

October 1990

INTERNAL CONTROLS

Funding of International Defense Research and Development Projects



**National Security and
International Affairs Division**

B-237823

October 30, 1990

The Honorable Richard B. Cheney
The Secretary of Defense

Dear Mr. Secretary:

We reviewed the practices and procedures the Navy and the Office of the Secretary of Defense (OSD) used to disburse fiscal year 1988 funds that were provided by your office for the North Atlantic Treaty Organization (NATO) cooperative research and development projects. Our work focused on whether the Navy disbursed these funds for the purposes intended by the Department of Defense Authorization Act of 1986 and by subsequent authorizations and appropriations acts.

Background

The Department of Defense Authorization Act of 1986 initiated the NATO Cooperative Research and Development Program. The act stated that the purposes of the program were to support NATO conventional warfare research and to encourage a more equitable sharing of research and development costs among NATO nations. (See app. I for a more detailed discussion of the program.)

Results in Brief

Our review indicated that OSD and the Navy did not have sufficient internal controls to adequately ensure that funds disbursed for NATO cooperative research and development projects are actually used for the purposes intended and in accordance with authorizing legislation. There are no written Department of Defense directives or instructions for the NATO research and development project certification and funding process.

The Navy's International Research and Development Office realigned program funding without first seeking required OSD approval. For example, of the \$50.6 million of fiscal year 1988 funds OSD released to the Navy for NATO cooperative research and development projects, \$39 million was released by the Navy to specific research and development projects approved by OSD but not in the amounts OSD authorized. (See app. II.) In addition, \$7.9 million was used by the Navy to fund administrative support services for the research and development office, but only \$3.7 million was authorized by OSD to be spent for this purpose. We found that the Navy's research and development office took actions that made it difficult to account for these funds. (See app. III.) Furthermore,

the Navy did not report to OSD how these funds were spent until April 1990. The services are required to report quarterly to OSD on how these funds are spent.

Section 1103 of the Department of Defense Authorization Act of 1986 required that funded projects be conducted under memorandums of understanding between the participating countries. However, some of the approved projects did not have memorandums of understanding. As of January 1, 1990, the Navy had not completed memorandums of understanding with other nations for 11 of the 17 research and development projects that were funded in fiscal year 1988. (See app. IV.)

A NATO cooperative research and development project is statutorily defined as a project "under a memorandum of understanding (or other formal agreement)." We examined whether fiscal year 1988 funds allocated in various committee reports for NATO research and development could be used for projects that were not NATO cooperative research and development projects because they were not conducted under memorandums of understanding. Because the fiscal year 1988 research and development appropriation was a lump sum, without funds specifically earmarked for the NATO projects, the fiscal year 1988 funds could legally be used for all research and development activities, including those that had the potential to be NATO cooperative projects but which then had no memorandums of understanding. Nonetheless, House and Senate Committees on Armed Services and on Appropriations reports on the legislation show that funds were approved for NATO cooperative research and development. In view of the committees' actions and the continuing requirement that NATO cooperative projects be conducted under memorandums of understanding, the release of funds from the Department of Defense's NATO research and development account for projects without a memorandum of understanding seems contrary to the intent expressed in the congressional committee reports.

Recommendations

We recommend that you (1) issue written instructions for the implementation of NATO cooperative research and development programs and (2) establish sufficient internal controls necessary for the Departments of Defense and the Navy to ensure that the funds made available for the program are used appropriately.

Agency Comments and Our Evaluation

In its comments on a draft of this report, the Department of Defense concurred with most of our findings. It did not agree that the Congress originally intended that NATO research and development funds be disbursed only to projects under completed memorandums of understanding. That question has been resolved because the Department now requires the prerequisite memorandum of understanding or other formal agreement.

The Department concurred with our recommendation for the issuance of written instructions. The Department is preparing a handbook of guidelines that should be issued by January 1991.

The Department acknowledged that the Navy realigned funds without authorization and concurred that internal controls are needed. To that end, the Department has disbanded the Navy's International Research and Development Office and transferred its functions to the International Programs Office, which has an internal control program. The Department stated that (1) the Navy will distribute funds directly to responsible project offices, (2) the project managers will report on how the funds were used, and (3) the Navy will submit timely and accurate quarterly reports to the Department. (The Department of Defense's comments are included in app. VI.)

We believe that the Department has initiated the steps necessary to establish the proper framework for handling future NATO cooperative research and development funds, but implementation will be the key to effective controls.

As you know, the head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these 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.

Our objectives, scope, and methodology are detailed in appendix V.

Copies of this report are being sent to the Chairmen, House and Senate Committees on Appropriations and on Armed Services, House Committee on Government Operations, and Senate Committee on Governmental Affairs; the Secretary of the Navy; and the Director of the Office

of Management and Budget. Copies will also be made available to others upon request.

Please contact me at (202) 275-6504 if you or your staff have any questions concerning the report. Major contributors to this report are listed in appendix VII.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Martin M. Ferber", with a long horizontal flourish extending to the right.

Martin M Ferber
Director, Navy Issues

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Abbreviations

AAW	anti-air warfare
DOD	Department of Defense
MOU	memorandum of understanding
NATO	North Atlantic Treaty Organization
OSD	Office of the Secretary of Defense
R&D	research and development
SSTD	Surface Ship Torpedo Defense

The NATO Cooperative Research and Development Program

The Congress initiated the NATO Cooperative Research and Development Program under section 1103 of the Department of Defense Authorization Act of 1986.¹ The program's purposes were to support NATO conventional warfare research and to encourage a more equitable sharing of research and development (R&D) costs among NATO nations. This act resulted from congressional concerns that, collectively, NATO countries had spent significantly more resources on defense than members of the Warsaw Pact, but the Warsaw Pact had produced and deployed more major combat items than the NATO countries. The Congress concluded that a major reason for this was inadequate cooperation among NATO countries on research, development, and production of military equipment.²

According to OSD officials, written Department of Defense (DOD) directives or instructions for the NATO R&D project certification and funding process do not exist. Instead, the Deputy Under Secretary of Defense (Industrial and International Programs) certifies an international project when it meets certain criteria specified in the act. To be selected as an international cooperative project, OSD stipulates that a project must

- meet a critical conventional force deficiency,
- have a secure position in service/agency priorities,
- be suitable for collaboration, and
- be supported in the Five-Year Defense Plan or in the next Program Objectives Memorandum submission.

Once a cooperative R&D project is certified, the Deputy Under Secretary grants authority to the services to negotiate a memorandum of understanding (MOU) with participating governments or potential international partners. OSD officials review the draft MOU to ensure that an equitable arrangement exists for the United States and then authorize the appropriate project official in the services to complete the agreement.

In addition to certifying cooperative R&D projects, the Deputy Under Secretary authorizes and determines funding levels for the projects. According to OSD officials, the two criteria to be used for releasing NATO cooperative R&D funds to such a project are (1) it must be a certified cooperative project and (2) an international MOU must be completed. The

¹P. L. 99-145, 99 Stat. 712.

²In 1987, the Congress expanded the program to include five non-NATO nations (Australia, Israel, Egypt, South Korea, and Japan).

**Appendix I
The NATO Cooperative Research and
Development Program**

individual services allocate the funds to their certified projects. If project managers are unable to obligate the funds or if other international projects require a higher funding priority, the funds may be realigned. However, officials from the services' international R&D offices must seek OSD approval before they realign these funds among projects.

DOD concurred that there were no specific written directives and stated that the Office of the Under Secretary of Defense for Acquisition is preparing a handbook of guidelines.

Funds Not Disbursed in Accordance With Authorization

OSD requires written justification for each project funding request and approves each request based on that documentation. It also requires project managers to (1) expend funds only for approved programs and within the amounts authorized, (2) obtain prior approval for realigning funds, and (3) report quarterly on how funds are being expended. These internal controls, however, have not been effectively implemented. The Navy's R&D office did not follow OSD requirements for using these funds and did not report to OSD on how fiscal year 1988 funds were spent until April 1990.

During our review of the Navy's fiscal year 1990 Research, Development, Test, and Evaluation budget request, we noted a discrepancy between the amount OSD had authorized in fiscal year 1988 to be spent on specific projects and the amount that the Navy's international R&D projects had received from the R&D office. OSD released about \$50.6 million—\$46.9 million for specific R&D projects and \$3.7 million for administration and project start-up costs—to the R&D office, which, in turn, only released about \$39 million to the authorized projects. The remaining funds were used for administrative services and for funding a program in which the Navy did not request funds.¹ The R&D office did not seek required OSD approval for the added project, nor did it seek approval for realigning funds to pay for administrative expenses. Information on project funding is presented in table II.1.

¹OSD authorized the SAXON program as an international cooperative R&D project. However, the Navy did not request fiscal year 1988 funding for this project.

**Appendix II
Funds Not Disbursed in Accordance
With Authorization**

**Table II.1 NATO Cooperative R&D
Program Fiscal Year 1988 Funding**

Project	Amount authorized by OSD	Expenditure authorized by the R&D office	Difference
Automatic Ship Classification	\$200,000	\$200,000	•
Coastal/Harbor Defense	300,000	256,000	- 44,000
E2C Display Software	400,000	16,316	- 383,684
Fiber Optic Sensor Array	500,000	500,000	•
Hull Degaussing System	1,300,000	1,110,000	- 190,000
Magnetic Anomaly Detector	300,000	700,000	+ 400,000
Maritime Patrol Aircraft 90	1,000,000	1,400,000	+ 400,000
Mass Memory Module	200,000	200,000	•
NATO Anti-Air Warfare System	9,000,000	7,517,876	-1,482,124
NATO Frigate Replacement	1,000,000	927,000	- 73,000
Night Attack Avionics	8,900,000	3,818,000	-5,082,000
Radar Upgrade for Fighter Aircraft	6,300,000	4,980,000	-1,320,000
Remotely Piloted Vehicle	2,700,000	776,667	-1,923,333
Rolling Airframe Missile Upgrade	2,600,000	3,800,000	+1,200,000
Surface Ship Torpedo Defense	11,400,000	9,570,000	-1,830,000
Tactical Command for Over-the-Horizon	800,000	3,170,000	+2,370,000
Subtotal	\$46,900,000	\$38,941,859	
Other Projects			
SAXON-FPN	^a	3,373,000	+3,373,000
Cooperative Opportunities Documents ^b	3,700,000	7,902,530	+4,202,530
Total	\$50,600,000	\$50,217,389	

^aFunds not requested.

^bAdministrative support for the Navy's international R&D office.

DOD concurred that the Navy did not disburse funds as authorized and stated that it has taken several steps to preclude recurrence. A new organization, the Navy's International Programs Office, will assume the function of the Navy's R&D office and will be responsible and accountable to the Assistant Secretary of the Navy (Research, Development and Acquisition). In addition, the Navy established a management control directive that should ensure that DOD controls are followed. Furthermore, the Navy has assured OSD that it will submit accurate, timely, quarterly reports. Finally, DOD stated that the Navy no longer receives funds unless the reports are complete. We agree with DOD's opinion that these additional internal controls should be sufficient to ensure that the Navy uses the NATO cooperative R&D funds according to DOD's authorization.

Funds Used for Administrative Support Services

OSD authorized the Navy to spend about 7 percent, or \$3.7 million, of its total fiscal year 1988 allocation of \$50.6 million for administrative support services. However, the Navy expended 15 percent, or \$7.9 million, of the allocation for this purpose. In addition, we found that the Navy (1) did not report to OSD on how the funds were used, (2) made misleading statements of purpose on contracts and work orders to show that funds were used for authorized projects, and (3) used multiple agents to disburse the funds, which made it difficult to account for the funds.

The R&D office channeled funds for administrative support for itself through several activities, including the NATO Anti-Air Warfare (AAW) Office in the Naval Sea Systems Command in Washington, D.C.; the Air Force Air Development Center in Rome, New York; the Naval Ocean Systems Center in San Diego, California; the Naval Underwater Systems Center in Newport, Rhode Island; and the Naval Ordnance Station in Indian Head, Maryland. The projects through which funds were channeled did not receive benefits or deliveries from the contractors. The following four cases show how funds were used to obtain administrative support services with NATO cooperative R&D funding.

In the first case, the R&D office provided \$597,124 to the NATO AAW project office in the Naval Sea Systems Command for work on AAW systems. As arranged with the R&D office, the NATO AAW project office, in turn, allocated these funds to the Air Force Development Center, Rome, New York, which contracted to develop prototype software for an R&D office document tracking system. This software development was performed by the contractor that was conducting ongoing research for the Defense Advanced Research Projects Agency to develop an expert management information system.

Because the R&D office had problems tracking large quantities of documents, its officials arranged for the R&D office to be the model office for the development of the Defense Advanced Research Projects Agency's information system. Consequently, the R&D office requested the NATO AAW project office to submit this contract through its account, giving the appearance that the funding was for the NATO AAW project. NATO AAW officials never saw the actual contract, and work on the NATO AAW systems was never undertaken. As of April 1990, the Navy had not received the software delivery required by the contract.

In the second case, an administrative contract for the R&D office was managed through the Naval Ocean Systems Center, San Diego, California. The R&D office provided \$1 million to the Center, which contracted for what was supposed to be a prototype system to be used for developing and testing new automation concepts for assessment of anti-submarine warfare technology. According to the contractor, the contract was actually to develop prototype software to track Data Exchange Agreements. The contract was not specifically tied to research on anti-submarine technology. As of April 1990, the Navy had not received the prototype software from the contractor.

In the third case, the R&D office disbursed funds to the Naval Underwater Systems Center, Newport, Rhode Island, which entered into two contracts for a total of about \$2.7 million. The statement of work for these contracts describes tasks to support the Surface Ship Torpedo Defense (SSTD) project. However, SSTD project officials did not see these contracts, did not know about them, and did not work with the contractors involved. When we showed the contracts to these officials, they stated that the contracts did not support the SSTD project and that they had not received any benefits from these contracts. Our review of the actual tasks cited in the statement of work for these contracts revealed that their scopes were limited to providing administrative support to the R&D office.

In the fourth case, the R&D office provided \$3.1 million to the Naval Ordnance Station, Indian Head, Maryland, stating on the work order that the work was for the SSTD project. However, it was not. Rather, it was for this station to perform administrative services such as the development of a financial software data program for the R&D office to better manage itself. For example, engineers evaluated various project candidate proposals and cooperative agreements and reviewed new requests for proposals for contract support. Some of the funding was used to purchase computer systems for the station's research facility and hardware for the R&D office. In addition, the station purchased a facsimile and a copier machine, and it was developing a financial accounting system for the R&D office. All of these items were procured with NATO R&D program funding.

Agency Actions

DOD concurred that NATO R&D funding was used for administrative support services. Both OSD and Navy officials have taken steps to control the flow of funds for administrative uses. OSD asked the Navy to provide justification and documentation on how fiscal year 1988 funds were

**Appendix III
Funds Used for Administrative
Support Services**

used, which the Navy provided in April 1990. Also, the R&D office has suspended and/or allowed to expire all contracts and work orders for administrative support. The Naval Investigative Service and the Naval Audit Service are investigating the use of these funds.

Projects Without Memorandums of Understanding Were Authorized and Funded

Eleven of the 17 Navy international R&D projects were approved for funding through fiscal year 1988 R&D appropriations without first having obtained memorandums of understanding between the participating countries and the Navy. The status of MOUs for these projects as of January 1, 1990, is shown in table IV.1.

Table IV.1: Status of MOUs for the Navy's International R&D Projects

Program title	Completed MOU
Automatic Ship Classification	No
Coastal/Harbor Defense	No
E2C Display Software	No
Fiber Optic Sensor Array	No
Hull Degaussing System	No
Magnetic Anomaly Detector	No
Maritime Patrol Aircraft 90	Yes ^a
Mass Memory Module	No
NATO Anti-Air Warfare System	Yes ^b
NATO Frigate Replacement	Yes ^c
Night Attack Avionics	No
Radar Upgrade for Fighter Aircraft	No
Remotely Piloted Vehicle	Yes ^d
Rolling Airframe Missile Upgrade	Yes ^e
Surface Ship Torpedo Defense	Yes ^f
Tactical Command for Over-the-Horizon	No
SAXON-FPN (not authorized by OSD to be funded)	No

^aSigned April 5, 1989.

^bSigned October 19, 1987.

^cSigned January 25, 1988.

^dSigned June 7, 1988.

^eSigned August 16, 1989.

^fSigned October 26, 1988.

We assessed whether these projects complied with the 1986 legislation and were appropriately funded. The legislation originally authorizing the NATO cooperative R&D projects, specifically section 1103 (c)(2), required that MOUs be completed before the projects could be considered NATO cooperative projects. In addition, section 1103 (c)(1) earmarked \$200 million that could only be used for such projects. Section (c)(1) pertained only to 1986 R&D funding and, subsequently, lapsed, while the requirement of section 1103 (c)(2), now stated in 10 U.S.C. 2350a, still applies to NATO cooperative projects. Concerning projects funded with

1988 R&D appropriations, Senate and House Committees on Armed Services and on Appropriations reports stated the amounts of R&D funds that were to be appropriated for NATO cooperative R&D projects. These reports allocated funds by program, such as "NATO Research and Development." However, the fiscal year 1988 authorization¹ and appropriation² legislation authorize and appropriate R&D funds on a lump sum basis. Consequently, since neither law specifically addresses NATO R&D projects, legally fiscal year 1988 R&D funds were available for any R&D activity without regard to what the various committees may have indicated in their committee reports. Nonetheless, in view of the committees' actions and the continuing statutory requirement that a NATO cooperative project be under an MOU (or other formal agreement), release of funds from DOD's NATO R&D account for R&D projects without MOUs seems contrary to the intent expressed in the congressional committee reports.

According to Navy and DOD officials, an MOU was generally considered a prerequisite for funding projects, but they frequently made exceptions in order to start projects. For example, the Navy F/A-18 radar upgrade received about \$5 million in fiscal year 1988 funding from the R&D office, even though an MOU had not been completed. This project is funded through the Navy's fiscal year 1990 budget, and it also will receive additional funds from Canada once an agreement is completed.

On January 28, 1988, the Deputy Secretary of Defense issued a memorandum to the secretaries of the military departments regarding the selection of NATO and non-NATO cooperative R&D projects for fiscal year 1988. The memorandum stated that:

Since MOU negotiations can take up to a year or more, and not all proposals are likely to result in MOUs, Nunn Amendment (NATO and non-NATO cooperative) funds will be provided to the project sponsors as satisfactory MOUs are achieved. If necessary, projects will be initiated with FY 1989 funds. This approach allows the Services and Agencies more time to conclude MOUs and to ensure that outyear funds are programmed.

In fiscal year 1988, the Navy requested \$30 million in start-up funds from OSD for potential NATO R&D projects without MOUs. On March 3, 1988, OSD officials requested a DOD General Counsel opinion on whether an MOU was necessary before releasing NATO cooperative R&D funds to the Navy. On March 10, 1988, the General Counsel concluded that fiscal

¹P.L. 100-180 §201, 101 Stat. 1045.

²P.L. 100-202, 101 Stat. 1329-59.

year 1988 funds could be legally released to international projects before MOUs are completed. However, the General Counsel cautioned that it appeared that the Congress appropriated the 1988 funds to carry out the continuation of the NATO cooperative R&D Program and suggested that not doing so might "present an issue of relationships with the Congress". He further suggested that the NATO cooperative R&D funds be used in accordance with the original statutory framework. Notwithstanding this caution, OSD authorized the Navy to fund projects that did not have MOUs.

OSD officials told us that for fiscal year 1990 and beyond, they have revised their policy to reflect the 1989 codification of section 2350a, Public Law 101-189, which they said now requires an MOU before releasing funds to a NATO cooperative R&D project.

Agency Comments and Our Evaluation

DOD did not concur that the intent of the Congress was that an MOU be in place before the start of a project. DOD stated that the requirement for an MOU had been consistently interpreted by the Navy as meaning there was intent and progress toward an MOU. The Navy did not believe it was necessary to have a completed agreement. DOD also commented that because the fiscal year 1988 legislation was silent, DOD officials made several attempts within DOD to find a correct interpretation.

Our review of the initiating legislation, the Defense Authorization Act of 1986, indicated that the original intent of the Congress was to require an MOU (or other formal agreement). Since the enactment of section 1103 of Public Law 99-145 on November 8, 1985, a NATO cooperative R&D project by definition requires an MOU or formal agreement to be a NATO cooperative R&D project. In view of this continuing requirement, the use of funds allocated by committee reports and by OSD for NATO R&D projects to projects without MOUs seems to be contrary to congressional intentions. Notwithstanding DOD and Navy nonconcurrence with the position we have taken in this appendix, OSD subsequently adopted a policy of requiring a completed MOU before funds are disbursed.

Objectives, Scope, and Methodology

Our objectives were to determine how the Navy's International Research and Development Office distributes and uses funds provided by OSD for international cooperative projects. To achieve these objectives, we interviewed officials from the Departments of Defense and the Navy in Washington, D.C.; representatives from defense research laboratories and defense contractors; and officials from 20 Navy international programs, 17 of which received fiscal year 1988 funding. We also examined OSD, Navy Comptroller, and individual Navy program funding documents. On the basis of information that the Naval Investigative Service and the Naval Audit Service provided, we limited the review to the distribution of funds appropriated for fiscal year 1988, most of which were distributed to the services during fiscal year 1989.¹ To verify the R&D office's accounting records and to determine how the funds were spent, we compared funding documents and information provided by individual Navy international R&D program managers with OSD records.

Our review was conducted in cooperation with the Naval Investigative Service and the Naval Audit Service. Our review also was conducted from October 1989 to April 1990 in accordance with generally accepted government auditing standards.

¹Research, development, test and evaluation funds may be obligated during a 2-year period. Fiscal year 1988 funds expired on September 30, 1989.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



ACQUISITION

THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301

15 AUG 1990

Mr. Frank C. Conahan
Assistant Comptroller General
General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "INTERNAL CONTROLS: Concerns About Controls Over Funding of International Defense Research and Development Projects," dated June 28, 1990 (GAO Code 394341/OSD Case 8401).

The DoD basically concurs in most of the report findings. The Department only partially concurs in the second recommendation and the corresponding finding that concludes new controls are now required. The Navy did not properly follow the controls that were in place and has subsequently improved its control. It is the DoD position that if the in-place and new controls are followed, there will be adequate control.

Detailed comments on the findings and recommendations are included in the enclosure. Corrective actions have been taken as outlined. Thank you for this opportunity to review and to comment on the subject GAO draft report.

Sincerely,

A handwritten signature in cursive script that reads "Donald J. Yockey".

Donald J. Yockey
Deputy Under Secretary
for Acquisition

Enclosure

GAO DRAFT REPORT - DATED JUNE 28, 1990
(GAO CODE 394331) OSD CASE 8401

"INTERNAL CONTROLS: CONCERNS ABOUT CONTROLS OVER
FUNDING OF INTERNATIONAL DEFENSE RESEARCH AND
DEVELOPMENT PROJECTS"

DEPARTMENT OF DEFENSE COMMENTS

FINDINGS

FINDING A: Background: North Atlantic Treaty Organization Research and Development Program. The GAO reported the Congress concluded that there was inadequate cooperation among North Atlantic Treaty Organization countries on research, development, and production of military equipment; and, consequently, the Department of Defense Authorization Act of 1986 initiated the North Atlantic Treaty Organization cooperative research and development program. The GAO noted that, according to DoD officials, there are no written DoD directives or instructions for the North Atlantic Treaty Organization research and development certification and funding process. Instead, the GAO found that the Deputy Under Secretary of Defense (Industrial and International Programs) certifies an international project when it meets certain criteria specified in the Act. The GAO also found that, once a project is certified, the Deputy Under Secretary grants authority to the Services to negotiate a memorandum of understanding with participating governments or potential international partners. The GAO observed that, in addition, the Deputy Under Secretary authorizes and determines funding levels for the Military Services' international research and development projects. The GAO further observed that, according to officials of the Office of the Secretary of Defense, the two criteria to be used for releasing North Atlantic Treaty Organization research and development funds for these projects are (1) it must be a certified international project and (2) an international memorandum of understanding must be signed for the project. The GAO also noted that officials from the Services' international research and development offices must seek Office of the Secretary of Defense approval before they realign the funds among projects. (p. 1, pp. 8-10/GAO Draft Report)

DoD Comments: Concur. There are no written directives specifically relating to the North Atlantic Treaty Organization research and development certification and funding. There are, however, guidelines which cover all funds (DoD Accounting Manual DoD 7220.9-M chapter 21 Funding Controls and Chapter 28 International Agreements).

ENCLOSURE

Now on pp. 1 and 8-9.

FINDING B: Funds Not Disbursed In Accordance With Authorization; Internal Controls Inadequate. The GAO reported that the Office of the Secretary of Defense requires project managers to (1) expend funds only for approved programs and within the amounts authorized, (2) obtain prior approval for realigning funds, and (3) report quarterly on how funds are being expended. The GAO concluded, however, that the cited internal controls have not been effectively implemented. The GAO reported that the Navy's International Research and Development Office realigned program funding without first seeking required Office of the Secretary of Defense approval. The GAO found that the Office of the Secretary of Defense released about \$47 million for specific FY 1988 projects to the Navy office--which, in turn, only released about \$39 million to the authorized projects. The GAO further found that the remaining funds were used for administrative services (in addition to the \$3.7 million that was authorized for that purpose) and for funding of the SAXON-FPM program (an authorized program for which the Navy had not requested funds). In report table II.1. the GAO set out the specific amounts authorized for FY 1988 projects and the amounts actually spent. The GAO also found that the Navy did not report to the Office of the Secretary of Defense until April 1990 how FY 1988 funds were spent. In summary, the GAO concluded that the Office of the Secretary of Defense and the Navy do not have sufficient internal controls to adequately ensure that funds disbursed for North Atlantic Treaty Organization cooperative research and development projects are actually used for the purposes intended and in accordance with the authorizing legislation. (pp. 2-3, pp 12-13/GAO Draft Report)

See comment 1

Now on pp.1-2 and 10-11.

DoD Comments: Concur. The primary control function from the Office of the Secretary of Defense to the Services is the quarterly report required on every release of funds. The preparation and review of this report forces a careful analysis of how the funds are spent. In the past, the Navy failed to complete the report accurately and in a timely manner. The Navy no longer receives funds unless the reports are complete.

As a result of the Defense Management Review, the Department of the Navy has established a new organization (Navy International Programs Office) responsible and accountable to the Assistant Secretary of the Navy (Research, Development and Acquisition) for management control of Defense Research & Development (Nunn) funds. Additionally, the Navy has established a management control program directive (IPD-89-27), which is in place and which will ensure that the DoD management control criteria for use of these funds are followed. Finally, the Navy International Programs Office management oversight of the Navy Defense Research and Development international program efforts will ensure that the Navy project managers follow the management control criteria for use of these funds. The Navy has assured the Office of the Secretary of Defense that it will submit accurate, timely quarterly reports in the future.

FINDING C: Funds Used For Administrative Support Services. The GAO reported that the Office of the Secretary of Defense authorized the Navy to spend services about 7 percent--or \$3.7 million of its total FY 1988 allocation of \$50.6 million--for administrative support. The GAO found, however, that the Navy actually expended \$7.9 million for that purpose. The GAO further found that the Navy research and development office channeled funds for administrative support to itself through several activities. In one case, for example, the GAO found that \$597,124 provided the North Atlantic Treaty Organization Anti-Air Warfare project office was used to develop software for a document tracking system in the Navy research and development office. In a second case, the GAO identified cited a \$1 million contract relating to antisubmarine warfare technology, managed through the Naval Ocean System Center, which (according to the contractor), was actually used to develop software to track Data Exchange Agreements. In a third case, the GAO found that that same center entered into two contracts, totalling about \$2.7 million, which were described as support for the Surface Ship Torpedo Defense project. The GAO reported that the actual tasks in the statement of work for the cited projects were to provide administrative support to the research and development office. Finally, the GAO found that the \$3.1 million provided the Naval Ordnance Station, Indian Head, Maryland, for work on the torpedo defense project was also for administrative support to the research and development office. The GAO noted that both Office of The Secretary of Defense and Navy officials have taken steps to control the flow of funds for administrative uses, including (1) requiring the report finally delivered in April 1990, (2) the suspension or expiration of all contracts and work orders for administrative support, and (3) examinations by the Naval Investigative Service and Naval Audit Service. The GAO concluded that the Navy did not report to the Office of the Secretary of Defense how the funds were used. The GAO also concluded that the Navy made misleading statements of purpose on contracts and work orders in order to show that funds were used for authorized projects and used multiple agents to disburse the funds (thus making it difficult to account for them). The GAO also concluded that 1988 research and development appropriations expended for administrative costs were not inconsistent with the legislation authorizing or appropriating the funding. (pp 2-4, pp 14-17/GAO Draft Report)

Now on pp. 2 and 12-14.

DoD Comments: Concur. The 1988 research and development appropriations expended for administrative costs were not inconsistent with the legislation authorizing or appropriating the funding.

FINDING D: Projects Without Memoranda of Understanding. The GAO reported that section 1103 (c) (2) of the Department of Defense Authorization Act of 1986 (now 10 U.S.C. 2350a) requires that memoranda of understanding be completed before projects can be considered North Atlantic Treaty Organization cooperative research and development projects. The GAO pointed out that

FY 1988 Senate, House of Representatives and conference appropriations reports stated the amounts of appropriated funds that were to be used for such projects. The GAO found, however, that the FY 1988 authorization and appropriations legislation actually authorized and appropriated research and development funds on a lump sum basis--and, thus, FY 1988 research and development funds were legally available for any research and development activity. The GAO observed, therefore, that although the intent of the Congress was that memoranda of understanding be in place for such projects, the lump sum nature of the FY 1988 legislation provided the Navy with the opportunity to fund projects legally without the intended memoranda of understanding. The GAO found that, as a result, 11 of the 17 Navy international research and development projects were approved for FY 1988 funding without first having memoranda of understanding between the participating countries and the Navy. In report table IV.1, the GAO provided a list showing those memoranda of understanding which had been signed for the Navy's international research and development projects as of January 1, 1990. The GAO noted that, according to a Navy official, the DoD policy has always been to release funds after a memorandum of understanding has been signed. The GAO noted that, on January 28, 1990, the Deputy Secretary of Defense issued a memorandum pointing out negotiations on memoranda of understanding could take up to a year or more. The GAO reported that, in FY 1988, the Navy requested \$30 million in start-up funds for projects without memoranda of understanding. The GAO noted that Office of the Secretary of Defense officials requested a DoD General Counsel opinion on whether a signed memorandum of understanding was necessary for a project to receive North Atlantic Treaty Organization cooperative research and development funds. The GAO noted that, on March 10, 1988, the General Counsel stated that funds could be released to international projects before memoranda of understanding were signed, but that such disbursements might be contrary to congressional intentions. The GAO found that the Office of the Secretary of Defense nevertheless authorized the Navy to fund projects that did not have a memorandum of understanding in effect. The GAO noted that Office of the Secretary of Defense officials stated that, for FY 1989 and beyond, they have revised their policy to reflect the codification of Sec. 2350a, Public Law 101-189, which now requires a memorandum of understanding before releasing funds to a North Atlantic Treaty Organization cooperative research and development project. (p. 3-4, pp. 18-22/GAO Draft Report)

Now on pp. 2 and 15-17

DoD Comments: Nonconcur. Most of the facts are correct, but there is some ambiguity as to their interpretation. The DOD takes exception to the GAO observation that the intent of the Congress was that a Memorandum of Agreement be in place prior to the initiation of a project. The requirement that the project have a Memorandum of Understanding had consistently been interpreted by the Navy as meaning there was intent and progress toward a Memorandum of Understanding type of project. In FY 1987, when the Navy had full authority on all the funds it, in

Comment 2.

fact, allocated funds for several projects that did not yet have an Agreement. The FY 1988 legislation was silent as to the agreement and it was widely understood that congress meant Memoranda of Agreement projects and, in deference to common Navy practice, deliberately avoided any mention of it. Since this was the first year that Office of the Secretary of Defense had the responsibility to distribute the funds, several attempts were made to find a correct interpretation. They were: (a) the General Counsel office stated there were no legal restrictions to the use of post FY 1986 Nunn funds prior to agreement signing. (b) the Navy Assistant Secretary made a determination that it was appropriate to spend the funds and requested they be released, and (c) prior to release of the funds, the funding request was sent to General Counsel with the statement that this is an appropriate use of the funds. The General Counsel provided concurrence. It is unclear what is meant that a Navy official indicated there always was a policy of requiring the Memorandum of Agreement be signed before expenditure of funds, since this was the first year of the Office of the Secretary of Defense fund allocation and, previously, the Navy had consistently used funds prior to Memoranda of Agreement signing.

Comment 3.

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RECOMMENDATIONS

Now on p. 2.

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense issue specific written instructions for the implementation of the North Atlantic Treaty Organization cooperative research and development program. (p. 5/GAO Draft Report)

DoD Comments: Concur. The office of the Under Secretary of Defense for Acquisition is preparing a handbook of guidelines that will consolidate useful information for identifying, submitting, and funding International Cooperative projects. The handbook will be completed by January 1991. The guidelines required for the treatment of the funds addressed in this report, however, were explicitly clear. Each time the funds were transmitted, the authorizing document identified the specific project, the fact that the funds could be used only on that project, and that a report covering fund usage was required each quarter.

Now on p. 2.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense establish sufficient internal controls necessary for the Department of Defense and the Navy to assure that the funds made available for the North Atlantic Treaty Organization cooperative research and development program are used appropriately. (p. 5/GAO Draft Report)

DoD Comments: Concur. The recommendation is moot, however, and concurrence is based on the fact that appropriate controls are

already in place. While it is true that the Navy realigned funds without authorization, additional internal controls are no longer needed. At that time, the funds disbursing office co-mingled all the Nunn funds and relied on the Program Office (OP-098F) to make allocation decisions. Since that time, OP-098F has been disestablished and its functions transferred to the Navy International Programs Office. That office has in place a formal internal controls program. The Navy will henceforth segregate Nunn project accounting lines. All project funds will be distributed directly to the responsible project office with all funding requirements stated. Project managers will be required to report on planning and execution of all funds. In addition, the Navy will accurately complete the required quarterly reports and submit them to the Office of the Secretary of Defense in a timely manner.

GAO Comments

1. DOD released a total of \$50.6 million of fiscal year 1988 funds for Navy NATO cooperative research and development. About \$47 million was designated for specific projects, and \$3.6 million was designated for administrative purposes.
2. DOD's comments must be tempered by the fact that the DOD Office of General Counsel cautioned DOD officials that release of funds to nonagreement projects may be contrary to congressional intentions because the original authorization stipulated that agreements were necessary.
3. The text of the report has been revised based on this comment.

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