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The Department of Defense (DOD) has absorbed millions of dollars of transportation and handling costs which should have been recovered from customers under the Foreign Military Sales Program. Findings/Conclusions: DOD has problems identifying and billing customers under the program. Foreign customers have been undercharged about \$17 million for air shipment of their items. Unrealistic percentage factors are applied under the surcharge billing method. Over \$7 million in ocean transportation costs had not been billed to customers for military sales items withdrawn and shipped from depots in Germany, and the future costs of shipping replacement items overseas had not been considered. The Secretary of Defense should direct that the following actions be taken: foreign military sales documentation and billing procedures be modified so that customers can be billed for the actual cost of transportation and port handling services provided; the surcharge rates used to determine packing, handling, and crating costs be increased to cover actual costs; controls over foreign military sales shipments originating at overseas depots be strengthened; procedures be established to obtain proof of delivery documentation on foreign military sales shipments to aid personnel responsible for processing loss and damage claims; previous shipments made from overseas installations be reviewed and an attempt made to recover any costs that have not been billed; and previous air shipments be reviewed and customer billings recomputed using the correct non-Government shipper rates, and an attempt be made to collect the amounts underbilled. (SC)

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*UNITED STATES
GENERAL ACCOUNTING OFFICE*

Improvements Are Needed To Fully Recover Transportation And Other Delivery Costs Under The Foreign Military Sales Program

Department of Defense

The Department of Defense has absorbed millions of dollars of transportation and handling costs which should have been recovered from customers under the Foreign Military Sales Program. The Department should:

- Modify its procedures and bill customers for actual transportation and handling charges.
- Establish realistic surcharge rates for packing, crating, and handling.
- Strengthen controls over shipments originating at overseas depots.
- Attempt to recover significant underbilled costs on both past shipments of materials from overseas depots and air shipments from the United States.
- Establish proof of delivery procedures.



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

LOGISTICS AND COMMUNICATIONS
DIVISION

B-165731

The Honorable
The Secretary of Defense

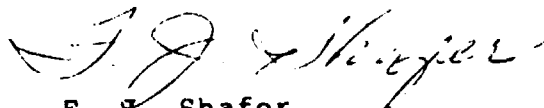
Dear Mr. Secretary:

This report discusses the costs of packing and transporting material under the Foreign Military Sales Program.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; the Chairmen, Senate and House Committees on Appropriations and Armed Services; the Chairmen, Senate Committee on Governmental Affairs; the Chairman, House Committee on Government Operations; and the Secretaries of the Air Force, the Army, and the Navy.

Sincerely yours,


F. J. Shafer
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE
SECRETARY OF DEFENSE

IMPROVEMENTS ARE NEEDED TO
FULLY RECOVER TRANSPORTATION AND
OTHER DELIVERY COSTS UNDER THE
FOREIGN MILITARY SALES PROGRAM
Department of Defense

D I G E S T

The Foreign Military Sales Act and the recently enacted Arms Export Control Act require that the U.S. Government be reimbursed for the costs of material and services sold to foreign countries under the foreign military sales program.

While the Department of Defense intends that charges to foreign governments cover accessorial--packing, crating, handling, and transportation--costs, GAO found that the Department has problems identifying and billing customers for such services. As a result, many millions of dollars in accessorial costs have not been recovered from foreign governments.

For example:

- Foreign customers had been undercharged about \$17 million for air shipment of their items. (See pp. 4, 5, 6, and 8.)
- The Department is applying unrealistic percentage factors under the surcharge billing method. GAO estimates that the Department is recovering only about half of the cost it incurs in packing and handling charges on foreign military sales shipments and that undercharges for this service alone may exceed \$71 million a year. (See pp. 11, 14, and 15.)
- Over \$7 million in ocean transportation costs had not been billed to customers on foreign military sales items withdrawn and shipped from depots in Germany, and the future costs of shipping replacement

items overseas had not been considered.
(See p. 17.)

--The Department generally does not obtain delivery receipts for foreign military sales shipments; consequently, it has no basis for challenging or establishing responsibility for thousands of loss and damage claims received and processed under the foreign military sales program each year. (See p. 22.)

The millions of dollars of underbilled and unrecovered costs disclosed by GAO's study attest to the need for immediate action to strengthen controls over the accessorial service costs of the foreign military sales program.

The Department could solve many of its problems by using actual cost data to bill customers for the transportation and port handling services it has provided on foreign military sales shipments. Although this would require modifying procedures, it should not present significant management problems. (See p. 21.)

To improve the program, the Secretary of Defense should direct that the following actions be taken.

--Discontinue using most standard surcharges to recover transportation and port handling costs and modify foreign military sales documentation and billing procedures so that customers can be billed for the actual cost of transportation and port handling services provided.

--Increase the surcharge rate used to determine packing, handling, and crating costs to cover the Department's actual costs.

--Strengthen controls over foreign military sales shipments originating at overseas depots.

- Assure that foreign military sales agreements provide for reimbursement of the future transportation and handling costs required to ship items from the continental United States to replace those withdrawn from overseas depots.
- Establish procedures to obtain proof of delivery documentation on foreign military sales shipments to aid personnel responsible for processing loss and damage claims.
- Review previous shipments made from overseas installations and attempt to recover any costs that have not been billed, including the cost of shipping replacement items from the continental United States.
- Review previous air shipments, recompute customer billings using the correct non-Government shipper rates, and attempt to collect amounts underbilled.
- Require, as a control procedure, the Defense Audit Service to periodically review and report on how effective the directed improvements are and if the costs of accessorial services provided by the Department are fully recovered.

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ABBREVIATIONS

DOD	Department of Defense
FMS	foreign military sales
GAO	General Accounting Office
ILC	international logistics center
MAC	Military Airlift Command
MSC	Military Sealift Command
MTMC	Military Traffic Management Command
USAMMAE	U.S. Army Material Management Agency, Europe

CHAPTER 1

INTRODUCTION

The Foreign Military Sales Act of 1968 and the recently enacted Arms Export Control Act authorize the sale of defense material and services to friendly countries and international organizations when the sale will strengthen the security of the United States and promote world peace.

Increasing congressional and public attention has been focused on the dramatic increase in the volume of U.S. foreign military sales (FMS). The rapid growth--from \$1 billion in fiscal year 1967 to almost \$10 billion in 1975 and over \$8.6 billion in fiscal year 1976--has sparked considerable debate over the program's operation and direction.

FMS MANAGEMENT RESPONSIBILITY

The Department of Defense (DOD) is responsible for administering the FMS program. Customer requests for military hardware or services are processed through the Defense Security Assistance Agency to the individual service's international logistics program headquarters office and ultimately to the respective service inventory commodity managers. In essence, the Army, Navy, and Air Force are responsible for purchasing, moving, handling, delivering, billing, and collecting for the FMS items that they have the logistic management responsibility for. To accomplish this task each military service operates an international logistics center (ILC), which administers the Grant Aid, FMS and Cooperative Logistics programs. These centers control the programs from implementation through completion, including processing requisitions to appropriate supply sources, maintaining supply and shipment status, and processing billing and final accounting actions. The authority for FM program implementation at the ILC is the receipt of an approved letter of offer and acceptance, which is the contract between DOD and the foreign customer.

This management structure will undoubtedly change in the near future. Centralized financial management for FMS was recently directed by the Office of the Secretary of Defense. The Air Force was named as the DOD executive agent for the operation of trust fund accounting, billing of foreign countries, cash collection, and administrative fee management. Thus, Army and Navy administrative and record-keeping responsibilities have been transferred to the Air Force. Security assistance (international logistics)

training is to be consolidated at the Air Force Institute of Technology, Wright-Patterson Air Force Base in Ohio. We have not determined what organizational changes will be made as a result of centralizing financial management in the Air Force, but we believe the matters discussed in this report will interest Air Force officials responsible for developing new operational procedures.

ACCESSORIAL SERVICES PROVIDED BY DOD

Controlling legislation requires that the Government recover all costs associated with the sale of material and services to foreign countries. This includes the costs for accessorial services provided after the sale. Accessorial services provided often include

- packing, crating, and handling costs for preparing material for shipment from storage or distribution points;
- inland transportation costs (by land, air, or waterways) in the United States or outside the United States, including parcel post;
- overocean transportation costs, including parcel post; and
- loading and unloading costs at ports of embarkation and debarkation.

DOD Instruction 2140.1 prescribes the procedures that service international logistic managers are to use to recover the costs for accessorial services provided under a FMS transaction.

The instruction states that for the sale of items with a unit price of less than \$10,000, the supplying agency may apply one or more of a group of percentage factors to recover the cost of each accessorial service rendered on the sale. (See page 11.) The surcharge percentages are applied to the billing price of the delivered material.

The instruction states also that the percentage rates are not to be arbitrarily applied to the sale of any item that is excess to DOD's needs or to single items having a unit billing price of \$10,000 or more. Instead, actual or estimated costs are to be used when the supplying agency determines that a more equitable charge will result.

This report discusses DOD's problems in identifying, billing, and recovering its costs for transportation and accessorial services under the FMS program. The severity of the problems and the millions of dollars of costs that have not been recovered from foreign customers are discussed in the following chapters.

CHAPTEF. 2

FOREIGN CUSTOMERS UNDERCHARGED

FOR MILITARY AIRLIFT COSTS

Various procedural problems are plaguing DOD's transportation and billing processes, including DOD's failure to recover millions of dollars because foreign customers were improperly billed for airlift services.

Although DOD encourages foreign customers to secure transportation to move their FMS purchases from point of origin to final destination, customer preference and the sensitive nature of the items sold often require DOD to arrange for delivery. DOD relies on its own supply and transportation systems to deliver, with the Military Airlift Command (MAC) providing the airlift.

MAC offers two types of airlift transportation to its DOD customers. "Channel" service is available on scheduled flights over established routes; charges are computed based on the weight or cube of the cargo. DOD components may also request a special assignment airlift mission, whereby MAC provides an entire aircraft to airlift items from points of origin or to destinations not normally covered by channel service. Military aircraft are used in these flights, and charges are based on established hourly rates for the type of aircraft used.

FOREIGN CUSTOMERS NOT PROPERLY CHARGED FOR SPECIAL AIRLIFT TRANSPORTATION SERVICES

We identified over \$11 million of costs that DOD had not recovered for special airlift service flights used to deliver FMS items. The circumstances causing this situation and corrective actions taken by the Army and Air Force to recover the costs are described below.

Army did not recover costs for special assignment airlift mission flights

From May 1973 to September 1975, MAC flew 68 special airlift missions to deliver FMS items for the Army. The Army paid MAC over \$10 million for these missions, but, because of vague instructions, neither the Army commodity managers nor the Army finance center submitted delivery and cost data to the international logistics center so that foreign customers could be billed.

The following example underscores the need for DOD to recover its costs when special assignment airlift is provided to deliver FMS items.

Between June 1974 and August 1975, MAC flew 48 special assignment flights to deliver helicopters and related spare parts under an Army FMS agreement. The Army paid MAC \$6.9 million for its services but made no attempt to recover costs from the foreign customer. The Army's ILC was completely unaware of the shipments because it had received no delivery or cost information from either the shipping commodity command or the Army finance center.

We brought our findings to the attention of officials at the Army's ILC in December 1975, pointing out the lack of procedures for recovering airlift costs, and worked with them in identifying airlift costs that should be recovered on past FMS shipments. We also suggested a new document processing procedure which gave the Army finance center responsibility for forwarding needed payment information to the ILC so that the costs of future special assignment airlift FMS missions could be promptly billed to the recipient country. By February 1976, the Army's ILC had collected \$6.9 million of the \$10 million we identified and was preparing billing documents to recover the remaining costs.

Air Force underbilled customers for special assignment airlift service

The Air Force has established a rate schedule for MAC to charge customers when airlift service is provided to deliver cargo. The rates for U.S. Government users are much lower than those charged to non-Government users, including FMS customers.

During fiscal year 1975, MAC provided special airlift flights to deliver F-5 aircraft under FMS agreements with two foreign nations. MAC used both C-5A and C-141 aircraft to deliver the FMS aircraft. The foreign customers were properly billed at the non-Government rates for C-141 flights, but the C-5A flights were billed at the lower Government rates. As a result, the foreign customers were underbilled by more than \$1 million for the special airlift transportation provided.

We called this to the attention of Air Force officials, and they issued supplemental billings of \$1,091,243 to recover the amounts underbilled.

COSTS FOR CHANNEL AIRLIFT SERVICE
ARE NOT BEING RECOVERED

In most cases, foreign customers have not been properly charged for channel airlift service used to deliver FMS items overseas. Many customers provided with air delivery service have been underbilled, and others were not charged at all. For example, the Air Force stated that FMS items moving on channel airlift were billed in two ways. Material costing more than \$10,000 is billed at the correct non-Government tariff, while material costing less than \$10,000 is billed at the standard surcharge. As discussed in the next chapter, we do not believe that the surcharge method covers surface transportation costs, let alone more expensive air transportation. The Army had a procedure to bill airlift charges for all items regardless of cost. In practice, however, the surcharge was normally applied and, in those instances when the actual airlift cost was computed, the Government tariff rates were charged to the foreign customer. The difference between the Government tariff and non-Government tariff is pronounced. For example, a Government user is charged 91 cents a pound for a shipment flown between Dover, Delaware, and Tehran, Iran, while the non-Government user is required to pay \$2.75 a pound for the same service.

Inadequate training, employee inattention to detail, and incorrectly coded billing and delivery documents are factors which contribute to DOD's nonrecovery of its costs.

Army problems deserve immediate attention

Although the FMS customer billing system at the Army's ILC is essentially automated, customer billings for airlift costs are computed manually upon receipt of material billing cards from the commodity command sponsoring the shipment.

We made a limited analysis of 195 billings to determine if the amounts charged customers recovered what the Army actually paid MAC to transport the items. We found that only one of the billings recovered the Army's costs and that the other customers had been underbilled by about \$1.2 million. The following table summarizes our analysis:

	<u>Number of billings</u>	<u>Army airlift costs</u>	<u>Amount billed to customers by ILC</u>	<u>Net amount underbilled or overbilled</u>
Underbilled	175	\$1,666,000	\$260,000	\$1,406,000
Overbilled	19	298,000	500,000	-202,000
Correct	<u>1</u>	<u>9,000</u>	<u>9,000</u>	<u>-</u>
Total	<u>195</u>	<u>\$1,973,000</u>	<u>\$769,000</u>	<u>\$1,204,000</u>

The Army had underbilled many of its customers for overseas air transportation costs primarily because material billing cards received by its ILC erroneously indicated that surface transportation had been used to deliver the items. As a result, customers were billed for transportation at the lower surface rates.

This practice also resulted in a few customers being overcharged. The problem occurred because commodity commands sponsoring shipments were coding the material billing cards with the mode of transportation used when the material left the vendor or depot. In most instances either truck or rail would be used to move the items to aerial ports for overseas air delivery. Since the material billing card had space for only one transportation code, the combination of surface and air actually used could not be indicated.

On some of the shipments, the commodity commands neglected to code material billing cards for any transportation provided. As a result, personnel at the logistics center assumed the shipments were made by surface transportation and arbitrarily billed customers based on the standard surcharge percentages.

In addition to the 195 shipments included in our analysis, we identified 17 others that the Army had not billed for at all. The Army had paid MAC \$69,000 for air transport of these shipments. Actually, the Army had no authority to ship the materials. The requisitions for these items were coded with delivery terms which specified that the customer would arrange for transporting the materials from the purchase point of origin. Transportation personnel at sponsoring commodity commands had apparently overlooked the restrictive delivery term code on the requisitions.

We called our findings to the attention of personnel at the Army's ILC. They said they would issue adjustment billings to customers and attempt to recover the additional costs.

Air Force has taken action
to improve billing practices
for channel airlift services

We analyzed Air Force use of channel service to deliver its FMS items for the 37-month period ended October 31, 1975. We found 857 shipments that had not been billed to recipient countries. On these shipments, the Air Force paid MAC over \$157,000 for transportation and port handling costs. The large number of unbilled shipments were the result of errors in coding the billing documents, failures to follow established procedures, and failures to review transportation charges in a routine manner at the Air Force logistics center sponsoring the shipments. The shipments had erroneous delivery term, mode, and transportation codes, which did not alert the Air Force finance center to bill and recover the charges from the foreign purchases.

Upon reviewing airlift cost computations on shipments of high value items--item price over \$10,000--made by personnel at the air logistics centers during the 12-month period ended October 31, 1975, we found that 38 of 53 were incorrect. In some cases, personnel had not used current or otherwise proper rates to determine airlift charges, and in others personnel had omitted transportation charges entirely. As a result, customers had been underbilled by about \$37,000.

We brought the errors in codings and cost computations to the attention of Air Force officials and recommended that revised billings be issued to recover airlift costs not billed or underbilled. We also suggested that they consider additional training for personnel responsible for coding FMS billing documents and computing air transportation costs, and that they establish an internal review system at the logistics centers to detect such errors.

We were later told that revised billings had been issued to recover costs and that:

--A letter detailing the discrepancies we disclosed is being sent to all air logistics centers. The letter will emphasize the need for a self-inspection program and will provide instructions on how to identify and report transportation costs.

--Instructions for recovering transportation costs on FMS shipments have been clarified and will be published in Air Force Manual 75-43.

- Training was given to employees at the five air logistic centers on how to use transportation rates and how to prepare the basic documentation used to recover transportation costs from recipient countries.
- The Logistics Command will ask the Air Force Auditor General to review this area in the near future.

CHAPTER 3

SURCHARGES ARE NOT RECOVERING ALL COSTS FOR TRANSPORTATION AND OTHER ACCESSORIAL SERVICES PROVIDED BY DOD

DOD often does not recover its actual costs for transportation and other accessorial services provided in connection with foreign military sales because, on sales of items valued at less than \$10,000 each, surcharges for such services are computed by using unrealistic standard percentages of the cost of the material sold. Some FMS customers have been charged much less and others much more because of the use of the standard percentage surcharges. Additional underbillings have resulted from the improper use of these standard surcharges on sales of higher value and excess items.

Although it was not possible to determine the overall cost impact of DOD's use of the percentage surcharges, it appears that FMS customers were undercharged about \$71 million during 1976 for packing, crating, and handling services because DOD used the unrealistic surcharges to compute billings.

DOD policy

Department of Defense Instruction 2140.1 prescribes the procedures that service international logistics managers are to use to recover the costs for accessorial services, including transportation, provided under FMS transactions.

The instruction states that, for the sale of items with a unit price of less than \$10,000, the supplying agency may apply one or more of the following percentage surcharges to recover the cost of accessorial services provided by DOD. The surcharges are applied to the billing price of the delivered material.

<u>Accessorial services provided by DOD</u>	<u>Standard percentage surcharge</u>
Packing, handling, and crating at storage depot	3.5
Parcel post to continental United States (CONUS) destination	1.0
CONUS transportation	3.0
CONUS port unloading and handling	2.5
Overseas port unloading and handling	1.0
Overseas inland transportation	3.0
Ocean transportation from CONUS to:	
Europe, Latin America, and Mediterranean ports	4.0
Newfoundland, Labrador, Iceland, South America, Far East, African (other than Mediterranean), and Near East ports	6.0

The DOD instruction states also that the standard surcharges will not be arbitrarily applied to items that are excess to DOD needs or to items having a unit price of \$10,000 or more. Instead, actual or estimated costs are to be used if a more equitable charge will result.

PERCENTAGE SURCHARGES ARE QUESTIONABLE AS A BASIS FOR RECOVERING COSTS AND CAUSE BILLING INEQUITIES

The standard surcharges listed above were published in 1969 and, with minor exceptions, have remained unchanged. DOD officials could not explain why the percentages billed for overseas transportation--4 or 6 percent, depending on the destination--have remained constant even though inflation and increased fuel costs have escalated ocean shipping costs by more than 200 percent since 1970.

Although inflation during this time has also increased prices charged for individual FMS items, which correspondingly increased amounts collected for transportation under the percentage billing method, it has not equaled the 200-percent increase in ocean shipping costs. For example, the price of industrial commodities, a commodity group that most closely resembles military hardware, has risen by only 90 percent over the last 10 years.

The Military Traffic Management Command (MTMC) also questioned the adequacy of the percentage method as a basis for recovering transportation costs on FMS shipments. In

June 1976, MTMC reported to the Assistant Secretary of Defense (Installations and Logistics) that:

"The percentage of dollar value alone, which is the present accessorial method, is not a valid criteria for collecting transportation costs. Transportation costs are, in fact, based upon measurement tons or weight criteria and the particular commodity and handling requirements, none of which have a direct correlation to dollar value. * * * The possibility of transportation cost charged for any one case to be representative of actual cost incurred would be even more improbable.

"The possibility of the accessorial charge method being representative is even more remote when viewed in terms of the various modes, or combination of modes and related costs, that are involved in the movement of goods or in the multitude of services that may have been performed. The simple knowledge that a shipment was delivered to the port under Code 3 (free alongside vessel, port of exit) for which a standard charge of three percent would have been billed, is not sufficient to assess the impact on the combinations of services provided. It is not known if the item was delivered to the port by motor, rail, LOGAIR, QUICKTRANS ¹/₁, or a combination of these. Also, it is not known if escort or signature service was involved, or if higher tariffs were paid due to the nature of the cargo. It is also not known, from a cost position, if the cargo went straight to a terminal and was locally drayed to a commercial pier when ocean carriage became available. Further, there is no difference in accessorial rates whether premium air transportation was used in lieu of lower priced water carriage."

We believe the last point is of particular significance. It seems unreasonable that the percentage surcharges do not differentiate between surface and air transport methods even though FMS material is frequently shipped by air. We identified

¹/LOGAIR and QUICKSTRANS are contract air carrier operations serving DOD in CONUS.

many instances in which the application of percentage rates did not recover even the lowest cost of surface transportation provided and would have been grossly inadequate had more expensive air transportation been used.

The following examples demonstrate the questionableness of charging customers for transportation and port handling services under the percentage surcharge method and show the inequitable billings that result.

Jeeps

A Middle East nation negotiated a sales agreement for the purchase of 1,472 jeeps. The agreement gave the Army delivery responsibility. The Army applied the 6-percent surcharge and estimated ocean transportation costs for the sale to be \$335,299. The Army had actually paid the Military Sealift Command (MSC) over \$400,000 for ocean transportation on the first 541 jeeps delivered. We discussed our findings with Army transportation officials, and the contract price was adjusted to increase ocean transportation costs.

Under another agreement the Army sold a country 147 jeeps for its forces stationed in Germany. Ocean transportation charges based on the 4-percent surcharge were \$22,000, but we estimate it actually cost the Army about \$76,000 for the ocean transportation services provided by MSC.

Practice guided missiles

An agreement with a European country called for the sale of 2,369 practice missiles with unit values ranging from \$3,005 to \$3,290 and a total price of \$7,659,380. The customer was billed for ocean transportation at 4 percent of the material's value, or \$306,375. Had the transportation charge been based on the applicable MSC tariff paid by the Army, the country would have been charged about \$30,000.

Antitank mines

A sales agreement with a South American country called for the purchase of 50,000 mines with a unit value of \$18.18, or a total value of \$909,000. The customer was billed for transportation at the 6-percent ocean surcharge, or \$54,540. Had the transportation charge been based on the applicable MSC tariff, the customer would have been billed about \$138,000.

These are only a few of the hundreds of instances in which ocean transportation billings were determined by applying the standard surcharges. It was not practical to quantify the net difference between the amounts DOD billed recipient countries using the standard surcharges and the amounts actually paid for ocean transportation for FMS shipments. However, based on its limited analysis, the Army estimated that it had underbilled FMS customers by more than \$7 million by applying the standard percentages on 40 large shipments of vehicles.

Surcharges even more inadequate for recovering the cost of airlift

We have shown that the surcharge is inadequate for items moving overocean by surface transportation. We noted that the Army and Air Force often used the standard percentage to bill for channel airlift services. For example, on an air shipment of combat boots to a Mideast country, the surcharge was applied and the country was billed only \$40,500 for the airlift service. We recomputed the bill using the proper non-Government tariff and determined that an additional \$222,000 should have been billed.

USE OF STANDARD SURCHARGES ON HIGH VALUE AND EXCESS ITEM SHIPMENTS RESULTED IN UNDERBILLINGS

Because the Army used the standard surcharge method of billing for shipments of excess material and items having a unit value of \$10,000 or more instead of complying with the DOD policy which states that actual or estimated costs will be billed for such items, it undercharged two customers by about \$2.7 million.

In the first instance, the Army sold 400 trucks to a Middle East nation at a price of between \$12,750 and \$13,200 per vehicle. Army officials could not explain how they had computed the \$340,000 ocean transportation costs that the customer was billed. However, this amount is about equal to the standard 6-percent surcharge prescribed by DOD Instruction 2140.1.

We projected that the Army would pay MSC about \$1.7 million for shipping the trucks to the customer and, therefore, had underbilled by about \$1.4 million. We discussed this with Army officials, who then tried to renegotiate the sales agreement price to recover actual delivery costs. The foreign customer, however, refused to pay the additional cost.

In the second instance, the Army had not recovered its costs for accessorial services provided to a customer on the sale of 1.5 million excess land mines because the standard surcharges were used in billing, instead of actual or estimated costs.

MTMC had forewarned the Army that inland transportation and handling costs on the mines would amount to \$2.5 million and asked whether the customer should be billed for the actual costs of services. The Army ignored this advice and billed the customer only \$1.2 million by applying the standard surcharges for packing, crating and handling, inland transportation, and port handling services.

Army officials said they had not billed the actual cost as suggested by MTMC because they believe that, while they might underbill \$1.3 million on this sale, the billing of actual transportation charges would cause an administrative burden, the current accounting system does not accumulate this data, and losses and gains under the surcharge method would average out in the long run.

Even if the surcharges were adequate, they are not applicable to excess items because such items are normally sold at a greatly reduced cost. This is why DOD regulations require the billing of actual transportation charges for such items.

STANDARD SURCHARGE FOR PACKING, CRATING,
AND HANDLING FMS SHIPMENT RECOVERS
ONLY ABOUT HALF OF DOD'S ACTUAL COSTS

The 3.5-percent surcharge that DOD uses to charge customers for packaging on FMS shipments clearly does not cover its actual cost.

FMS items shipped from DOD storage depots are normally packaged to provide full protection against extreme climatic conditions and rough handling. This type of packaging--categorized by DOD as level A--is relatively expensive compared to that provided for items to be distributed and used domestically.

In April 1975, the Army's Packaging, Storage and Containerization Center reported on packaging costs. Based on its review of payments to contractors for level A, or equivalent packaging of 488 different items procured by the five Army commodity commands, the center found that

these costs were 6.25 percent of the total acquisition cost of the items. This is almost double the 3.5 percent charged FMS customers and indicates that DOD is recovering only about half of its actual packaging costs.

A survey to determine the accessorial charges for packing was made by the Naval Supply Center, Norfolk, Virginia, in June 1973. The results show that, on a sample of 510 shipments of material having a value of between \$25 and \$10,000, the average packing cost was 10.3 percent of the value of the material.

During 1976 DOD shipped more than \$1.9 billion worth of FMS material to which it applied the 3.5-percent packing, crating, and handling surcharge. If customers had been charged what the military was actually paying for level A packaging, DOD would have recovered an additional \$71 million.

We believe that the results of the Army and Navy studies should have been sent to DOD to initiate necessary changes in the standard percentage for packing, which, in our opinion, could have resulted in a more realistic cost recovery for this service.

CHAPTER 4

DELIVERY COSTS FOR SHIPMENTS FROM EUROPEAN DEPOTS NOT FULLY RECOVERED

Large quantities of ammunition, wheeled and tracked vehicles, and general commodities sold under the FMS program have been shipped direct from Army depots in Europe to customers. Apparently, DOD had not contemplated that FMS items would be supplied from overseas depots as we found no reference in the FMS policy instructions to cover such shipments.

The Army absorbed millions of dollars of transportation and related handling costs on FMS items shipped directly to customers from overseas depots because it had not billed customers for the accessorial services provided. For example, we identified over \$9 million in ocean transportation costs alone that had not been billed to customers on FMS items withdrawn from depots in Germany.

In addition, some customers had not been properly charged for inland transportation, demurrage, and port handling costs associated with these shipments. Moreover, the future costs of shipping items from CONUS to replace those withdrawn from overseas depots had not been considered.

The U.S. Army Material Management Agency Europe (USAMMAE) was responsible for identifying and reporting accessorial costs for shipments of FMS items managed and controlled by the U.S. Army, Europe. Subsequently, the agency was assigned similar responsibility for shipments made under two major FMS sales agreements which involved materials located in Europe but controlled by Army commodity commands in CONUS.

The only guidance furnished to assist USAMMAE in identifying costs to be recovered under the FMS program was contained in messages from stateside commodity commands. These instructions did not clearly define USAMMAE's responsibilities and provided little procedural guidance. As a result, the agency did not assume any responsibility for identifying and reporting the ocean transportation costs of FMS shipments. This is one reason why millions of dollars of ocean transportation were not identified and billed to customers.

The following examples illustrate the need for DOD to develop procedures to assure that customers are properly

billed for services provided on FMS shipments from overseas depots.

In fiscal year 1973, DOD agreed to sell large quantities of vehicles and ammunition to a foreign government and elected to supply the items from Army depots in Europe. Under the terms of the FMS agreement, the customer was to provide the ships to deliver the items. Subsequently, DOD provided ocean transportation and the first shipment sailed on a charter vessel provided by MSC in November 1973. The contract was not formally amended to reflect the revised delivery terms and transportation costs until October 1975. Several additional shiploads of material had been sponsored by the Army in the interim. In March 1975, we observed that the Army had not billed the foreign government for any of the ocean transportation costs. Further analysis disclosed that the Army had annotated shipping documents in such a way that it could not correlate the FMS contract agreement with what it had paid MSC to transport the items. We restructured vessel sailings sponsored by the Army and estimated that, by March 1975, the Army had incurred ocean transportation costs of about \$6.6 million on shipments made under the FMS agreement. We furnished this information to the Army, and the foreign customer was billed to recover the costs.

In another case, the Army had not billed a customer to recover transportation and handling costs on 40 mortar carriers which had been shipped from Germany. The shipments had been assigned a transportation account code which identified them as nonreimbursable grant aid shipments. We called this to the attention of Army officials, pointing out that, in addition to the direct delivery costs, the mortar carriers were not excess items and, therefore, the customer should also be billed for the costs of shipping replacement items from CONUS. The Army agreed and said it was processing additional billings of \$1,110,735 for the transportation of these and other items shipped under the FMS agreement. The additional billings included the costs of shipping the items from Germany and the estimated transportation and handling costs required to ship replacement mortar carriers from CONUS.

The Army made errors on many other FMS shipments from Germany. Many of the shipments had lost their identity because they were improperly assigned transportation account codes that applied to nonreimbursable programs. In addition, costs had not been accurately reported on some shipments. For example, the costs reported for shipments

under one FMS agreement had been understated by more than \$600,000 because inland transportation, demurrage, and port handling costs had either been miscalculated or overlooked entirely.

We believe that many problems associated with overseas shipments of FMS materials could have been avoided if DOD had developed and furnished responsible commands with detailed procedures to be followed in identifying and reporting costs to be recovered from FMS customers. Although the Army has taken or promised corrective actions on the cases we called to their attention, formalized procedures to control overseas shipments are still needed.

CHAPTER 5

DOD SHOULD BILL FMS CUSTOMERS ON AN ACTUAL COST

BASIS FOR TRANSPORTATION AND PORT HANDLING

If DOD would modify its FMS documentation and billing procedures to facilitate the use of actual cost data, it could recover the actual costs of most transportation and port handling services provided on FMS shipments.

The procedures we envision should not present significant management problems. Although other accessorial costs-- primarily packing, crating, and handling at depots; parcel post services; and some overseas transportation costs--would still be billed on a percentage surcharge basis, putting the rest of the transportation and port handling costs on an actual reimbursement basis would be a great improvement.

HOW ACTUAL COSTS COULD BE ACCUMULATED AND BILLED

When approved, FMS purchase agreements are assigned a three letter (tri-alpha) case designator to identify the contract. Requisitions issued for items under the contract include the tri-alpha case designator and also identify the purchasing nation.

These two elements of data--contract and purchaser--together with minor procedural changes at shipping and billing activities would allow DOD to bill customers on the basis of actual cost data. Basically, we perceive the system could operate as follows.

Supply source actions

When the FMS requisition is received and processed at the supply source, the country-case designator would be included as part of the "appropriation charge" number on Government bills of lading issued to commercial carriers to move FMS items to ocean and aerial ports and on documents issued to military agencies (MTMC, MAC, and MSC) furnishing overseas transportation and port handling services.

MTMC, MAC, and MSC actions

These agencies would annotate the country-case designator on billing documents submitted to service finance centers for payment of transportation and port handling services.

Military finance center actions

After paying the carriers--both commercial and in-house--the service finance centers would furnish the cognizant international logistics billing office with monthly computer printouts of payments made under each country-case designator.

ADVANTAGES OF BILLING ON ACTUAL COST BASIS

With the procedures outlined above, foreign customers could be billed for the actual cost of transportation and port handling services provided by DOD on their shipments from contractors' plants and CONUS depots. The use of percentage surcharges for these services could be eliminated. In addition, transportation and port handling costs associated with shipments originating at overseas depots (as discussed in chapter 4) could be readily identified and billed. Billing on an actual cost basis should also result in more equitable charges to foreign customers for military airlift shipments by focusing more attention on procedures for applying actual cost techniques and by eliminating the use of percentage surcharges (as discussed in chapter 2).

CHAPTER 6

NEED FOR PROOF OF DELIVERY DOCUMENTATION TO REFUTE

LOSS AND DAMAGE CLAIMS ON FMS SHIPMENTS

With minor exceptions, DOD does not obtain receipts to show that FMS items have been delivered or received in an acceptable condition by a foreign customer or his agent. Consequently, DOD has no basis for challenging or establishing responsibility for the thousands of loss and damage claims processed under the FMS program each year.

It appears that DOD routinely honors such claims even though the loss or damage sustained may have occurred after DOD delivered the item. As a result, DOD may be absorbing significant costs to replace and ship new items to customers even though it was not responsible for the alleged loss and damage.

LOSS AND DAMAGE CLAIMS ON FMS SHIPMENTS

The Report of Item Discrepancy (Standard Form 364) is used by customers to submit claims to DOD for various billing and delivery discrepancies in their FMS shipments. Thousands of such claims are received each year, and we estimate that over half concern items allegedly lost or damaged during shipment. The service international logistics centers are responsible for processing these claims. Officials responsible for processing these claims at the ILCs said that they generally honored the claims--by granting credit or shipping new items--because they have no delivery receipts to prove that the items had in fact been delivered in an acceptable condition.

DELIVERY RECEIPTS ARE NOT REQUIRED

Although many FMS items are delivered overseas to the purchaser by DOD's defense transportation system, most are not. On most shipments, DOD is responsible only for the commercial transportation necessary to deliver FMS items from the supply source to the U.S. port of exit, at which point the customer or his authorized shipping agent assumes both custody of the items and future movement responsibility. DOD does not generally require a receipt of delivery from the customer or his agent on either type of shipment. For example, in February 1976, MAC delivered 12 F-5 aircraft to a customer but had nothing to prove that the customer had received them. Air Force officials acknowledged this and

explained that the items were delivered on special assignment airlift flights and that there were no procedures requiring them to document customer acceptance or otherwise account for materials delivered. Similar conditions exist on surface shipments. No procedures require that MSC or other DOD officials in foreign countries account for FMS materials delivered to foreign customer ports.

When DOD secures commercial transportation to move FMS items from its depots to a customer's shipping agent at the U.S. port of exit, the commercial carrier documents delivery, but copies are not provided to DOD.

PROOF OF DELIVERY DOCUMENTATION WOULD
FACILITATE CLAIMS PROCESSING ACTIONS

Although they are not required, we see no reason why both Government and commercial carriers could not obtain and furnish DOD with receipts--signed by the customer or his designated shipping agent--certifying that the goods had been delivered and describing any visible damage.

The delivery receipt would accomplish two things. First, it would alert DOD officials processing discrepancy claims that loss and damage had resulted on a shipment under DOD's controls, thereby enabling an early review to establish the liable party; second, it would provide a basis for refuting claims when alleged loss or damage occurred after delivery.

CHAPTER 7

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

DOD has had many problems in identifying, billing, and recovering its costs for transportation and other accessorial services provided under the FMS program. The millions of dollars of underbilled and unrecovered costs disclosed by our study attest to the need for immediate action to strengthen controls over the accessorial service costs of the FMS program.

Although actions were taken to recover costs and correct many of the weaknesses, major problems remain. We believe that DOD could solve many of its problems by using actual cost data for billing customers for the transportation and port handling services it has provided on FMS shipments. Although this would require modification of existing procedures--along the lines discussed in chapter 5--it should not present significant management problems. There would be a need, however, to fully acquaint responsible commands with the new procedures and to train employees.

While many problems associated with shipping FMS materials direct to customers from overseas depots will be eliminated if DOD adopts our suggested actual cost billing procedures, further action is needed. The commodity commands sponsoring these shipments should furnish detailed procedural guidance to the overseas commands responsible for controlling and reporting costs on FMS shipments. In addition, they should assure that the FMS sales agreements provide for reimbursement of the transportation and handling costs for shipping items from CONUS to replace those withdrawn from overseas depots.

Another area needing attention involves the lack of documentation to prove that customers or their shipping agents have accepted delivery of FMS materials. Proof of delivery is vital for DOD to challenge or establish liability for the thousands of loss and damage claims processed under the FMS program each year.

Finally, the magnitude of the conditions we described in this report, together with their having existed for a number of years, indicate to us a need for more effective internal review of these functions.

RECOMMENDATIONS

We recommend that the Secretary of Defense direct the DOD Comptroller to:

- Discontinue using standard surcharges to recover transportation and port handling costs and modify FMS documentation and billing procedures so that FMS customers can be billed for the actual cost of transportation and port handling services provided.
- Assure that responsible commands are fully acquainted with the modified procedures and that a program is developed to train employees in implementing the procedures.
- Increase the surcharge rate used to determine packing, handling, and crating costs to cover DOD's actual costs.

We recommend also that the Secretary direct commodity commands sponsoring FMS shipments to

- strengthen controls over FMS shipments originating at overseas depots,
- assure that FMS sales agreements provide for reimbursement of the transportation and handling costs for shipping items from CONUS to replace those withdrawn from overseas depots, and
- establish procedures to obtain proof of delivery documentation on FMS shipments to aid personnel responsible for processing loss and damage claims.

In view of the significant underbillings we identified on shipments of FMS materials from overseas depots and by air from the United States, we further recommend that the Secretary establish task groups to:

- Review previous shipments made from overseas installations and attempt to recover any costs that have not been billed, including the cost of shipping replacement items from CONUS.
- Review previous air shipments, recompute customer billings using the correct non-Government shipper rates, and attempt to collect amounts underbilled.

Finally, we recommend that the Secretary require, as a control procedure, the Defense Audit Service to periodically review and report on how effective the directed improvements are and if the costs of accessorial services are fully recovered.

CHAPTER 8

SCOPE OF REVIEW

We made our review at the international logistics centers of the Army, Navy, and Air Force and at major shipping activities of the military services in the United States and Europe.

We discussed our findings with the Director of the Defense Security Assistance Agency and appropriate officials of the Army, Navy, and Air Force.

We obtained billing and shipment records from the Military Airlift Command, the Military Sealift Command, the Military Traffic Management Command, the U.S. Army Finance and Accounting Center, the U.S. Air Force Accounting and Finance Center, and the Defense Security Assistance Agency Accounting Center.