maintenance costs, submitted to the Defense Security Assistance Agency (DSAA), for offshore procurement fund disbursements. As a result, we were unable to verify $324.7 million of Israeli expenses reimbursed with offshore procurement funds in FY 1995. Also, the fund reviews performed by DSAA were not meaningful in the absence of supporting documentation for disbursement requests.

The management control program needs to be improved or streamlined because DSAA management controls over verifying and approving Israeli offshore procurement fund disbursement requests were not meaningful (Appendix A).

Summary of Recommendations. We recommend that the Director, DSAA, either seek to include in each annual "Grant Agreement" with Israel the specific documentation that the Israeli Ministry of Defense must maintain to support the offshore procurement fund disbursement requests or streamline the disbursement approval process. Under the first option, the "Grant Agreement" should also include requirements for biannual review and negotiation of advanced weapons system production costs, standard labor rates, and standard hour estimates; biannual review of standard materials charges; and exclusion of military personnel costs from offshore procurement fund disbursement requests. Also under the first option, the Director, DSAA, should develop written policies and procedures for the annual review of the Israeli reconciliation between standard and actual depot maintenance costs.

Management Comments. The DSAA concurred with the recommendation to streamline the disbursement approval process. It stated that it did not dispute the finding. DSAA also stated that, while Congress had never clearly articulated its reasons for establishing the offshore procurement program, it was not the intent of Congress that the U.S. Government involve itself directly in the Israeli Ministry of Defense domestic procurement process. Finally, DSAA stated that it would take the necessary steps to streamline the disbursement process. A discussion of management comments is in Part I and the complete text is in Part III.

Audit Response. We consider the comments to be partially responsive. Although DSAA concurred with the streamlining recommendation, it did not provide the planned action and implementation date. Therefore, we request that DSAA provide its proposed streamlining actions and implementation date in response to this final report by January 22, 1997.

Table of Contents

Executive Summary i

Part I - Audit Results

Audit Background 2
Audit Objective 3
Offshore Procurement Funds 4

Part II - Additional Information

Appendix A. Audit Process
Scope 18
Methodology 19
Management Control Program 19
Prior Audit Coverage 20
Appendix B. Other Matters of Interest 21
Appendix C. Uses of Offshore Procurement Funds 22
Appendix D. Organizations Visited or Contacted 29
Appendix E. Report Distribution 30

Part III - Management Comments

Defense Security Assistance Agency Comments 34

Part I - Audit Results

Audit Background

Foreign Military Financing Program. Foreign military financing (FMF) is a program to carry out the provisions of Public Law 90-629, "Arms Export Control Act," section 23, "Credit Sales." The FMF program is a program of nonrepayable grants and of repayable and nonrepayable loans and credits to enable U.S. Allies to improve their defense capabilities through the acquisition of Defense articles and services. Each year since 1988, Congress has appropriated $1.8 billion for Israel as nonrepayable FMF grants, which it uses to procure Defense articles and services through direct commercial contracts with U.S. contractors; foreign military sales that are government to government agreements; and procurements in Israel, commonly referred to as offshore procurements. The Defense Security Assistance Agency (DSAA) manages the FMF program, to include establishing policies and procedures for the program, approving the use of FMF grants, and approving disbursements of grant funds to Israel. Upon approval of Israel's disbursement request, the Defense Finance and Accounting Service Denver Center disburses funds to Israel for offshore procurements made from Israeli contractors.

Grant Agreement. The "Grant Agreement" (the Agreement), which is negotiated annually, outlines the terms and conditions for the availability and use of FMF grant funds provided for offshore procurements. In October 1994, the U.S. Government and the Government of Israel signed the Agreement for FY 1995 with DSAA acting as the U.S. representative for that Agreement. Section 4(c) of the Agreement requires Israel to make all records and files related to its use of FMF grants available upon request for review by DoD.

Offshore Procurements. Beginning in FY 1984, the United States provided FMF grants for offshore procurements to finance Israel's development of the Lavi fighter aircraft. The United States Congress increased the annual appropriation for offshore procurement funds from $300 million for FY 1987, the year the Lavi program was canceled, to $475 million for FY 1991 and future years. Public Law 103-306, "Foreign Operations, Export Financing and Related Programs Appropriation Act, 1995," (Foreign Operations Appropriation Act) includes the annual appropriation of FMF grants for offshore procurements provided to carry out the provisions of section 23 of the Arms Export Control Act. Specifically, the Foreign Operations Appropriation Act states:

> That to the extent that the Government of Israel requests that funds be used for such purposes, grants made available for Israel by this paragraph shall, as agreed by Israel and the United States, be available for advanced fighter aircraft programs or for other advanced weapons systems, as follows: (1) up to $150,000,000 shall be available for research and development in the United States; and (2) not less than $475,000,000 shall be available for the procurement in Israel of defense articles and defense services, including research and development.

After cancellation of the Lavi fighter program, the use of FMF grants for offshore procurements was no longer tied to a specific Israeli procurement.

Issues Raised by the General Accounting Office. The General Accounting Office issued Report No. NSIAD 91-169 (OSD Case No. 8710), "Israel-U.S. Military Aid Spent In-Country," May 23, 1991, which questioned DSAA management of FMF grants for offshore procurements. The General Accounting Office report stated that DSAA approved FMF grants for offshore procurements for items the Foreign Operations Appropriation Act for 1991 did not allow, such as routine maintenance not related to advanced weapons systems, and that DSAA administered the use of FMF grants for offshore procurements as little more than a cash transfer program. DSAA generally concurred with the findings and conclusions; however, DSAA stated that it can reimburse Israel for all categories of expenses, including ammunition and maintenance, even if those expenses are not related to advanced weapon systems. Congress took no related action. Our report attempts to identify the documentation to support production and maintenance categories of expenses. See Appendix C for additional details on the General Accounting Office review.

Audit Objective

The primary audit objective was to review the policies and procedures related to the execution of the FMF program for Israel. The specific objective of this report was to evaluate the adequacy of support for Israeli requests for offshore procurement fund disbursements. We also evaluated the management controls as applicable to the specific audit objective. See Appendix A for a discussion of the audit scope, methodology, prior audit coverage, and our review of the management control program. See Appendix B for a discussion of other matters of interest. See Appendix C for a discussion of the uses of offshore procurement funds.

Offshore Procurement Funds

The Israeli Ministry of Defense (MoD) was not required to, and did not, maintain an adequate audit trail to allow verification of production costs for the Merkava tank and depot maintenance costs, submitted to DSAA, for DSAA approval of offshore procurement fund disbursements. An adequate audit trail was not maintained because the annual Agreement between the United States and Israel did not specify what documentation Israel was required to maintain to support its offshore procurement fund disbursement requests. Additionally, DSAA approved Israeli offshore procurement fund disbursement requests without:

o questioning the production costs of the Merkava tank for calendar year (CY) 1995;

o agreeing on standard labor rates for the Israeli Defense Forces[1] three Army and one Air Force maintenance depots;

o questioning the number of labor hours that the Israeli MoD submitted for disbursement for the four depots of Israeli Defense Forces; and

o questioning why Israel submitted costs incurred during CYs 1993 and 1994 at one Army depot for disbursement with FY 1995 offshore procurement funds.

As a result, we were unable to verify $324.7 million of Israeli expenses reimbursed with offshore procurement funds in FY 1995. Also, the DSAA disbursement request approval process serves little purpose and should, therefore, be streamlined unless DSAA is willing to require adequate supporting documentation for disbursement requests under future agreements.

Offshore Procurement Funds Disbursement Procedures

The Israeli MoD uses national funds to pay for programs, then requests offshore procurement fund disbursements from DSAA to reimburse those expenditures. The Israeli MoD initiates the disbursement process by submitting letters to DSAA and the Defense Finance and Accounting Service Denver Center requesting reimbursement for those costs, such as labor costs for depot maintenance. When DSAA receives those requests, it performs a superficial review. Specifically, DSAA only reviews the disbursement requests for

[1]The Israeli Defense Forces is the Armed Forces for Israel. The Israeli Defense Forces operates the four depots discussed in this report. The funding for Israeli Defense Forces depots is part of the Israeli MoD budget.

mathematical errors. If DSAA finds no mathematical errors, it informs the Defense Finance and Accounting Service Denver Center that it is authorized to disburse offshore procurement funds. The Defense Finance and Accounting Service Denver Center then disburses those funds to Israel. Even though Israel submits disbursement requests for costs incurred on specific programs, DSAA and Israeli MoD officials stated that there was not a one-to-one correlation between offshore procurement funds requested and Israeli MoD expenditures because offshore procurement funds are not always received in the same year that expenditures are made. When disbursements from offshore procurement funds are received, Israel deposits those funds into the Israeli Ministry of Finance Federal Reserve Account.

Uses of Offshore Procurement Funds Disbursed in FY 1995

In FY 1995, Israel requested, and DSAA approved, the disbursement of $474.7 million in offshore procurement funds for a variety of programs, as shown in Table 1.

Table 1. Israeli Programs Reimbursed With FY 1995 Offshore Procurement Funds

Program	Contractor	Dollars (million)
Merkava Tank Production	Israeli Defense Forces[1]	$140.3
Army Maintenance	Israeli Defense Forces[1]	134.5
Commercial Maintenance	Government Contractors[2]	84.4
Aircraft Maintenance	Israeli Defense Forces[1]	49.9
Navy Modernization	Israeli Contractors[3]	20.7
Arrow Cooperative Program	Government Contractor[2]	20.0
Munitions	Government Contractors[2]	17.7
Pioneer	Government Contractor[2]	3.5
F-100 Conversion	Israeli Contractor[3]	2.1
Puma APC[4]	Israeli Defense Forces[1]	1.4
Phantom 2000 Upgrade	Government/Israeli Contractor[2,3]	0.2
Total		$474.7

[1]Israel performed the work at either Israeli Defense Forces Army or Air Force maintenance depot.
[2]Israel contracted with either Israel Aircraft Industries Ltd., or Israel Military Industries, both of which are owned by the Government of Israel.
[3]Israel contracted with commercial contractors in Israel to perform the work.
[4]Armored Personnel Carrier.

Of the 11 programs listed in Table 1, we reviewed offshore procurement fund disbursement requests that Israel provided to DSAA for 6 of those programs, totaling about $446.8 million. Our review included documentation for three programs to support disbursement requests of about $324.7 million for the production of the Merkava tank and maintenance of military equipment at the four maintenance depots. We also reviewed purchase orders for two programs for munitions and commercial maintenance, totaling about $102.1 million (see Appendix B), and the Arrow Cooperative Program, totaling about $20 million (see Appendices B and C). We did not review documentation for the remaining five programs, totaling about $27.9 million because of the results of the review of the first six programs.

Cost of Production for Merkava Tank

The Israeli MoD did not maintain an adequate audit trail to allow verification of about $140.3 million in production costs for the Merkava tank submitted for offshore procurement fund disbursements in FY 1995. DSAA approved those disbursement requests without questioning the production costs. Israel provided us a listing of the major components of the Merkava tank. We requested cost information, totaling about $80.5 million, for "Other Systems and Parts"; for labor; and for spare parts. Israeli MoD officials explained that the cost information we requested was not required under agreements with the United States and was not available. Israeli MoD officials:

o stated that the costs for "Other Systems and Parts," totaling about $28.0 million, was proprietary and that that information would not be provided;

o could not provide documentation to support the standard labor rate of $ [2] per hour, which accounted for about $29.8 million of the $80.5 million; and

o stated that the $22.7 million for spare parts was based on a [2] percent estimate that the United States used. However, neither DSAA nor the Israeli MoD were able to provide documentation supporting the adequacy of that estimate.

Because of the lack of an audit trail for "Other Systems and Parts," for labor, and for spare parts, we did not attempt to validate the other production costs, totaling about $59.8 million. Without the above information, we were unable to validate about $140.3 million in production costs for the Merkava tank that Israel submitted to DSAA for offshore procurement fund disbursements.

[2]Government of Israel proprietary information omitted.

Army Maintenance Depots

The DSAA and the Israeli MoD did not consider it necessary for the Israeli MoD to maintain an adequate audit trail to allow verification of costs of about $134.5 million for maintenance, repair, and upgrade work performed at three Israeli Army maintenance depots from January 1993 through September 1995. Additionally, the Israeli MoD did not maintain that documentation for its internal management purposes. Israel submitted four requests to DSAA for FY 1995 offshore procurement fund disbursements without any supporting documentation because none was required or agreed-to. Table 2 summarizes those disbursement requests.

Table 2. FY 1995 Offshore Procurement Fund Disbursement Requests

Request Date	FY 1995 Funds (millions)	Time Period of Work Performed
November 29, 1994	$ 8.2	Adjustment to actual cost for CY 1994.
December 13, 1994	46.2	Costs for work performed from January 1993 through December 1994.
August 2, 1995	53.1	Estimated costs for January through June 1995.
September 11, 1995	27.0	Estimated costs for July through September 1995.
Total	**$134.5**	

We attempted to obtain supporting documentation for the disbursement requests in Table 2. However, Israel could not provide adequate documentation to support the disbursement requests. This included not providing documentation to support CY 1995 standard labor rates, standard labor hours, and standard materials charges used to calculate its disbursement requests. Israel estimated its costs at the Army depots throughout the year based on standard costs rather than actual costs. Israel and DSAA did not agree upon a standard labor rate and Israel had no obligation to provide an annual standard hours estimate and standard materials charges to DSAA for review. DSAA approved Israel's disbursement requests without requiring Israel to submit cost information to support those requests.

In November 1995 and June 1996, the Israeli MoD submitted two disbursement requests for FY 1996 offshore procurement funds for actual costs incurred above the standard costs reimbursed during CY 1995. Table 3 summarizes those disbursement requests.

Table 3. FY 1996 Offshore Procurement Fund Disbursement Requests for the Actual Costs of Work Performed During CY 1995

Request Date	FY 1996 Funds (millions)	Time Period of Work Performed
November 29, 1995	$27.0	Adjustment to actual costs for January through November 1995.
June 27, 1996	13.6	Second adjustment to actual cost for January through December 1995.
Total	**$40.6**	

As shown in Table 3, Israel's actual costs exceeded its standard costs for CY 1995 by $40.6 million. According to DSAA, Israel's actual costs always exceeded its standard costs for the year. However, DSAA had no written policies and procedures for validating either the standard costs reimbursed during the year or the actual costs reimbursed after the end of the year, nor did it attempt to validate those costs before approving the disbursement of FY 1996 offshore procurement funds.

Development of Standard Labor Rates. The Israeli MoD was unable to provide us the payroll data it used to develop the standard labor rates charged to the United States for each of the three Israeli Army depots. According to Israeli MoD officials, the standard labor rates consisted of direct wage cost, indirect wage cost, general cost, and depreciation on buildings and equipment. Table 4 illustrates the summary level data that the Israeli MoD provided to us.[2]

The Israeli MoD was unable to provide payroll records, estimates of indirect labor charges, monthly bills for the depots, or depreciation schedules to support the four components of the standard labor rate nor were they required to by the agreements with the United States. When asked to provide the payroll for one pay period, Israeli MoD officials were unable to do so. Additionally, the Israeli MoD was unable to provide supporting documentation for general costs. When

[2]Government of Israel proprietary information omitted.

we questioned them about the lack of depreciation schedules, Israeli MoD officials stated that they had included depreciation for equipment purchased under the direct commercial contract program.[3] Israeli MoD officials agreed to remove depreciation from the standard labor rates in the future.

Development of Standard Hours Estimates. The Israeli MoD could not provide the data it used to develop the standard hour estimates for work performed at each of the three Army depots. In addition, DSAA did not question the number of standard hours that Israel submitted for offshore procurement fund disbursements. Again, Israel had no obligation to provide DSAA its support for standard hour estimates. A May 3, 1996 Israeli MoD letter to the Inspector General, DoD (translated June 6, 1996, by the Israeli Mission to the United States[4]), explained that Israel based its methodology on actual hours expended in previous years for the same types of items serviced. However, Israel did not provide us its methodology for developing the standard hours estimates. Instead of the data used to develop the standard hour estimates for items serviced and to support its requests for offshore procurement fund disbursements, the Israeli MoD provided us with reports of the actual hours worked at the three Army depots from April through June 1995. Table 5 summarizes those reports.

[3]Of the $1.8 billion in FMF grants Israel receives annually, Israel spends about $900 million annually through direct commercial contracts with U.S. contractors.

[4]Israel established a Mission to the United States in New York City to administer the FMF grant program. The Israeli Mission submits contracts to DSAA for approval to use FMF funds, disburses funds to contractors, and submits offshore procurement fund disbursement requests to DSAA.

2

Based on information in Table 5, Israel's methodology for developing the standard hour estimates for items serviced at Army depots 7200 and 7300 appeared to be valid. However, Israel's methodology for developing the standard hour estimates for items serviced at Army depot 7100 did not appear valid because standard hours would not equal actual hours for the entire depot for the quarter.

Standard Materials Charges for Items Serviced. The Israeli MoD included standard materials charges in its requests for offshore procurement fund disbursements; however, Israel did not separately identify those costs in its disbursement requests or provide its methodology for determining the standard materials charges. The May 3, 1996, Israeli MoD letter to the Inspector General, DoD, explained that the standard material charges included such items as barrels, springs, and gaskets. The letter stated that Israel used an average

[2]Government of Israel proprietary information omitted.

materials cost based on estimates determined from experiences and through the use of accepted models to estimate planning and production. The Israeli MoD provided us with April through June 1995 summary reports that showed the standard materials charges for the three depots. According to the reports, as illustrated in Table 6, Israel incurred costs of $5.8 million for materials during the quarter.[2]

Because Israel provided DSAA with only the disbursement requests, DSAA was not aware that materials charges were included; thus, it had no way to evaluate those costs. We were unable to obtain sufficient documentation to determine the validity of the standard materials charges.

Army Depot 7200. The DSAA disbursed FY 1995 offshore procurement funds of about $46.2 million to Israel for costs incurred in CYs 1993 and 1994 for work performed at Army depot 7200. In a December 13, 1994, Israeli MoD letter to DSAA, the Israeli MoD established a new offshore procurement case for work performed at depot 7200 and requested disbursement of about $46.2 million in FY 1995 offshore procurement funds for work performed in CYs 1993 and 1994. The disbursement request to DSAA was a one-page summary of total hours worked, total cost, taxes, and net cost for both years; but, it did not provide any support for the summary. When we asked why they waited until December 1994 to submit those costs, Israeli MoD officials stated that they needed a mechanism to obtain the $46.2 million and used depot 7200 costs because those costs had not yet been submitted for disbursement. DSAA did not question the delay in submitting those costs for disbursement because DSAA officials stated that there was no time limit between when Israel incurred costs and when Israel should request disbursement of offshore procurement funds. Because of the lack of an audit trail for costs incurred in CY 1995, we did not attempt to validate costs incurred in CYs 1993 and 1994 for the depot.

Audit of Army Depots. As support for costs submitted to DSAA for offshore procurement fund disbursements, the Israeli MoD provided us a copy of a letter to the Economic Advisor, Israeli MoD, from Itzchaky and Co., an Israeli certified public accounting firm. The letter, dated March 5, 1996 (translated March 29, 1996, by the Israeli Mission to the United States), described audit work performed in CY 1993 at the Army depots. However, according to that letter, the Israeli accounting firm reviewed the management of the depots rather than the accuracy of costs incurred by the depots. In addition, the review suggested that the depot cost data were complete and correct and that the next

[2]Government of Israel proprietary information omitted.

phase of the audit would be to validate cost data for the depots. However, as of June 15, 1996, the cost validation phase of the audit had not been performed. As a result, the Israeli MoD could not provide audited costs to us or DSAA to support its requests for offshore procurement fund disbursements.

Without the supporting documentation for the standard labor rates, standard hour estimates, and standard materials charges, we were unable to validate costs of about $134.5 million for repair, maintenance, and upgrade of military equipment at the three Army depots reimbursed with FY 1995 offshore procurement funds.

Air Force Maintenance Depot

The DSAA and the Israeli MoD did not consider it necessary for the Israeli MoD to maintain an adequate audit trail to allow verification of costs of about $49.9 million for maintenance, repair, and upgrade of aircraft that was performed at one Air Force depot from August 1994 through August 1995. Additionally, the Israeli MoD did not maintain that documentation for its internal management purposes. The Air Force depot maintenance costs were submitted to DSAA in FY 1995 for offshore procurement fund disbursements. Israel calculated its requests using a standard labor rate and actual hours worked each month at the depot; however, Israel could not support its standard labor rate or fully support the actual hours worked that it used to calculate its requests. While DSAA was aware of the standard labor rate for the Air Force depot, DSAA and the Israeli MoD did not agree upon that rate.

Standard Labor Rate. The Israeli MoD could not provide the payroll data used to develop the standard labor rate of $ [2] per hour for CY 1995. Israeli MoD officials stated that the $ [2] per hour was the $ [2] per hour used in CY 1994 adjusted for inflation, but could not provide a breakdown of the elements of either rate. The only support Israel could provide was commercial labor rates approved by the Economic Advisor, Israeli MoD, for a government-owned, commercially-operated contractor performing aircraft maintenance.

Actual Hours. The Israeli MoD could not fully reconcile its reports for actual hours worked in June and July 1995 to its requests for offshore procurement fund disbursements. Those reports showed the actual direct hours worked on specific tasks in the depot workshops and the actual indirect hours attributable to such things as sick leave, annual leave, and training. Table 7 illustrates the difference between the hours submitted to DSAA and the hours shown on internal Israeli MoD documentation.[2]

[2]Government of Israel proprietary information omitted.

As shown in Table 7, Israel submitted [2] hours for June 1995 and [2] hours for July 1995 for offshore procurement fund disbursements that were in excess of the hours shown on Israeli Air Force reports, resulting in an excess disbursement of $[2]. According to Israeli MoD officials, the reports would never exactly match the hours submitted to DSAA for offshore procurement fund disbursements because the Israeli MoD:

- adjusted the reports to add time for premium pay,
- apportioned the hours for one of the workshops among all the other workshops because those hours were considered to be indirect hours, and
- did not print the reports until we made the request in February 1996. The reports could have been adjusted at any time between June and July 1995 and the day the reports were printed.

The apportioning of indirect hours to the workshops should not have affected the total hours submitted to DSAA for offshore procurement fund disbursements. Without the supporting documentation for the standard labor rate and report adjustments, we were unable to validate costs of about $49.9 million for the maintenance, repair, and upgrade of aircraft at the Air Force depot reimbursed with FY 1995 offshore procurement funds.

Civilian Versus Military Personnel Costs

The Israeli documentation provided for the Merkava tank production costs, standard labor rates, standard labor hours, and actual labor hours worked at the four depots did not indicate whether those rates and hours were calculated for civilian personnel, military personnel, or a combination of both. DSAA and Israel have an informal agreement prohibiting the use of offshore procurement funds to reimburse salaries of Israeli military personnel. However, based on the information that the Israeli MoD provided to us, there was no mechanism for either DSAA or the Israeli MoD to determine whether any offshore procurement funds were used to reimburse the salaries of military personnel.

[2]Government of Israel proprietary information omitted.

Documentation Requirements for Offshore Procurement Funds

The annual Agreement between the United States and Israel did not specify what documentation Israel was required to maintain to support its offshore procurement fund disbursement requests. As manager of the FMF grant program, DSAA was responsible for establishing policies and procedures for the use of offshore procurement funds and approving disbursements made with those funds. However, DSAA did not establish policies and procedures describing the documentation needed to validate Israeli disbursement requests before approving the disbursement of offshore procurement funds. While the annual Agreement required Israel to make records available to DoD for review; the Agreement was not specific as to the documentation that the Israeli MoD should maintain to support offshore procurement fund disbursement requests. Additionally, DSAA did not require Israel to submit any supporting documentation and did not attempt to validate costs that the Israeli MoD submitted before approving the disbursements of offshore procurement funds for those costs. By not establishing effective management controls and by not validating the costs that Israel submitted at least biannually, DSAA had no assurance that the requests for offshore procurement fund disbursements represented the actual costs that Israel incurred. Unless adequate documentation is provided to support disbursement requests under future agreements, there is no point in DSAA performing a review of those requests and the approval process ought to be streamlined.

Joint Security Assistance Planning Meeting

The Joint Security Assistance Planning Meeting is Israel's formal presentation to the United States of its security assistance needs, including FMF grant requirements. Each year, representatives from DoD (including DSAA), Department of State, Office of Management and Budget, and Israel meet to discuss and agree upon the aid package to be provided to Israel the following fiscal year. At that meeting, Israel presents its security assistance requirements, including the estimated costs of the programs to be funded with FMF grants for offshore procurements. Since the Joint Security Assistance Planning Meeting evaluates Israel's security assistance needs and agrees on the funding level, DSAA could consider that forum to constitute approval for the use of FMF grants for offshore procurements, subject to Congress appropriating the funds. This would streamline the disbursement approval process by eliminating the requirement for the Israeli MoD to submit, and DSAA to approve, disbursement requests for offshore procurement funds throughout the fiscal year. DSAA could provide the Defense Finance and Accounting Service Denver Center with an annual funds approval document. As Israel required funds, disbursement requests would only be provided to the Defense Finance and Accounting Service Denver Center.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Security Assistance Agency, select one of two options:

1. Seek to include in each annual "Grant Agreement" with Israel the specific documentation that the Israeli Ministry of Defense must maintain to support the offshore procurement fund disbursement requests. The annual "Grant Agreement" should requirements for:

a. Biannual reviews and agreement on Israeli production costs for advanced weapons systems, such as the Merkava tank, that the Israeli Ministry of Defense uses in offshore procurement fund disbursement requests.

b. Biannual review and agreement on standard labor rates that the Israeli Ministry of Defense uses in offshore procurement fund disbursement requests for maintenance, repair, and upgrade work it performs at the Israeli Defense Forces Army and Air Force maintenance depots.

c. Biannual review and agreement on standard hour estimates that the Israeli Ministry of Defense uses in offshore procurement fund disbursement requests for maintenance, repair, and upgrade work it performs at the Israeli Defense Forces Army and Air Force maintenance depots.

d. Biannual review of standard materials charges that the Israeli Ministry of Defense uses in offshore procurement fund disbursement requests for maintenance, repair, and upgrade work it performs at the Israeli Defense Forces Army and Air Force maintenance depots.

e. Exclusion of military personnel costs from standard and actual costs included in offshore procurement fund disbursement requests.

and

2. Develop written policies and procedures to include requirements for the annual review of the reconciliation between standard costs that the Israeli Ministry of Defense submits during the year for offshore procurement fund disbursements and actual costs that the Israeli Ministry of Defense submits at the end of the year for offshore procurement fund disbursements.

or

3. Streamline the disbursement approval process by using the Joint Security Assistance Planning Meeting as the approval forum for the use of foreign military financing grants for offshore procurements.

Management Comments. The DSAA concurred with Recommendation 3. It stated that it did not dispute the finding. DSAA also stated that, while Congress had never clearly articulated its reasons for establishing the offshore procurement program, it was not the intent of Congress that the U.S. Government involve itself directly in the Israeli MoD domestic procurement process. As a result, DSAA chose to implement Recommendation 3.

Audit Response. We consider the comments to be generally responsive. Although DSAA concurred with the streamlining recommendation, it did not provide the planned implementation date. We request that DSAA provide further details on its proposed streamlining actions and specify an implementation date in response to this final report.

Part II - Additional Information

Appendix A. Audit Process

Scope

Review of Offshore Procurement Fund Disbursements. We reviewed Israeli disbursement requests totaling about $446.8 million in FMF grants for offshore procurements in FY 1995. We visited DSAA to review the Agreement and DSAA procedures for verifying and approving Israel's disbursement requests. We visited the Israeli MoD, Merkava tank plant, Army depots 7100 and 7300, and Air Force depot 22 and reviewed the procedures for accumulating costs in support of Israeli disbursement requests. We obtained Israeli MoD data on standard and actual costs incurred and submitted to DSAA for disbursement. We reviewed invoices that two government-owned, commercially-operated contractors submitted in FY 1995 for munitions and commercial aircraft maintenance paid by the Israeli MoD.

Review of Arrow Cooperative Program. We reviewed the method of financing Israel used for its share of the Arrow Cooperative Program. We reviewed international agreements, disbursement requests, and contract milestone payment schedules from FY 1988 through FY 1996 that described the sources of financing available to Israel for the program. We visited the Ballistic Missile Defense Organization (BMDO), DSAA, and the Arrow Project Office and reviewed the memorandum of understanding, program management reviews, and contract milestone documentation from June 1986 through March 1996. We also reviewed the three international agreements, totaling about $1 billion, that the United States negotiated with Israel for the Arrow Cooperative Program and the DSAA process for approving Israel's requests for disbursement of FMF grants for the Arrow Cooperative Program (see Other Matters of Interest).

Limitation to Audit Scope. During the audit, we did not have unlimited access to Israeli MoD records. Additionally, we could not independently verify all the information the Israeli MoD provided because much of that information and the potential supporting records were in Hebrew. We relied on officials at the Israeli Mission to the United States to translate the data provided to us.

Audit Period, Standards, and Location. We performed this program audit from February 1995 through June 1996 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 or computer-processed data for this audit. See Appendix D for a list of organizations visited or contacted.

Methodology

Evaluation of Offshore Procurement Fund Disbursements. We obtained the disbursement requests that Israel submitted to DSAA for FY 1995 offshore procurement funds and evaluated the procedures that DSAA used to verify the information Israel provided. We also evaluated the Israeli MoD procedures for accumulating cost information and preparing requests for offshore procurement fund disbursements. We obtained a listing of production costs for the Merkava tank for CY 1995 and attempted to evaluate Israel's methodology for determining those costs. We obtained the standard labor rates Israel used in CY 1995 to calculate costs that the Army and Air Force depots incurred and attempted to evaluate Israel's methodology for establishing those rates. We obtained actual cost data for the Army depots for April through June 1995 and the Air Force depot for June and July 1995 and attempted to evaluate Israel's method for determining the number of hours submitted to DSAA for disbursement.

Evaluation of Arrow Cooperative Program. We evaluated the use of offshore procurements funds by Israel to finance its share of the Arrow Cooperative Program and the procedures DSAA used to verify the offshore procurement fund disbursement requests Israel submitted for the program. Additionally, we determined whether Israel received funds before completion of work on the Arrow Continuation Experiments stage of the program by reviewing the DD Form 250, "Material Inspection and Receiving Reports," and Israel's requests for disbursement for 32 completed contract milestones, totaling $86.7 million.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987*, requires DoD organizations to implement a comprehensive system of management control 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 DSAA management controls over verifying and approving Israeli offshore procurement fund disbursement requests. Specifically, we reviewed whether DSAA obtained adequate documentation to verify the accuracy of the requests Israel submitted. We also reviewed the results of any self-evaluations of those management controls.

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.

Adequacy of Management Controls. The DSAA management controls over the verification of Israeli offshore procurement fund disbursement requests were not meaningful. DSAA did not have sufficient information to evaluate whether the Israeli offshore procurement fund disbursement requests were valid. The management controls need to be improved or streamlined. All recommendations will either improve DSAA oversight over Israel's use of offshore procurement funds or streamline the approval process. A copy of the report will be provided to the senior official responsible for management controls at DSAA.

Adequacy of Management's Self-Evaluation. The DSAA did not designate offshore procurement funds as an assessable unit and, therefore, did not identify or report the material management control weaknesses identified by the audit.

Prior Audits and Other Reviews

Prior audits and other reviews are discussed in Appendix C.

Appendix B. Other Matters of Interest

Offshore Procurement Fund Disbursements for Purchase Orders. The Israeli MoD internal controls over processing invoices for purchase orders and preparing offshore procurement fund disbursement requests for those purchase orders were good. During FY 1995, Israel submitted three offshore procurement fund disbursement requests, totaling $102.1 million, for munitions and aircraft maintenance provided by two government-owned, commercially-operated contractors. We reviewed the support for one of those requests covering invoices for 84 purchase orders, totaling $66.5 million, at the Israeli MoD. We reviewed the invoice activity lists from January through August 1995, which showed the invoices and adjustments (for example returns and changes in the value of New Israeli Shekel) for each purchase order and verified that the total from the invoice activity list agreed with the request for disbursement. We verified all invoices, totaling $11.7 million, for one purchase order for munitions for the 8-month period and found no discrepancies. Only one duplicate request existed for offshore procurement funds of $475 for maintenance. Israeli MoD officials stated that they would reconcile that error on Israel's next request for offshore procurement funds.

Offshore Procurement Fund Disbursements for the Arrow Cooperative Program. The DSAA had not ensured that disbursements made to Israel for the Arrow Continuation Experiments stage were made after milestone completion. For the contract issued to execute the Arrow Continuation Experiments stage of the Arrow Cooperative Program, Israel agreed to finance 35 milestones, totaling $92.6 million. As of March 1996, DSAA approved and the Defense Finance and Accounting Service Denver Center disbursed FMF grants of $86.7 million to Israel for 32 completed contract milestones. Of the $86.7 million disbursed to Israel, the Defense Finance and Accounting Service Denver Center disbursed $30.2 million before completion of the milestones. Those disbursements were made because DSAA did not have the current contract milestone schedule or verify milestone completion before approving the disbursement of FMF grants. DSAA officials recognized the control weakness during the audit and stated that they would request a current version of the contract milestone schedule from the Arrow Project Office, U.S. Army Space and Strategic Defense Command when Israel requested the next disbursement of FMF grants for the Arrow Continuation Experiments stage. The DSAA action, when complete, should ensure that FMF grant funds are disbursed to Israel after contract milestones are completed. DSAA should be included on the distribution list for all changes to the contract milestone schedule.

Appendix C. Uses of Offshore Procurement Funds

GAO Report on Uses of Offshore Procurement Funds

The General Accounting Office (GAO) issued Report No. NSIAD 91-169 (OSD Case No. 8710), "Israel-U.S. Military Aid Spent In-Country," May 23, 1991, which stated that Israel procured Defense articles and services that were not permitted under offshore procurement funding. Specifically, GAO stated:

> DSAA has not observed the legislative requirement that offshore procurement funds be used for the development and production of advanced weapons systems. During fiscal years 1988-90, Israel was reimbursed for fuel, maintenance, and ammunition. DSAA believes that the law is ambiguous about what items qualify for offshore procurement funding. In the absence of clear legislative intent, DSAA has adopted a flexible approach toward offshore procurement which is tantamount to a cash transfer program. This approach reimburses Israel for defense items that we believe the law does not allow. . . . the legislation does not define advanced systems and DSAA has permitted Israel to determine what procurements are covered. We take a narrower view of the legislation and believe that only items associated with advanced weapon systems should be reimbursed.

Additionally, GAO stated that Israel used its FMF grants for offshore procurements to finance Defense articles and services that might not have contributed to Israel's qualitative edge, such as maintenance on light aircraft and cargo plane, painting of planes, and small arms and ammunition. GAO stated:

> If the purpose of offshore procurement is to improve Israel's qualitative advantage, we believe that only defense items meeting that purpose should be funded. Criteria that might be used in determining whether defense articles and services provide a qualitative edge could include whether the item (1) enhances the capability of an existing defense system, (2) appears to be technically superior to other systems in Israel's inventory, or (3) represents a significant element of an advanced system.

Further, DoD did not require Israel to account for the hard currency provided for offshore procurements. GAO recommended that the Secretary of Defense direct DSAA to:

- o define advanced weapon systems and limit funding for those systems,
- o take a more active role in reviewing and approving projects for U.S. FMF grant financing, and
- o require Israel to account for the hard currency provided by offshore procurement.

The DSAA generally concurred with the findings and conclusions; however, DSAA stated that it can reimburse Israel for all categories of expenses, including ammunition and maintenance, even if those expenses are not related to advanced weapon systems. GAO responded to DSAA comments by stating that the DSAA interpretation resulted in the reimbursement for all categories of expenses and nullified congressional changes in the appropriations language that appeared to establish eligibility requirements for offshore procurement. GAO stated that, if the Congress agreed with DSAA that all items should be eligible for financing, then offshore procurement was little more than a cash transfer program and should be included in the State Department Economic Support Fund budget. As of July 1996, offshore procurement funds were still part of the FMF grant program administered by DSAA. We found no evidence that changes in the legislation had occurred.

FY 1995 Uses of Offshore Procurement Funds

During FY 1995, Israel continued to use FMF grant funds of $474.7 million for offshore procurements to reimburse similar categories of expenses discussed in the GAO report. Those expenses consisted of maintenance of about $268.8 million, advanced weapons systems procurement of about $188.2 million (including $20 million for research and development under the Arrow Cooperative Program), and munitions of about $17.7 million. However, as stated in the 1991 GAO report and this report, DSAA has continued to approve Israel's use of FMF grant funds for other than the development and production of advanced weapon systems rather than using those funds to fully finance priority advanced weapon system requirements, such as the research and development of the Arrow missile. We recognize that the international agreements between the United States and Israel divided the cost of the Arrow Cooperative Program between the two countries and did not require Israel to finance the entire cost of the program. We believe, however, that Israel should, in the future, use the United States provided FMF grants for offshore procurements to finance a greater portion of advanced weapon systems in development, such as the Arrow Cooperative Program, one of Israel's highest priority requirements.

The Arrow Cooperative Program

The Strategic Defense Initiative Organization signed a memorandum of understanding, "Between the Government of the State of Israel and the Government of the United States of America Concerning Cooperation in the Strategic Defense Initiative Program," May 6, 1986. That memorandum

initiated the Arrow Cooperative Program[1] for the development of the Israeli Arrow missile. To execute the memorandum, DoD and Israel entered into three international agreements, totaling about $1 billion, for cooperative research and development of the Arrow missile. Each agreement constitutes a new stage for the research and development of the Arrow weapons system with separate implementing contracts and financial arrangements for each stage. Although the Strategic Defense Initiative Organization was a party to the agreements signed before May 13, 1993, to avoid confusion, we are using the current name of the organization, the Ballistic Missile Defense Organization (BMDO[2]).

Arrow Experiments Program Stage. The DoD signed a memorandum of agreement, "Between the Department of Defense as presented by the Strategic Defense Initiative Organization (SDIO) and the Ministry of Defense of Israel Concerning Development of Technology to Support U.S. and Israeli Requirements for Theater Ballistic Missile Defense," June 29, 1988, to validate an Israeli defense concept and demonstrate a prototype missile for theater ballistic missile defense. To execute the agreement, BMDO awarded a contract to Israel Aircraft Industries, Ltd., totaling $158 million, of which, Israel agreed to finance $32 million (20 percent). Of the $32 million, Israel used $8 million in FMF grants to finance a foreign military sales case. The Arrow Experiments Program (AEP) stage concluded in December 1992, after the contractor had demonstrated the feasibility of the Israeli theater ballistic missile defense concept and the Arrow I missile.

Arrow Continuation Experiments Stage. The DoD signed a memorandum of agreement, "Between the Department of Defense of the Government of the United States of America and the Ministry of Defense of the Government of the State of Israel Concerning Arrow Continuation Experiments (ACES)," June 7, 1991, for the second stage of the program. The work performed under that agreement was used to make decisions concerning the full scale development[3] and deployment of the Arrow II missile. To execute the agreement, BMDO established the Arrow Project Office under the U.S. Army Space and Strategic Defense Command (formerly the U.S. Army Strategic Defense Command) to manage the contract for the ACES stage. The U.S. Army Space and Strategic Defense Command awarded a $330 million contract to Israel Aircraft Industries,

---

[1]A cooperative program is a joint arrangement to enhance the conventional defense capabilities of each participant. Each participant in a cooperative program contributes a share of the program costs and receives a share of the program results.

[2]The Strategic Defense Initiative Organization was renamed BMDO, effective May 13, 1993. The two agreements signed before that date were signed by the Director, Strategic Defense Initiative Organization. The agreement signed after that date was negotiated and concluded by BMDO and signed by the Under Secretary of Defense (Acquisition and Technology).

[3]During full-scale development, the selected system and its principal items of support are fabricated. The intended output, as a minimum, is a preproduction system that closely approximates the final product.

Ltd., for additional Arrow I flight tests and for the development of the Arrow II missile and launcher. For that contract, Israel agreed to finance $92 million, or 28 percent, of which, Israel used FMF grants to finance $86 million and is expected to finance the remaining $6 million with FMF grants. An additional four intercept tests are to be conducted before the ACES stage will be completed.

Arrow Deployability Program Stage. The DoD signed the third international agreement, "Between the Department of Defense of the United States of America and the Ministry of Defense of Israel for the Arrow Deployability Program (ADP)," March 29, 1996, to develop technologies associated with deploying the Arrow II missile. That stage is to assess the effectiveness of the Israeli anti-theater ballistic missile defense system, establish interoperability with U.S. systems, and collect and evaluate kill assessment data over the next 5 years. Under the agreement, Israel will award and manage the contract, estimated at $556 million. Israel has agreed to finance $354 million (64 percent of the $556 million). To finance the ADP stage, DSAA approved Israel's request to use the interest earned from Israel's FMF grant[4] to pay for a portion of the stage.

DoD Participation in the Arrow Cooperative Program

The Arrow Cooperative Program is a high priority advanced weapon system program for Israel. While the United States has no requirement for the missile, the United States does expect to derive some benefits from the program.

BMDO Testimony. The BMDO recognized that the primary goal of the Arrow Cooperative Program was to fulfill an Israeli Defense requirement rather than a DoD requirement. The Director, BMDO, testified before the House Subcommittee on the Department of Defense, Committee on Appropriations, during the 1994 Department of Defense Appropriations hearings. The Director stated:

> The U.S. [United States] has no operational requirement for the ARROW and has no plans to purchase it. The purpose of the cooperative program is to contribute technology and data to the development of U.S. interceptors and concurrently, satisfy the Israeli requirement for development of a tactical ballistic interceptor. The ARROW is an Israeli-developed missile that was designed to counter current and projected tactical ballistic missile threats facing Israel. The operational and technical requirements for the ARROW are dramatically different than requirements applicable to U.S. interceptors. U.S. anti-tactical ballistic missiles must be air transportable for rapid deployment worldwide and capable of countering the full spectrum of tactical ballistic missile threats present in all regions of the world.

[4]In 1992, the United States authorized Israel to earn interest on its FMF grants in lieu of increasing the annual $1.8 billion grant amount.

Benefits From Participating in the Arrow Cooperative Program. Although the United States had no operational requirement for the Arrow I and II missiles and launchers, the United States has received benefits from the Arrow Cooperative Program. The Director, BMDO, testified before the House Subcommittee on the Department of Defense, Committee on Appropriations, during the 1995 Department of Defense Appropriations hearings on the benefits of the Arrow Cooperative Program. The Director stated:

> The U.S. [United States] could also benefit from the eventual presence of an anti-missile defense system in Israel, through the potential contribution to the deterrence of future TBM [theater ballistic missile] conflicts in that region and the potential contribution to a more robust defensive response if deterrence fails. The potential interoperability of the Arrow system with U.S. systems would facilitate effective coordinated defense if U.S. systems should deploy to the Middle East theater. Redundant systems in a shared theater of operations would improve defense synergistically and reduce the costs of a single-system defense.

Products from the Arrow Cooperative Program have enhanced the Theater High Altitude Area Defense missile and the Patriot theater missile defense programs. Specifically, the Arrow Program provided test results on the infrared and cooperative active radio frequency seeker technology data bases, kill assessment data from intercepting Scud class targets that are not used in U.S. programs, radar signature data collected from surrogate target detonation, and analysis of stage separation at high velocities.

United States Financial Involvement in the Arrow Cooperative Program

Between 1986 and 1996, the United States has used $421 million in Research, Development, Test, and Evaluation funds for its share of contract costs for the Arrow Cooperative Program. Israel has used $100 million in FMF grants towards its share of contract costs for the Arrow Cooperative Program. During the same period, the United States made $4.65 billion available to Israel for offshore procurements. Table C summarizes the extent of U.S. financial involvement in the contracts for the three stages of the program.

Table C. Financing Contracts Under the Arrow Cooperative Program

Stages	Contract[1] Cost	U.S.[2] Share	Israeli Share	Israeli Financing Source
AEP	$ 158	$126	$ 32	Mixed[3]
ACES	330	238	92	FMF
Subtotal	**$ 488**	**$364**	**$124**	
ADP	556	202[4]	354	Interest[5]
Total	**$1,044**	**$566**	**$478**	

[1]Cost of prime contract awarded to Israeli Aircraft Industries Ltd.
[2]The U.S. share of AEP and ACES was financed with DoD Research, Development, Test, and Evaluation funds. The U.S. share of ADP is also expected to be financed with DoD Research, Development, Test, and Evaluation funds.
[3]Israel used non-FMF funding of $24 million and FMF grants for foreign military sales of $8 million to finance the AEP stage.
[4]Of the $202 million, $27 million was appropriated in FY 1996. The remaining $175 million is expected to be appropriated in FY 1997 through FY 2001.
[5]Interest earned on the FMF grant funds.

The DoD share of contract costs for the AEP and ACES stages was financed with appropriated Research, Development, Test, and Evaluation funds of $364 million. For FY 1996 and prior years, DoD financed $27 million of its commitment for the ADP stage with appropriated Research, Development, Test, and Evaluation funds for a total use of $391 million in Research, Development, Test, and Evaluation funds through FY 1996. Israel requested and DoD authorized the use of $8 million in FMF grants for foreign military sales to partially finance the Israeli share of the AEP stage and $92 million in offshore procurement funds to finance the entire Israeli share of the ACES stage. The current agreement between the United States and Israel prohibits Israel from using FMF grants for offshore procurements to finance the Israeli share of the ADP stage. U.S. financial involvement in the ADP stage is expected to continue through FY 2001.

United States Support for Israel

Since the United States provides FMF grant funds, it would be reasonable for Israel to fund a greater portion of future advanced research and development efforts using FMF grant funds provided for that purpose; thereby, requiring less United States Research, Development, Test, and Evaluation funds. However, our review did not encompass an overview of the entire military relationship between the two countries; therefore, we are not making a recommendation on this issue.

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Deputy Under Secretary of Defense (International and Commercial Programs), Washington, DC
General Counsel of the Department of Defense, Washington, DC

Department of the Army

U.S. Army Space and Strategic Defense Command, Huntsville, AL
Program Executive Office, Missile Defense, Huntsville, AL
Arrow Project Office, Huntsville, AL

Other Defense Organizations

Ballistic Missile Defense Organization, Washington, DC
Defense Attache Office, American Embassy, Tel Aviv, Israel
Defense Finance and Accounting Service Denver Center, Denver, CO
Defense Security Assistance Agency, Washington, DC

Non-Defense Federal Organization

American Embassy, Tel Aviv, Israel

Non-Government Organizations

Ministry of Defense, Government of Israel, Tel Aviv, Israel
Mission to the United States, New York, NY

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
  Deputy Under Secretary of Defense (International and Commercial Programs)
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense (Policy)

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)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Ballistic Missile Defense Organization
Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, Defense Security Assistance Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
General Accounting Office
National Security and International Affairs Division
Technical Information Center
American Embassy, Israel

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 Foreign Relations
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 International Relations
House Committee on National Security
House Subcommittee on Military Research and Development, House Committee on National Security

Non-Government Organizations

Ministry of Defense, Government of Israel
Mission to the United States

Part III - Management Comments

Defense Security Assistance Agency Comments

DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

17 OCT 1996

In reply refer to
I-005575/96

MEMORANDUM FOR DIRECTOR, LOGISTICS SUPPORT DIRECTORATE
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Israeli Use of Offshore Procurement Funds
(Project No. 5LG-0069)

This responds to your August 20 memorandum which requested that DSAA review and provide comments on the subject report. Specifically, you asked that we indicate our concurrence or nonconcurrence with the report's finding and recommendations.

During its review of Israel's foreign military financing (FMF) program, the DoD/IG audit team found that:

> The Israeli Ministry of Defense (MOD) was not required to, and did not, maintain an adequate audit trail to allow verification of production costs for the Merkava tank and depot maintenance costs, submitted to DSAA.

This led them to conclude that:

> [T]he DSAA disbursement request approval process serves little purpose and should, therefore, be streamlined unless DSAA is willing to require adequate supporting documentation for disbursement requests under future agreements.

DSAA does not dispute this finding. It is our position that, while Congress has never clearly articulated its reasons for establishing the offshore procurement (OSP) program, it is not their intent that the U.S. Government involve itself directly in the Israeli MOD's domestic procurement process. For this reason, we concur with and are prepared to take the necessary steps immediately to streamline the disbursement process as suggested in Recommendation 3. of the audit report.

Thank you for the opportunity to comment on your audit report. Please do not hesitate to contact us if we can be of additional assistance in this matter.

Thomas G. Rhame
Lieutenant General, USA
Director

Audit Team Members

This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Shelton R. Young
Evelyn R. Klemstine
Catherine M. Schneiter