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Department of Defense



Fees and Surcharges Assessed on Afghanistan
Security Forces Fund Orders Need Improved Cost
Accounting

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Acronyms and Abbreviations

AFCEE	Air Force Center for Engineering and the Environment
ANSF	Afghan National Security Forces
ASFF	Afghanistan Security Forces Fund
CAS	Contract Administration Services
CECOM	U.S. Army Communications–Electronics Command
CSTC-A	Combined Security Transition Command–Afghanistan
DFAS	Defense Finance and Accounting Service
DIFS	Defense Integrated Financial System
DoD FMR	DOD Financial Management Regulation
DSCA	Defense Security Cooperation Agency
FM&C	Financial Management and Comptroller
FMS	Foreign Military Sales
USACE	U.S. Army Corps of Engineers
USD(C)/CFO	Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD
USD(P)	Under Secretary of Defense (Policy)
USTRANSCOM	U.S. Transportation Command



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
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September 19, 2012

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (POLICY)
DIRECTOR, DEFENSE SECURITY COOPERATION AGENCY

SUBJECT: Fees and Surcharges Assessed on Afghanistan Security Forces Fund Orders Need Improved Cost Accounting (Report No. DODIG-2012-128)

We are providing this report for review and comment. We evaluated the fees and surcharges assessed by DoD components on orders funded by Afghanistan Security Forces Fund (ASFF) appropriations and whether the components supported the fees and surcharges with actual costs. DoD components generally identified actual costs to support the fees and surcharges assessed when fulfilling ASFF orders. However, the Defense Security Cooperation Agency needed to improve its cost accounting for the \$2.8 billion in three Foreign Military Sales Trust Fund surcharge accounts to ensure that its surcharge rates were reasonable estimates of actual expenses and that it paid transportation expenses from the proper source of funding. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that recommendations be resolved promptly. The comments received from the Under Secretary of Defense (Policy) were partially responsive. Therefore, we request that the Under Secretary provide additional comments on Recommendation 1 by October 19, 2012. The comments from the Director, Defense Security Cooperation Agency, were partially responsive. Therefore, we request that the Director provide additional comments on Recommendation 2 by October 19, 2012.

If possible, send a portable document format (.pdf) file containing your comments to auddpao@dodig.mil. Comments provided on the final report must be marked and portion-marked, as appropriate, in accordance with DoD Manual 5200.01. Copies of management comments must contain the actual signature of the authorizing official. We are unable to accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945, DSN 329-5945.

A handwritten signature in black ink, reading "Lorin T. Venable".

Lorin T. Venable
Acting Assistant Inspector General
DoD Payments and Accounting Operations



Results in Brief: Fees and Surcharges Assessed on Afghanistan Security Forces Fund Orders Need Improved Cost Accounting

What We Did

We reviewed the fees and surcharges assessed by DoD components when they fulfilled orders funded by the Afghanistan Security Forces Fund (ASFF) and how they identified their actual costs to support the fees and surcharges assessed.

What We Found

The U.S. Army Corps of Engineers and the Air Force Center for Engineering and the Environment generally had appropriate cost accounting procedures; however, the Defense Security Cooperation Agency (DSCA) did not maintain adequate cost accounting records that showed whether three surcharge rates represented reasonable estimates of actual costs on Foreign Military Sales cases funded by ASFF appropriations (ASFF cases). Specifically, DSCA collected the following surcharges:

- Administrative: over \$848 million from cases funded by FY 2005 through FY 2011 ASFF appropriations, but its cost records did not support the surcharge rate.
- Contract administration services (CAS): an unknown amount and it could not compare actual expenses to surcharges collected.
- Transportation expense: an unknown amount and it could not identify the expenses for each ASFF case.

This occurred because DSCA did not have adequate policies and procedures that required preparation of detailed cost accounting records to support surcharge rates with actual cost data or to use available cost data when reviewing the CAS and transportation expense surcharge rates. Also, DSCA did not have policies to determine

whether it properly used ASFF appropriations when it made transfers between the administrative and transportation expense surcharge accounts.

As a result, it was unclear whether DSCA assessed appropriate surcharges to pay for the actual expenses for ASFF cases or how much of the \$2.8 billion balance in the three surcharge accounts resulted from high rates for ASFF cases. Further, a DSCA transfer of \$130 million from the administrative account to clear deficits in the transportation account may have subsidized sales of military equipment and services to foreign governments with ASFF appropriations.

Improved cost accounting and a DoD working group would facilitate cost-saving measures, such as those advocated by the Secretary of Defense. Such measures could reduce future estimated administrative surcharges DSCA expects to collect on ASFF cases (DSCA expected to collect \$185 million on FY 2012 appropriations), which would help free up funds for operations in Afghanistan.

What We Recommend

- The Under Secretary of Defense (Policy) should establish a working group to review surcharge policies, rates, and accounting requirements related to ASFF orders.
- The Director, DSCA, should implement policy to require detailed cost accounting procedures. The policy should ensure that the DSCA rates reasonably reflect actual costs for ASFF cases, identify actual CAS and transportation expenses, and establish controls to segregate appropriated and foreign country funds in the surcharge accounts.

Management Comments and Our Response

Comments from the Under Secretary of Defense (Policy) and Director, DSCA, were partially responsive. The Under Secretary stated that an executive steering committee already existed to oversee the creation and implementation of the planned Security Cooperation Enterprise System. The executive steering committee includes the key stakeholders for the FMS process; therefore, a new working group would only duplicate that effort.

The Director stated that DSCA maintained an adequate and compliant resource management system to support the application of surcharges

and the DoD FMR did not mandate the specific systems or level of detail by which an agency must collect and report data. The Director also stated that DSCA was developing an enterprise resource planning system to expand the integration of financial and logistics systems.

We request that the Under Secretary of Defense (Policy) and the Director, DSCA provide additional comments that specifically identify the improved processes and controls developed in the Security Cooperation Enterprise System that will allow DSCA to compare its surcharge rates to the actual costs of providing the related services. Please see the recommendations table.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Under Secretary of Defense (Policy)	1	
Director, Defense Security Cooperation Agency	2.a, 2.b, 2.c	

Please provide comments by October 19, 2012.

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Introduction

Audit Objective

The audit objective was to determine what fees and surcharges were applied by DoD components when they fulfilled orders funded by Afghanistan Security Forces Fund (ASFF) appropriations and whether actual costs supported the fees and surcharges we identified. See the Appendix for our scope and methodology and prior coverage on fees and surcharges assessed on Afghanistan Security Forces Fund orders or related costs.

Background on ASFF Surcharges

Afghanistan Security Forces Fund

Congress enacted Public Law 109-13, “Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005,” on May 11, 2005, to establish ASFF. Through January 2012, 12 public laws have appropriated \$50.9 billion to ASFF. Public Law 109-13 designated ASFF appropriations to provide assistance to the Afghan National Security Forces (ANSF), “including the provision of equipment, supplies, services, training, facility and infrastructure repair renovation, and construction, and funding.”

ASFF Appropriations Allocation and Project Execution

Congress designated the ASFF appropriations to the Secretary of Defense for the Secretary to allow the Commander, Combined Security Transition Command–Afghanistan (CSTC-A) to provide the desired support to Afghanistan’s security forces. The Deputy Secretary of Defense directed the Secretary of the Army to provide funds distribution and accounting support through the Defense Security Cooperation Agency (DSCA). For appropriations that funded ASFF through FY 2009, substantially all purchasing activity by CSTC-A was conducted through the DSCA Foreign Military Sales (FMS) Program.

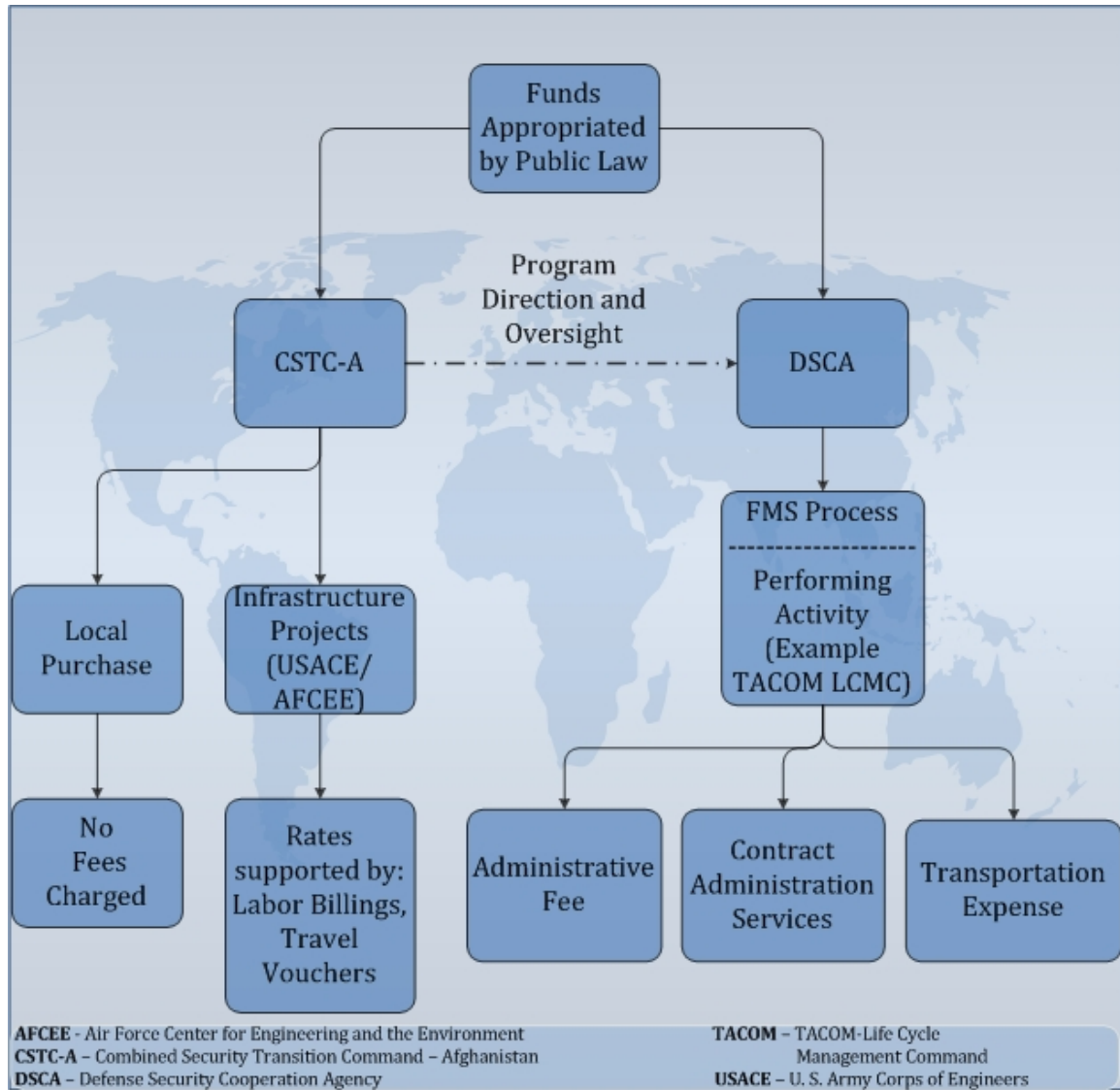
Starting in FY 2010, the Assistant Secretary of the Army (Financial Management and Comptroller), allocated the funds appropriated for ASFF between CSTC-A and DSCA.

CSTC-A did not incur the DSCA fees and surcharges discussed later in this report for local purchasing and infrastructure projects funded by ASFF appropriations after FY 2009.

The FY 2010 project flow for ASFF appropriations and the fees charged are shown in Figure 1. The allocation of ASFF appropriations directly to CSTC-A allowed the commander in Afghanistan to execute local purchasing and infrastructure projects without using the DSCA FMS process. Accordingly, CSTC-A did not incur the DSCA fees and surcharges discussed later in this report for local purchasing and

infrastructure projects funded by ASFF appropriations after FY 2009.

Figure 1. FY 2010 ASFF Project Flow and Fees Charged



Beginning in FY 2010, CSTC-A ordered ASFF goods and services in three ways. First, CSTC-A ordered construction services from the U.S. Army Corps of Engineers (USACE) and Air Force Center for Engineering and the Environment (AFCEE) on military interdepartmental purchase requests. Second, CSTC-A contracted directly with local Afghan suppliers for goods and services. CSTC-A received an allocation of \$4.7 billion in ASFF appropriations for FY 2010 for the infrastructure projects as well as to make local purchases. Third, CSTC-A continued to purchase equipment and training through the DSCA FMS process. DSCA received an allocation of \$4.3 billion in ASFF appropriations for FY 2010 for that purpose.

Fees and Surcharges Assessed on ASFF Orders

Orders placed with other Federal agencies are subject to the requirements of the Economy Act. The Economy Act requires Federal agencies providing goods and services to other Federal agencies to charge the actual cost of the goods and services provided. To

meet this requirement and collect reimbursement for their full costs, the providing agencies assess fees and surcharges on customers. USACE and AFCEE assessed fees for supervision of the infrastructure projects. DSCA assessed surcharges to cover administrative, contract administration, and transportation expenses for the cases it processed. For additional details regarding the fees and surcharges assessed on ASFF orders, please refer to the Glossary. Table 1 illustrates the key fees and surcharges collected on ASFF orders.

Table 1. Fees and Surcharges Assessed and Collected on ASFF Orders

Ordering Agency	Providing Agency	Fee or Surcharge Description	How Assessed	Rate	Cost Methodology
CSTC-A	USACE	Supervision and Administration Fee	Percentage fee on project contract value collected and deposited to revolving fund.	7% to 9%	Identified costs charged to revolving fund
	AFCEE	Supervision, Inspection, and Overhead Fee	Percentage fee used for order estimate.	4.5%	Identified costs accumulated and billed monthly on a reimbursable basis
DSCA	Military Departments and Other Defense Organizations (including security assistance commands, materiel commands, life cycle commands, and so forth)	Administrative Surcharge	Percentage Fee on order value	3.8%	Components received allotments from surcharge account
		Contract Administration Services Surcharge	Percentage fee on ordered goods and services contract value	1.5%	Service providers send billings
		Transportation Surcharge	Table of values of estimated cost of transport provided by U.S. Transportation Command based on mode and region	Varies based on mode and region	Service providers send billings

CSTC-A did not collect any fees or surcharges on the purchase orders it placed.

CSTC-A ordered local purchases in Afghanistan directly with the vendors of the goods and services and did not involve other DoD components in those purchases. CSTC-A did not collect any fees or surcharges on the purchase orders it placed, either with other DoD components or non-Government vendors.

Costs Supporting Fees and Surcharges Assessed on Infrastructure Projects Overseen by USACE and AFCEE

USACE identified its expenses related to execution of ASFF projects to the district offices performing the work. The Afghanistan Engineering Districts are a separate operating and accounting entity. USACE operated an authorized revolving account for its supervision and administration expenses. It charged this account for those expenses when incurred. USACE regularly reviewed the revolving account to monitor the balance that resulted from the collection of the percentage fee on orders and the expenses charged to the account. USACE maintained a balance that covered approximately 4 months of supervision and administration expenses and was working to reduce the balance to 3 months.

AFCEE entered into a memorandum of understanding with CSTC-A to perform supervisory, inspection, and oversight services for its management of Afghanistan projects. It identified its costs of such services through timekeeping and specific identification of direct expenses, collected the total of such expenses monthly, and prepared billings to recover those costs. Therefore, its revenue collections matched its identified costs for the services it provided. USACE and AFCEE maintained sufficient processes and accounting records to demonstrate that they based their rates on actual costs and the estimates could adjust to actual expenses when they were known.

Costs Supporting Fees and Surcharges Assessed on Military Equipment and Training Orders Using the DSCA FMS Process

DSCA is the designated DoD organization operating U.S. Government security assistance programs providing military goods and services to foreign countries. DSCA coordinates FMS and U.S. military assistance in the event of disasters around the world, facilitates the upgrading of partner countries' equipment and training, and monitors the end-use of U.S.-provided military equipment. Standard FMS are sales in which a friendly foreign government buys military equipment and services from the United States. It does not rely on U.S.-appropriated funds. However, in 2005, Congress appropriated funds to enable the commander in Afghanistan (currently CSTC-A) to equip, sustain, and train the ANSF.

As discussed earlier, DSCA was allocated ASFF appropriations and directed to provide support to CSTC-A. DSCA elected to use its established FMS process to fulfill requests from the commander in Afghanistan to provide durable military equipment and training to support that country's security forces.

DSCA personnel treated ASFF cases the same as they would treat a standard FMS case.

Accordingly, DSCA deposited U.S.-appropriated funds into the DSCA-managed FMS Trust Fund and used those funds to complete the objectives of the ASFF. DSCA personnel treated ASFF cases the same as they would treat a standard FMS case, except for tracking the appropriate expiration and cancellation of the funds as required by appropriation law.

DSCA assessed and collected various fees and surcharges on ASFF orders, the most substantial of which were the administrative, CAS, and transportation surcharges.

DSCA assessed and collected various fees and surcharges on ASFF orders, the most substantial of which were the administrative, contract administration services (CAS), and transportation surcharges. For accounting purposes, the Defense Finance and Accounting Service (DFAS) created separate accounts for these collections within the FMS Trust Fund. DSCA paid the expenses related

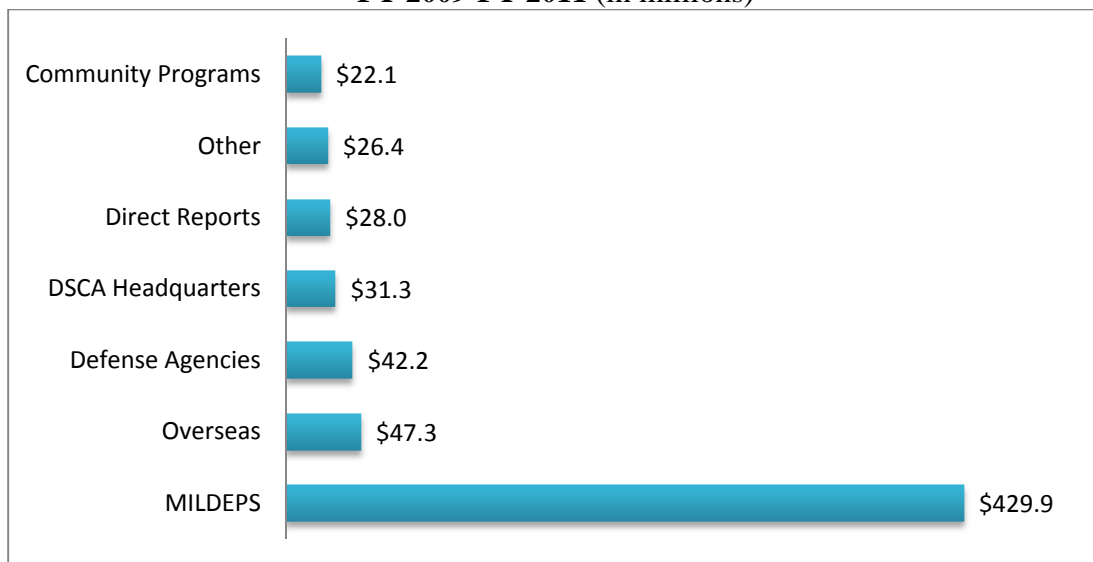
to the surcharges it collected on FMS cases, including ASFF cases, from these accounts. DoD organizations that provide support to the FMS Program must recoup the full cost to provide such support.

Administrative Surcharge

The administrative expenses of operating the FMS process were primarily personnel costs (U.S. Government and contractor-furnished) required to develop, execute, and close FMS cases. Initially each year, to identify and fund these administrative expenses, DSCA reviewed and approved budgets submitted by DoD components that performed those functions in the administration of FMS cases. DSCA provided budget authority through allotments from the administrative surcharge account to those components. The components directly cited the budget authority provided by DSCA or billed to reimburse their funds as they incurred expenses.

DSCA allocated the administrative surcharge account funding to organizations performing support services. Figure 2 shows the organizations receiving the annual budget authority allocated by DSCA from the administrative surcharge account for FY 2009 through FY 2011. The average annual administrative distribution from FY 2009 through FY 2011 was \$627 million.

Figure 2. Average Annual Budget Allotments to DoD Activities From the Administrative Surcharge Account FY 2009-FY 2011 (in millions)



Note: See the Glossary for descriptions of the allotment categories.

Source: DSCA

Contract Administration Services Surcharge

DSCA used the CAS surcharge account differently when paying expenses. For CAS, DSCA provided reimbursable authority for the Defense Contract Management Agency, the Defense Contract Audit Agency, and two smaller organizations in the Army and Navy to perform contract management and audit services. These organizations prepared billings monthly for work performed. Organizations receiving funding from the CAS surcharge account did not receive funding from the administrative surcharge account.

Transportation Expenses

DSCA provided budget authority for transportation expenses when the requesting activities placed purchase orders with DoD components. When DoD providing agencies received goods and services, they billed the FMS Trust Fund or directly cited that appropriation to pay for transportation expenses.

DSCA Did Not Have Cost Accounting Records for ASFF Surcharges or Policies to Determine Whether Transfers Between Accounts Were Proper

Internal control weaknesses in DSCA's accounting and cost analysis existed as defined by DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," July 29, 2010. DSCA personnel did not prepare detailed cost accounting records to support surcharge rates with actual cost data or determine whether DSCA properly used ASFF appropriations when it made transfers between the administrative surcharge account and the transportation expense account. We will provide a copy of the report to the DSCA senior official responsible for internal controls.

Finding. Improvement Needed in DSCA Cost Accounting for Surcharges Assessed on Afghanistan Security Forces Fund Orders

The U.S. Army Corps of Engineers (USACE) and Air Force Center for Engineering and the Environment (AFCEE) generally had appropriate cost accounting procedures when they assessed fees and surcharges while fulfilling Afghanistan Security Forces Fund (ASFF) orders. However, the Defense Security Cooperation Agency (DSCA) did not maintain adequate cost accounting records that showed whether three of its surcharge rates represented reasonable estimates of actual costs on Foreign Military Sales (FMS) cases funded by ASFF appropriations (ASFF cases). Specifically, DSCA collected:

- Administrative surcharges of approximately \$848 million¹ on cases funded by FY 2005 through FY 2011 ASFF appropriations, but did not maintain adequate cost records that directly supported the surcharge rate.
- Contract administration services (CAS) surcharges of an unknown amount on ASFF cases and lacked adequate cost accounting records to compare actual expenses to surcharges collected.
- Transportation expense surcharges of an unknown amount on ASFF cases and did not have cost accounting information to identify the expense for each ASFF case.

This occurred because DSCA did not have adequate policies and standard operating procedures that required the preparation of detailed cost accounting records to support surcharge rates with actual cost data or to use available cost data when reviewing the CAS surcharge and transportation expense surcharge. Additionally, DSCA did not have policies to determine whether it properly used ASFF appropriations when it made transfers between the administrative and the transportation expense surcharge accounts.

As a result, it was unclear whether DSCA assessed appropriate surcharges to pay for the actual expenses of administration related to ASFF cases or how much of the \$2.8 billion balance in the administrative, CAS, and transportation expense surcharge accounts resulted from high surcharge rates for ASFF cases. In addition, DSCA transfers of \$130 million from the administrative surcharge account to clear deficits in the transportation surcharge account may have resulted in the use of ASFF appropriations to subsidize sales of military equipment and services to foreign governments.

Improving the cost accounting procedures and forming a DoD working group to review current business practices and policies would help implement cost-saving measures, such as those advocated by the Secretary of Defense, and possibly reduce future estimated administrative surcharges that DSCA expects to collect for ASFF cases (DSCA expected to collect \$185 million on FY 2012 appropriations). Reduced surcharges on the ASFF cases would make additional funds available for operations in Afghanistan.

¹ Collected from the inception of ASFF through September 30, 2011.

Cost Accounting Requirements

Federal agencies are required to comply with standard accounting practices established by the Federal Accounting Standards Advisory Board. These standards have included cost accounting since 1997. DoD's policy to comply with these standards is included in DoD Regulation 7000.14-R, "DoD Financial Management Regulation" (DoD FMR), which provides specific guidance related to pricing and cost accounting for goods and services.

For example, the DoD FMR, Volume 15, Chapter 7, "Pricing," mandates that DoD components add an administrative surcharge to all FMS cases to recover the full costs required to develop, execute, and close FMS cases. In accordance with this policy, surcharge collections must not exceed the full costs of the services provided.

The DoD FMR emphasizes the importance of preparing and maintaining cost information related to reimbursements collected. DoD FMR, Volume 4, Chapter 19, Paragraph 190204, "Determining Reimbursements and Setting Fees and Prices," states that cost information is an important basis in setting fees and reimbursements. It recognizes, however, that pricing and costing are two different concepts. The DoD FMR also states that in the Federal Government, setting prices is a policy matter, but statutory provisions and regulations may govern it, and as stated in volume 15, chapter 7, DSCA is required to limit its surcharges to the recovery of full costs.

Further, DoD FMR, volume 4, chapter 19, provides specific guidance about tracking costs and using the results to price goods and services. It specifically requires DoD components to comply with the Statement of Federal Financial Accounting Standard No. 4, "Managerial Cost Accounting and Standards." This includes establishing a consistent methodology to accumulate costs of the resources required to produce goods and services. Components should identify these costs by activity. Specifically, paragraph 190405 states:

The full costs of resources that directly or indirectly contribute to the production of outputs should be assigned to outputs through cost methodologies or cost finding techniques that are most appropriate to the segment's operating environment and should be followed consistently. The cost assignments should be performed using the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

USACE and AFCEE Maintained Adequate Cost Accounting Records

Both USACE and AFCEE maintained accounting records that included direct costs. USACE was also able to allocate a percentage of its indirect costs to each project, thus recouping the full cost of the services provided. The Economy Act requires Federal agencies to recoup the actual cost of providing goods and services to other Federal agencies. This includes an appropriate amount of indirect costs.

For example, for one project, CSTC-A provided a military interdepartmental purchase request to AFCEE for \$24.4 million to build administrative buildings for the Afghan Ministry of Defense. AFCEE tracked its personnel costs, the amount of contractor support used to complete the project, and travel expenses. AFCEE billed its actual expenses, which were \$735,639, and collected reimbursement in the same amount.

DSCA Needed Better Cost Accounting Records and Management of Surcharge Accounts

DSCA collected administrative surcharges of approximately \$848 million on cases funded by FY 2005 through FY 2011 ASFF appropriations through September 30 2011, but either did not maintain actual expense records that directly supported the surcharge collections or did not rely on existing cost accounting information when setting its rates. Specifically, DSCA lacked sufficient documentation to show that the administrative surcharge rate it assessed on FMS cases funded by ASFF appropriations was a reasonable estimate of the actual costs incurred. In addition, DSCA did not always identify CAS and transportation expenses for each ASFF case and adjust reimbursement to the actual cost.

DSCA lacked sufficient documentation to show that the administrative surcharge rate it assessed on FMS cases funded by ASFF appropriations was a reasonable estimate of the actual costs incurred.

Administrative Surcharge Rate

DSCA needed to improve its cost accounting for the administrative surcharge account so that the surcharges collected represented a reasonable estimate of DSCA costs incurred. Table 2 shows the amount of administrative surcharges collected on cases funded by FY 2005 through FY 2011 ASFF appropriations.

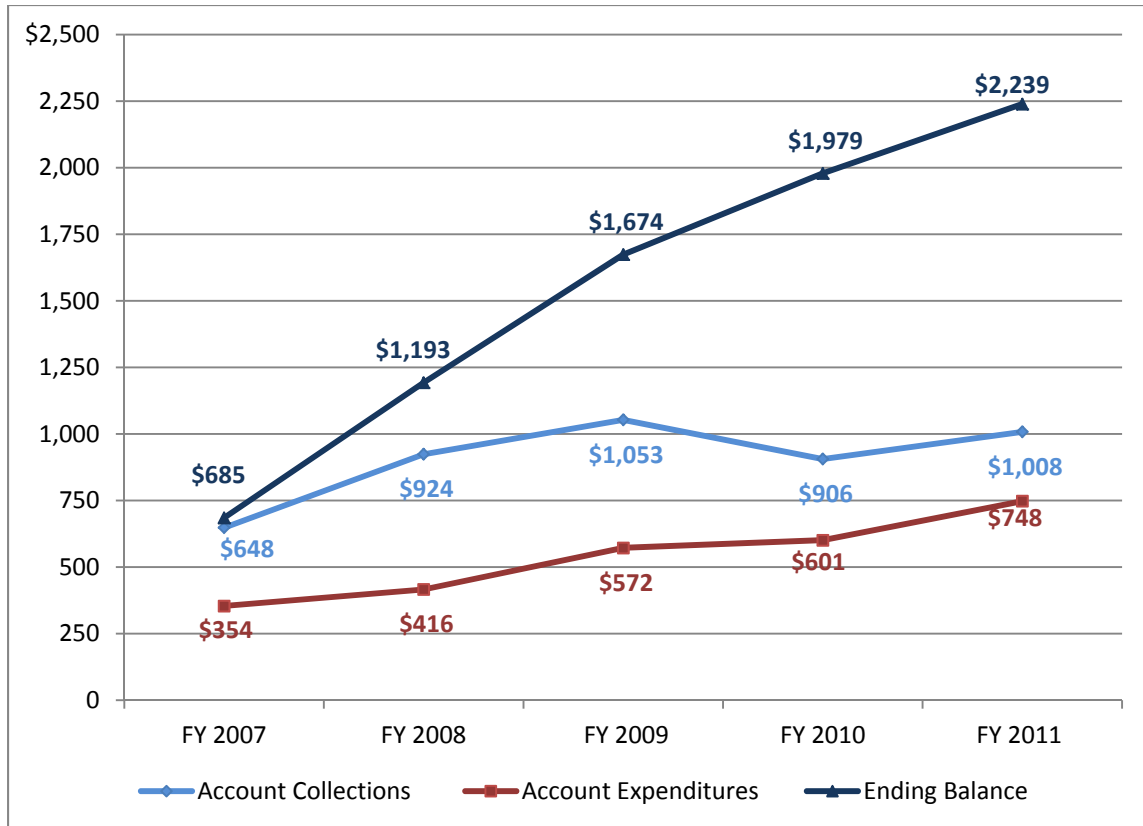
Table 2. Administrative Surcharges Collected on Cases Funded by FY 2005-FY 2011 ASFF Appropriations
(in millions)

Fiscal Year	Amount Collected
2005	\$26.3
2006	46.6
2007	243.6
2008	91.7
2009	177.8
2010	148.4
2011	114.0
Total	\$848.4

From FY 2007 through FY 2011, the DSCA administrative surcharge account balances for all FMS activity grew significantly. DSCA personnel explained that surcharge collections exceeded forecasted levels because sales levels exceeded expectations. In addition, most of the administrative surcharge collections occurred well in advance of the

services provided and the expenditures to pay for them. During the audit, DSCA officials stated that this resulted in the significantly increased balances in the administrative surcharge account. The administrative surcharge account total collections, expenditures, and account balance for FY 2007 through FY 2011 appear in Figure 3.

Figure 3. DSCA Administrative Surcharge Account Collections, Expenditures, and Account Balance FY 2007-FY 2011
(in millions)



The ending balance in the administration surcharge account increased 227 percent (\$685 million to \$2,239 million) from FY 2007 to FY 2011, and related account expenditures increased 111 percent (\$354 million to \$748 million). DSCA personnel stated that the ending balance increase was related to the fact that they collected between 50 percent and 100 percent of the administrative surcharges at the time DSCA and CSTC-A implemented each case, but the related administrative case management services occurred over the life of fulfilling the order, which could be years. DSCA personnel explained that cases for purchases of military equipment could involve complex contracts that take years to fully complete.

DSCA did not maintain records that tracked the associated cost or expenses of providing the goods and services. DSCA reported the collections and disbursements related to the administrative surcharges in the administrative surcharge account, which is a subaccount

within the FMS Trust Fund. DSCA did not segregate funds collected from ASFF cases from funds collected from traditional FMS cases.

DSCA collected administrative surcharges under the authority of the Public Law 90-269, “Arms Export Control Act,” October 22, 1968, as amended, section 21(e)(1)(A), and the “Economy Act,” as amended, section 1535, title 31, United States Code. Section 21(e)(1)(A) requires that all FMS cases include a charge stated at an average percentage rate to recover the full cost of the administration of sales. While the Arms Export Control Act governs FMS cases, the Economy Act governs the ASFF-funded orders because they are not FMS cases paid by foreign countries’ funds.

The Economy Act requires goods and services to be sold to other government organizations at cost. DSCA assessed an administrative surcharge at the rate of 3.8 percent of the value of each case since 2006. DSCA maintained that the 3.8 percent rate charged to ASFF was the best estimate of its costs in accordance with the Economy Act. However, DSCA did not determine its 3.8 percent administrative surcharge rate based on historical expenses (for example, personnel compensation and travel, among other operating expenses). Instead, DSCA based its determination on projections of cash flow (collections and disbursements), with the objective of maintaining a surcharge account balance it judged to be necessary to maintain a “healthy balance” for continuing operations, even though DSCA was required to limit the rate charged to the recovery of full costs. In ensuing reviews of the surcharge account and rate, DSCA has continued to perform similar cash flow analyses to judge whether the surcharge account balance and rate were appropriate.

DSCA did not determine its 3.8 percent administrative surcharge rate based on historical expenses.

DSCA prepared various supporting documentation when it made its determination of the 3.8 percent rate in 2005. However, DSCA policy did not require the identification and collection of historical costs to support the rate determination. DSCA personnel acknowledged that DSCA did not have a policy or standard operating procedure requiring cost accounting for actual costs to support the 3.8 percent rate directly. In its determination of the surcharge rate in 2005 and reviews in subsequent fiscal periods, DSCA did not use detailed cost accounting to determine that the 3.8 percent administrative surcharge rate was an appropriate estimate of actual costs. While a cash flow analysis might include some elements of cost accounting, DSCA should have used appropriate detailed cost accounting (such as accounting for employee time by specific cases) to determine whether its administrative surcharge rate was an appropriate estimate of actual costs of the services provided.

For example, one case reviewed for the purchase of radios for ANSF, valued at \$117 million, demonstrated a need for improved cost accounting records. Of the case value, \$110.1 million was subject to DSCA’s administrative fee, which resulted in the collection of \$4.1 million. DSCA was not able to relate the specific expenses anticipated or incurred for the project to the amount collected. After depositing the funds in the administrative surcharge account, DSCA was not able to track the use of the funds to

reimburse the performing activity for its costs. DSCA did not require performing activities to track the individual personnel and other direct costs for specific cases. Instead of charging each case for the costs of case administration, the performing activity requested funding through DSCA's annual budget process for the administrative surcharge account. Had DSCA required and used better cost accounting records, it would have had assurance that the amount charged for administrative fees reflected the actual expenses incurred.

Contract Administration Services Surcharge Rate

DSCA did not rely on existing cost data in reviewing the CAS surcharge account. Specifically, DSCA did not use existing cost data from the Defense Contract Management Agency and Defense Contract Audit Agency to set the CAS rates assessed on ASFF cases to ensure that it limited collections to full cost recovery. DSCA personnel did not match the CAS expense billings to the surcharge amounts collected on each FMS case even though they indicated these two agencies maintained sufficient cost accounting information for this analysis and provided DFAS the information.

Matching expenses to actual costs might have ensured that the CAS surcharge was a reasonable estimate of the actual costs incurred.

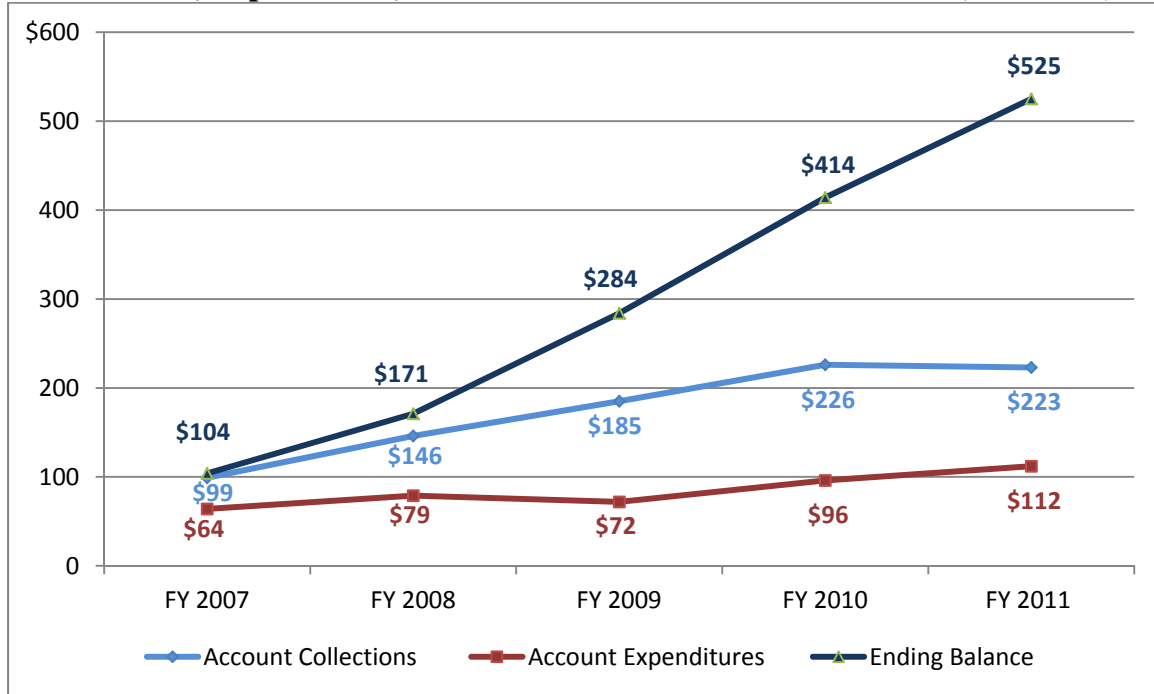
Matching expenses to actual costs might have ensured that the CAS surcharge was a reasonable estimate of the actual costs incurred. In addition, DSCA could not determine the amount of CAS surcharges it collected for ASFF cases. We requested that DSCA provide the amount it collected from FY 2007 through FY 2011. DSCA indicated that its accounting records could not segregate the funds in the CAS surcharge account by case. Therefore, DSCA could not provide the total amount of surcharges collected from ASFF appropriations for CAS.

DSCA has assessed a CAS surcharge at 1.5 percent of the contract values included in FMS cases since 2002. DFAS paid contractors for goods and services delivered for specific cases using the Services' disbursement systems. The systems then reported the transactions to the Defense Integrated Finance System (DIFS), the accounting system for the FMS Trust Fund. The disbursement triggered the collection of the CAS fee from the case to a separate account in the FMS Trust Fund. When it collected the CAS, DSCA lost visibility to match the case with the expenses paid.

The Defense Contract Management Agency and Defense Contract Audit Agency primarily performed contract management, quality assurance and inspection, and audit services on contracts for ASFF-funded cases. Those agencies billed at standard rates, and DSCA paid for their services from the CAS account.

During FY 2007 through FY 2011, the DSCA CAS surcharge account balance for all FMS activity grew significantly. DSCA personnel explained that surcharge collections exceeded forecasted levels because sales levels did not decline as projected. Figure 4 presents the total collections, expenditures, and account balance in the CAS surcharge account for FY 2007 through FY 2011.

Figure 4. DSCA Contract Administration Services Surcharge Account Collections, Expenditures, and Account Balance FY 2007-FY 2011 (in millions)



The ending balance in the CAS surcharge account increased 405 percent (\$104 million to \$525 million) from FY 2007 to FY 2011, and related account expenditures increased 75 percent (\$64 million to \$112 million). DSCA personnel stated that they collected the CAS surcharges at the time the providing agencies delivered the ordered goods and services, while certain CAS services, in particular, contract audit and closure, occurred well after delivery.

DSCA policy did not require the use of cost accounting data during reviews of the CAS account. By not identifying the direct CAS expenses to each FMS case funded by ASFF appropriations and comparing those to the surcharge collected, DSCA had a risk that it undercharged or overcharged individual cases for CAS.

Even though the CAS surcharge is limited to the recovery of full cost, the balance in the CAS account has grown from \$104 million to \$525 million over the past 5 years.

Even though the CAS surcharge is limited to the recovery of full cost, the balance in the CAS account has grown from \$104 million to \$525 million over the past 5 years. This account contains funds from both ASFF and FMS cases for foreign countries. DSCA indicated the balance has grown because more ASFF cases and FMS cases have been using contracts to acquire military equipment.

CAS is collected on contract deliveries and progress payments. DSCA needed to use actual CAS expenses, when available, to set the CAS surcharge rates and assess the CAS surcharge account balance. Therefore, DSCA needs to obtain adequate cost accounting

data to identify these direct expenses for each ASFF case because these are appropriated funds. This would allow it to determine when the collected amounts do not match the actual expenses and take appropriate actions. DSCA would then ensure that it collected a fair amount of CAS expenses on each case, including the ASFF appropriations.

Transportation Fee Rate

DSCA did not always segregate ASFF-related transportation fees and expenses from traditional FMS transportation fees and expenses. Additionally, DSCA could not match the amounts collected from specific cases with the actual expenses and amounts billed by the U.S. Transportation Command (USTRANSCOM). When deficits occurred in the transportation expense account, DSCA transferred funds from the administrative surcharge account rather than identify the specific transportation expenses that caused the deficit and collect payment from the appropriate FMS cases. We requested that DSCA provide the amount of transportation fees it collected for ASFF orders from FY 2007 through FY 2011. DSCA indicated that its accounting records did not segregate transportation fee collections by case funding, and the time and cost of compiling such information based on a review of all collections for the period requested would be extensive. Therefore, DSCA could not provide data to determine the total amount of transportation fees collected from ASFF appropriations.

DSCA could not match the amounts collected from specific cases with the actual expenses and amounts billed by USTRANSCOM.

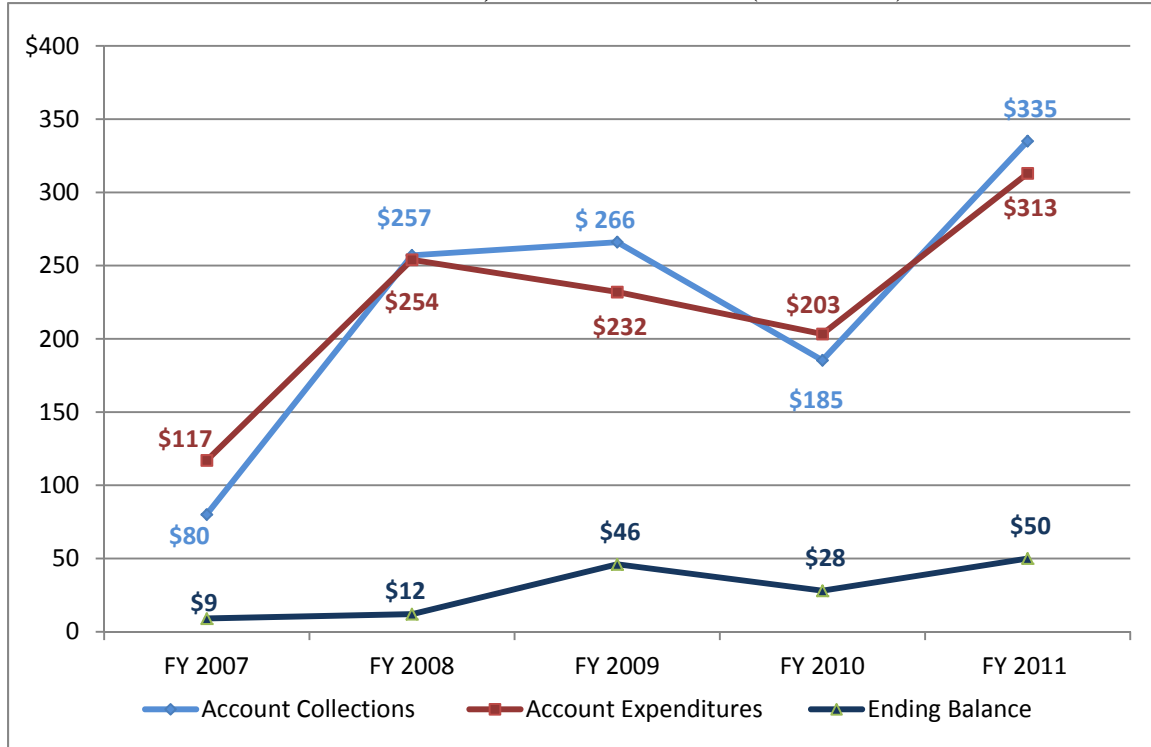
DSCA assessed a transportation surcharge on each FMS case based on a table of estimated transportation rates for various modes of transportation for delivery of ordered goods. During case development, security assistance personnel entered a planned mode of transportation for the goods ordered on each FMS case. As the Army delivered goods to ANSF, it recorded the delivery in its logistics system, which then posted it in DIFS. When DSCA received delivery notifications, it collected a transportation surcharge on each case based on the shipping mode and the USTRANSCOM rate entered when the case was established. DFAS recorded this collection into the transportation fee account, which contains funds from ASFF cases as well as FMS cases. After DSCA collected the fee, USTRANSCOM would submit a bill to DFAS for reimbursement. A single shipment could contain goods for multiple ASFF orders or FMS cases; however, the billings lacked enough detail to identify the specific cases that were included in the shipment billed.

DFAS paid the USTRANSCOM billings with funds in the transportation account and did not track the summary expenses back to specific cases. DFAS recorded all collections and disbursements in the transportation expense account, which like the administrative surcharge account, is a subaccount within the FMS Trust Fund.

During FY 2007 through FY 2011, the DSCA transportation surcharge account balance for all FMS activity grew significantly. DSCA personnel explained that surcharge collections exceeded forecasted levels because sales levels did not decline as projected.

Figure 5 presents the total collections, expenditures, and account balance in the transportation expense account for FY 2007 through FY 2011.

Figure 5. DSCA Transportation Expense Account Collections, Expenditures, and Account Balance, FY 2007-FY 2011 (in millions)



The ending balance in the transportation surcharge account increased 456 percent (\$9 million to \$50 million) from FY 2007 to FY 2011, and related account expenditures increased 168 percent (\$117 million to \$313 million).

A deficit occurred when DFAS, on behalf of DSCA, disbursed more funds from the transportation account than were collected. In FY 2008 and again in FY 2011, DSCA transferred funds from the administrative surcharge account to avoid deficits in the transportation account balance. Specifically, on March 18, 2008, and then again on October 21, 2010, DSCA transferred \$80 million and \$50 million, respectively, between those accounts. DSCA personnel stated that the key reasons the deficit occurred were the increase in fuel costs without a resulting increase in the amount collected and the requirement to use the Defense Travel System to move goods for ASFF.

DSCA assessed a transportation fee on the original ASFF order based on the rates prescribed by USTRANSCOM and collected that amount upon delivery. DSCA did not match transportation billings to the original order and determine that an additional transportation amount was due. Its policy did not require the matching of collections to the expenses, and the billings generally did not contain adequate detail to allow the matching of the surcharge collected to the expense incurred. Further, DSCA did not perform a detailed analysis of the deficit in the transportation account by reviewing the

accounting data to determine the transportation expenses that caused the overall account deficit. Instead, DSCA authorized the transfer of funds from the administrative surcharge account to replenish the account balance. DSCA should have an adequate cost accounting system to identify these direct expenses for each FMS case to allow DSCA to determine when it should return surcharges collected in excess of actual expenses and adjust the rates charged on future cases.

Management Actions on Transportation Expenses

DSCA management reviewed the transportation account and implemented two actions. First, DSCA adjusted the transportation rate for all shipments to Afghanistan to provide increased collections into the transportation surcharge account and to increase the balance available to pay actual expenses. This action reduced the likelihood of deficits, but did not change the accounting procedures for the transportation surcharge account to match actual expenses and surcharge collections.

Second, DSCA established special transportation cases, totaling \$106 million in FY 2010 and \$375 million in FY 2011, funded by ASFF appropriations. DSCA and the U.S. Army Security Assistance Command then required coordination of all expedited shipments to Afghanistan to ensure the payment of actual transportation expenses for those shipments from the ASFF transportation cases. As of September 30, 2011, the remaining unobligated balances on these cases totaled \$4.7 million and \$323.2 million, respectively.

While DSCA did not implement procedures to match transportation billings to each ASFF case, it did match expedited transportation costs for ASFF orders to the appropriations available to fund them. However, even though DSCA took action to mitigate the causes of deficits in the transportation surcharge account, it needed to develop and implement improvements that would result in sufficient detailed cost accounting to match actual transportation expenses to the surcharges collected.

DSCA Cost Accounting Did Not Identify Actual Costs to Support Surcharges Assessed on ASFF Orders

It was unclear whether DSCA assessed appropriate surcharges to pay for the actual expenses of administration and CAS related to ASFF cases or how much of the ending balances of \$2,239 million in the administrative surcharge account and \$525 million in the CAS surcharge account (see Figures 3 and 4) resulted from high surcharge rates. The increases in the ending balances in these two accounts since FY 2007, amounting to \$1,975 million,² raised questions about DSCA's rate-setting and collection methodologies.

² Combined increases in the administrative surcharge account of \$1,554 million (\$685 million to \$2,239 million) and the CAS account of \$421 million (\$104 million to \$525 million).

Cost accounting has been a requirement for Federal agencies since 1997, and the DoD Inspector General reported on DSCA's lack of cost accounting in that year.³ However, DSCA has not fully implemented cost accounting. DSCA might have determined different surcharge rates if it had completed appropriate cost accounting analyses. Also, DSCA could not show that ASFF appropriations that might have been included in the transfer of \$130 million from the administrative surcharge account to the transportation expense account were used for the proper purpose. By not identifying actual expenses to each case funded by ASFF appropriations, DSCA risked paying for transportation costs related to purchases of military equipment by other foreign countries from the ASFF appropriations or vice versa.

Cost-Savings Initiatives Needed for ASFF Orders

FY 2012 budget data showed that DSCA would collect about \$185 million in fees associated with ASFF goods and services, unless it implemented cost-saving measures. In an August 2010 memorandum, the Secretary of Defense outlined numerous efficiency initiatives designed to reduce duplication, overhead, and excess, and instill a culture of savings and restraint across the DoD.

We consider the ASFF program, which has to date received about \$51 billion, significant and one that should be included as part of DoD's cost-saving initiatives. With millions of

With millions of dollars being charged for administrative fees on ASFF cases, a process should exist to systemically review and potentially reduce these fees.

dollars being charged for administrative fees on ASFF cases, a process should exist to systemically review and potentially reduce these fees. Such a review could achieve cost-savings throughout DoD. Accumulating and tracking cost data would enable DSCA to comply with this initiative and maintain adequate cost accounting data that support future rate changes.

The ASFF appropriation for FY 2012 was \$11.2 billion. If DSCA receives FY 2012 ASFF appropriations in a percentage similar to that received in FY 2011, we estimate that DSCA would collect \$185 million in administrative fees without sufficient cost data and associated fund management to support the charges. Implementing actions that result in the preparation of detailed cost accounting records that directly support DSCA surcharge rates would provide DSCA and DoD with a way to demonstrate that the fees charged relate directly to the cost of providing the ASFF-related goods and services. This cost accounting information would also provide more support for the fees that DSCA must assess to comply with the requirements of the Economy Act. In addition, DSCA should have better cost accounting records and controls to safeguard appropriated funds so they do not subsidize sales of U.S. military goods and services to other foreign countries.

³ DoD IG Report No. 97-227. "Foreign Military Sales Administrative Surcharge Fund," September 30, 1997.

DoD Would Benefit From Forming a Working Group on Fee and Surcharge Rate-Setting Policy for ASFF Orders

Reduced charges for support costs could make additional funds available for operations in Afghanistan. Since fulfilling the requirements of the ASFF program requires coordination between numerous activities within and outside DoD, no single component within DoD can accomplish the program's mission alone or without impacting other DoD activities. To help ensure that DSCA prepares appropriate cost accounting information and establishes appropriate surcharge rates and surcharge-setting policies, DoD would benefit from forming a working group to review current business practices and policies associated with fees and surcharges assessed on ASFF orders.

The main objective of the working group should be to review the policies associated with fees and surcharges assessed on ASFF orders, the supporting documentation that supports the costs associated with the fees and surcharges, and the amount of fees and surcharges assessed. The working group should also provide a forum for agencies to elevate concerns.

DoD Directive 5111.1, "Under Secretary of Defense for Policy (USD(P)), December 8, 1999, makes the USD(P) responsible for establishing policies and providing oversight and supervision in the programming and execution of contingency operations and gives USD(P) direct authority over DSCA. USD(P) is in the best position to serve as the chair of the working group as a result of these responsibilities.

Additionally, the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD (USD[C]/CFO) should serve as a key participant of the working group. DoD Directive 5118.03, "Under Secretary of Defense (Comptroller) (USD(C))/Chief Financial Officer (CFO), Department of Defense," January 6, 1997, provides that USD(C)/CFO is responsible for reviewing the fees charged within DoD. The Directive charges USD(C)/CFO to:

Review, at least on a biennial basis, the fees, royalties, and rents and other charges imposed by the Department of Defense for services and things of value it provides, and make recommendations on revising those charges to reflect costs incurred by it in providing those services and things of value.

Other members of the working group could include personnel from the Under Secretary of Defense (Acquisition, Technology, and Logistics), NATO Training Mission–Afghanistan, Combined Security Transition Command–Afghanistan, DSCA, and DFAS.

Defense Security Cooperation Agency Comments on the Finding

We received comments on the finding in our draft report from the Director, Defense Security Cooperation Agency. The Director disagreed that DSCA did not maintain adequate cost accounting and stated the report was based on "incorrect assumptions that charging general administrative costs on an average percentage basis is an impermissible cost allocation system." The Director further stated that a separate system for tracking

the actual surcharge amounts specific to the ASFF program was not authorized, funded, or cost-effective and that the Deputy Secretary of Defense did not include any such directive in the memorandum that instructed DSCA to support ASFF. Furthermore, he stated that the establishment, application, and management of the surcharge accounts are in compliance with the Economy Act and the DoD FMR.

The Director also stated that the percentage rate of the FMS surcharge is set so that costs are recovered but a profit is not made by DSCA. He further stated that the FMS Administrative Surcharge represents a method that allocates cost on a reasonable and consistent basis.

In addition, the Director stated that DSCA conducted annual reviews of the FMS administrative surcharge account and further analyzed the account every 5 years to determine whether a rate change was warranted. He stated that DSCA coordinated the results of these reviews with USD(C)/CFO. Further, he stated that the development of CAS rates was the responsibility of USD(C)/CFO and that DSCA coordinated its transportation surcharge policy with the USD(C)/CFO.

Our Response

DSCA lacked sufficient cost accounting to determine whether the surcharge rates set as an average percentage in accordance with the Arms Export Control Act were a reasonable estimate of the actual costs of providing the goods and services under the Economy Act. We did not question whether DSCA's policy of charging general administrative costs on an average percentage basis was a permissible cost allocation system. When DSCA data showed \$2.2 billion of accumulated surcharge account balances as of September 30, 2011, we requested that DSCA provide cost accounting support to verify that it could support its surcharge collections with actual costs. DSCA officials stated that they did not perform or require detailed cost accounting records for the surcharge accounts.

The Director stated that a separate system for tracking the actual surcharge amounts specific to the ASFF program was not authorized, funded, warranted, or cost-effective. Although our finding stated that DSCA did not maintain adequate cost accounting records, that conclusion did not assume that DoD would need to create a separate system to maintain such records. The information in our report indicated that DSCA could work with its existing systems and those of the implementing agencies, USTRANSCOM, and CAS providers to ensure that DSCA could appropriately identify actual expenses paid from the surcharge accounts for meaningful cost analysis. DSCA could develop adequate cost accounting records to support its surcharge rates and the accumulated balances in the surcharge accounts without the creation of a new system. As stated in our report, we did not share DSCA's view with regard to its compliance with the Economy Act and the DoD FMR for its surcharge management. We stated that DSCA should improve its cost accounting because its reviews, analyses, and reliance on the budget process did not adequately support its surcharge rates as reasonable estimates of actual costs.

Additionally, the DSCA Director stated, “The percentage rate of the FMS surcharge is set so that costs are recovered, but a profit is not made by DSCA.” This statement was not supported by any cost analysis presented to us during our audit. As indicated in our report, DSCA’s cost accounting records were not adequate to make this determination. The Director further stated, “The FMS Administrative Surcharge represents a method that allocates cost on a reasonable and consistent basis.” This statement was not supported by any cost analysis presented to us during our audit. We would agree that assessing the FMS administrative surcharge on an average percentage basis was a reasonable and consistent basis of collecting revenues to recover administrative costs. However, without adequate cost accounting records, DSCA remained unable to determine whether the assessed surcharges were reasonable estimates of actual costs.

Recommendations, Management Comments, and Our Response

1. We recommend that the Under Secretary of Defense (Policy) coordinate with the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD, and other appropriate DoD activities to establish a working group. The working group should review surcharge and fee policies, rates, and accounting requirements related to Defense Security Cooperation Agency surcharges on Afghanistan Security Forces Fund orders, with the goal of reducing future support costs and refunding surcharge collections that exceeded actual costs.

Under Secretary of Defense (Policy) Comments

The Chief of Staff, responding for USD(P), disagreed with establishing a working group and stated that DSCA had already established an executive steering committee to design and implement the Security Cooperation Enterprise System. He stated that the executive steering committee co-chaired by the Deputy Chief Management Officer and the Director, DSCA, includes the key stakeholders for the FMS process; therefore, a new working group would only duplicate that effort.

In addition, he explained the acquisition approach DSCA was taking to build a new information technology system to enhance transparency, improve accounting procedures, and strengthen internal controls for the FMS program. Further, he stated that in lieu of creating an additional working group, DSCA would leverage the existing executive steering committee to address the finding in our report.

Our Response

The Chief of Staff’s comments were partially responsive. We agree that the executive steering committee can fulfill our recommendation if the implementation process for the enterprise resource planning system includes consideration of DSCA’s surcharge and fee policies, rates, and accounting requirements.

We request that the USD(P) provide specific details of the committee’s plans that would meet the intent of our recommendation. The process for creating an enterprise system could take years to accomplish; therefore, we encourage USD(P) to consider establishing

the plan for the committee to make the review we recommended as soon as possible. The decisions from that review would provide the guidance necessary to include adequate cost accounting in the new system.

2. We recommend that the Director, Defense Security Cooperation Agency, implement the “DoD Financial Management Regulation,” volume 4, chapter 19, and establish policies and standard operating procedures for maintaining cost accounting records for the administrative, contract administration services, and transportation surcharges that ensure that DSCA:

a. Assesses an administrative surcharge rate on cases funded by Afghanistan Security Forces Fund appropriations supported by analysis that shows the rate is an accurate estimate of actual costs.

b. Adequately identifies the actual contract administration surcharge and transportation expenses for reimbursement from the appropriate Afghanistan Security Forces Fund case.

c. Establishes controls to ensure segregation between appropriated and foreign country funds in the surcharge accounts to prevent Afghanistan Security Forces Fund appropriations from being used to subsidize costs of Foreign Military Sales cases.

Defense Security Cooperation Agency Comments

The Director, DSCA, disagreed and stated that a former Deputy Secretary of Defense directed that ASFF programs be executed through existing systems and processes managed by DSCA. He stated that DoD FMR Volume 4, Chapter 19, “Managerial Cost Accounting,” provides that entities can develop standard rates as a tool to estimate future costs and conduct variance analyses but that cost data may be adjusted to meet budgetary information needs.

Next, the Director stated that Statement of Federal Financial Accounting Standard No. 1, “Accumulate and Report Costs of Activities on a Regular Basis for Management Information Purposes,” allows for each reporting entity to determine the appropriate detail for its processes and procedures. He also stated that DSCA did not mandate the specific systems or level of detail by which an implementing agency must collect and report data. Further, he stated that DSCA developed the surcharges at an overall FMS program level which provided the appropriate level of detail and precision. Lastly, he stated that DSCA was developing the Security Cooperation Enterprise Solution enterprise resource planning system to expand the integration of financial and logistics systems.

Our Response

The DSCA Director’s comments were partially responsive. Our recommendation that DSCA establish policies and standard operating procedures for maintaining cost accounting records for its surcharges did not require the agency to create a new accounting system. DSCA could support its surcharges through analysis of existing data,

such as matching bills submitted to pay for administrative costs to the surcharges collected on cases, encouraging implementing agencies to initiate timekeeping that attributes employees' time to specific cost centers, or overall analytical procedures that correlate actual costs to output measures that DSCA would determine were meaningful. Cost accounting records relating actual historical costs of the services provided to the actual execution of cases would be more persuasive support than the budgeting processes and cash flow reviews discussed by DSCA. We encourage DSCA to perform the variance analysis it refers to in the DoD FMR and compare the surcharge rates it collects to the actual expenses incurred in providing its services. DSCA should maintain adequate cost accounting records to support its surcharge rates as reasonable estimates of actual costs at either the overall FMS program or individual case level and fully comply with the Economy Act.

While the Director's comments included plans to implement an enterprise resource planning system, they did not include the specific steps that DSCA would take to improve its cost accounting, nor milestones indicating when it will implement the enterprise resource planning system. DSCA should include cost accounting as part of its Financial Improvement Plan.

We request that the Director provide additional comments indicating the cost accounting analyses that it will perform to support its surcharge rates pending its long-term solution of a new enterprise resource system. In addition, we request that the Director provide system specifics related to improved cost accounting and milestones for implementation of the new system.

Appendix. Scope and Methodology

We conducted this performance audit from March 2011 through June 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted entrance conferences and site visits to determine the fees assessed on intragovernmental purchases funded by Afghanistan Security Forces Fund (ASFF) appropriations and reviewed whether the accounting methods the providing agencies used supported those fees with actual costs. Our conferences and visits included the Army Financial Management and Comptroller (Army FM&C), U.S. Combined Security Transition Command–Afghanistan (CSTC-A), Defense Security Cooperation Agency (DSCA), Defense Finance and Accounting Service (DFAS), U.S. Army Security Assistance Command, U.S. Army Corps of Engineers (USACE), and Air Force Center for Engineering and the Environment (AFCEE).

We reviewed ASFF funding for FY 2005 through FY 2011 and determined the most significant fees and surcharges assessed on purchases with ASFF funds. We examined congressional appropriation bills to establish the total appropriations of \$50.9 billion for the ASFF during those fiscal years. Through Army FM&C, we obtained funding authorization documents to identify CSTC-A and DSCA as the components having the obligation authority to execute the funding. We conducted interviews and examined budget justifications and spending plans, agency manuals and standard operating procedures, military interdepartmental purchase requests, letters of acceptance for Foreign Military Sales (FMS) cases, and accounting reports to identify the fees and surcharges assessed by providing agencies.

We selected the fees and surcharges that applied to the largest dollar volume of purchases for a further review of costs that support them. We identified the supervision and administration fee assessed by USACE (between 7 percent and 9 percent); supervision, inspection, and overhead (4.5 percent) assessed by AFCEE; and the administrative surcharge (3.8 percent), contract administration services surcharge (1.5 percent), and transportation surcharge⁴ assessed by DSCA for detailed review. Neither CSTC-A nor U.S. Army Security Assistance Command collected fees or surcharges on ASFF orders. We requested a transaction population of the fees and surcharges collected on ASFF orders for FY 2010, but the providing agencies did not maintain separate accounts for ASFF orders.

⁴ To assess transportation costs, which were significant, DSCA used a standard schedule that varied based on mode and distance.

We evaluated whether cost data existed to support the supervision and administration fees charged by USACE and AFCEE. We conducted interviews and examined standard operating procedures; memoranda of understanding; military interdepartmental purchase requests; billings; payroll extracts; and client-prepared worksheets regarding the cost and reimbursement methodology used when providing planning, architect engineering, construction supervision, and oversight on infrastructure projects in Afghanistan. We reviewed AFCEE records that identified the actual costs of its personnel performing services and compared them to the terms of the applicable memorandum of understanding and related military interdepartmental purchase request.

To gain familiarity with the processes used by DSCA when it collected administrative, CAS, and transportation surcharges on ASFF cases, we conducted interviews; reviewed published agency financial statements, policy memoranda, administrative surcharge budget guidance, requests, and allotments; and examined the Security Assistance Management Manual, client-prepared worksheets, training materials, and standard operating procedures. In DIFS, the accounting system used to track FMS and ASFF orders, we reviewed the summary-level data transferred from the accounting systems of the DoD providing agencies.

We obtained the summary-level data of total collections, disbursements, and ending balances in the surcharge accounts to prepare the charts in our report. We visited DFAS and examined data extracted from DIFS to show the collection of administrative fees charged to ASFF cases. We examined DFAS-prepared worksheets that contained the supporting documentation for monthly reports provided to DSCA. We requested the transaction listing for the administrative surcharge account and DFAS officials stated the time and cost to compile such information from the data as currently maintained was extensive, and they could not provide it. Therefore, we relied on summary data from DFAS monthly reports to DSCA showing the status of the surcharge accounts and calculated the changes in the accounts. We examined records from DSCA that documented its rate setting and monitoring of the surcharges.

Use of Computer-Processed Data

We relied on computer-processed data stored and processed by various DoD components, such as the TACOM Life Cycle Management Command and the U.S. Army Communications-Electronics Command. Specifically, we reviewed computer-processed data contained in DIFS, Standard Operation and Maintenance Army Research and Development System, and Defense Security Assistance Management System. To assess the reliability of the data, we reviewed original, hardcopy, supporting documentation, such as ASFF letters of offer and acceptance and the supporting pricing reports. We did not observe any discrepancies between the system data and the hardcopy documentation reviewed. From our assessment, we determined that the computer-processed data were sufficiently reliable for the purposes of our audit.

Prior Coverage on Fees and Surcharges Assessed on Afghanistan Security Forces Fund Orders

During the last 5 years, the Department of Defense Inspector General (DoD IG), and the Army Audit Agency (AAA) have issued five reports that discussed fees and surcharges assessed on Afghanistan Security Forces Fund orders or related costs. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

Unrestricted Army reports can be accessed from .mil and gao.gov domains over the Internet at <https://www.aaa.army.mil/>.

DoD IG

DoD IG Report No. D-2010-062, “Controls Over Funds Appropriated for Assistance to Afghanistan and Iraq Processed Through the Foreign Military Sales Network,” May 24, 2010

DoD IG Report No. SPO-2009-007, “Report on the Assessment of U.S. and Coalition Plans to Train, Equip, and Field the Afghan National Security Forces,” September 30, 2009

DoD IG Report No. D-2009-063, “Funds Appropriated for Afghanistan and Iraq Processed Through the Foreign Military Sales Trust Fund,” March 24, 2009

Army Audit Agency

AAA Report A-2010-0094-ALA, “Foreign Military Sales Process for Iraq and Afghanistan: U.S. Army Security Assistance Command,” May 3, 2010

AAA Report A-2010-0060-ALA, “Pricing and Funding Security Assistance to Iraq and Afghanistan: U.S. Army Security Assistance Command,” March 3, 2010

Glossary

Administrative Surcharge. Surcharge collected by DSCA to cover the costs of administering sales made under the Arms Export Control Act. During the period covered by this report, the administrative surcharge was 3.8 percent for both standard and nonstandard articles and services.

Community Programs (see Figure 2, page 5). The security assistance systems supported include the Defense Security Assistance Management System and the fees the Defense Information Systems Agency charged.

Contract Administration Services Surcharge (CAS). Surcharge collected by DSCA to cover the costs of: (1) quality assurance and inspection; (2) contract management; and (3) contract audit. For cases implemented after October 1, 2002, a rate of 0.65 percent applied to quality assurance and inspection; 0.65 percent to contract management; and 0.20 percent to contract audits, for a total of 1.5 percent.

Defense Agencies (see Figure 2, page 5). Defense agencies include DFAS, Defense Logistics Agency, National Geospatial-Intelligence Agency, National Security Agency, Defense Information Systems Agency, and Defense Contract Management Agency.

Direct Reports (see Figure 2, page 5). Organizational divisions that report directly to DSCA management include the Cash Writing Division, Defense Institute of International Legal Studies, Defense Institute of Security Assistance Management, and Defense Security Assistance Development Center.

DSCA Headquarters (see Figure 2, page 5). This term refers to the organizational element of DSCA responsible for its executive operations as they relate to the FMS process.

Implementing Agency. The DoD component assigned responsibility by DSCA to prepare a letter of offer and acceptance and implement the case. The implementing agency is responsible for overall management of the actions that result in delivery of the materials or services set forth in the letter of offer and acceptance.

MILDEPS (see Figure 2, page 5). One of the Military Departments within DoD created by the National Security Act of 1947, as amended; that is, the Department of the Army, Department of the Navy, and Department of the Air Force.

Other (see Figure 2, page 5). This is a group of miscellaneous organizations and activities that provide small individual efforts to the FMS process.

Overseas (see Figure 2, page 5). DoD functions not performed within the United States, including Security Assistance Offices and some Combatant Command Headquarters.

Surcharge or Fee. Charge to cover expenses incident to issues, sales, and transfers of materiel and services that are not included in the standard price or contract cost. Elements of surcharges include, but are not limited to, packing, crating, handling; transportation (2nd destination); administration; logistics support; contract administration services; storage; and staging.

Transportation Surcharge. Surcharge collected by DSCA to cover the cost to the United States of transporting purchaser materiel using the Defense Transportation System or commercial services. The transportation surcharge is included as a percentage of applicable line items.

Under Secretary of Defense (Policy) Comments



POLICY

OFFICE OF THE UNDER SECRETARY OF DEFENSE
2000 DEFENSE PENTAGON
WASHINGTON, DC 20301-2000

JUL 30 2012

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL, DEFENSE
BUSINESS OPERATIONS

SUBJECT: DSCA Comments on DoD Office of Inspector General, Draft Report on Fees and Surcharges Assessed on Afghan Security Forces Orders Need Improved Cost Accounting (Project No. D2011-D000FD-121.000)

Reference: DoD Office of Inspector General, Draft Report on Fees and Surcharges Assessed on Afghan Security Forces Orders Need Improved Cost Accounting (Project No. D2011-D000FD-121.000), June 14, 2012

I have conducted a thorough review of the referenced draft report in response to your June 14, 2012 request and do not concur with the recommendation to establish a working group to review surcharge policies, rates, and accounting requirements related to the Afghan Security Forces Fund (ASFF) orders.

An improved Information Technology (IT) system that enhances transparency, improves accounting procedures, and strengthens internal controls for Foreign Military Sales (FMS) funds is required. DSCA will use the established Security Cooperation (SC) IT governance structure to oversee the development of the Security Cooperation Enterprise System (SCES). This SCES can then be used to drive significant improvements in the management, control, and traceability of FMS funds, including FMS administrative surcharge collections and expenditures.

Key to achieving this objective is the SCES IT governance structure DSCA administers for the implementation of a clearly defined, repeatable IT investment process that ensures interoperability, fiscal accountability, and compliance with the Department's rules, regulations, and standards. The SCES IT governance structure includes an Executive Steering Committee (ESC), Security Cooperation Governance Board, and an IT Change Review Board. The IT governance for the SC Community is subordinate to, and is required to operate within the parameters and constraints of the governance structure approved by the Deputy Secretary of Defense.

The ESC was established June 1, 2009, is co-chaired by the Deputy Chief Management Officer and the Director, DSCA, and includes Principal-level representatives from DSCA, the Military Departments, the Defense Logistics Agency, the Defense Finance and Accounting Service, and leaders from the Enterprise Resource Planning and SC communities. The ESC ensures Principal-level coordination and guidance for the SCES system and the required improvements to processes, controls, and management of FMS case-data—including FMS Administrative Surcharge funds.

DSCA is successfully engaging with the SC IT governance structure, specifically the ESC, to convene enterprise-level working groups to discuss current and future improvements in the management and control of FMS funds, processes, and controls. In lieu of adding an additional working group as recommended in the report, DSCA will leverage the existing ESC construct to address the finding in this report related to systems; this solution is both time and cost-effective.

Thank you for your detailed assessment and I hope that this information provides further clarification on the current efforts to improve the FMS financial systems.


601 Peter F. Verga
Chief of Staff

Defense Security Cooperation Agency Comments



DEFENSE SECURITY COOPERATION AGENCY
201 12TH STREET SOUTH, STE 203
ARLINGTON, VA 22202-5408

JUL 13 2012

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL, DEFENSE
BUSINESS OPERATIONS

SUBJECT: DSCA Comments on DoD Office of Inspector General, Draft Report on Fees and Surcharges Assessed on Afghanistan Security Forces Fund Orders Need Improved Cost Accounting (Project No. D2011-D000FD-121.000)

Reference: DoD Office of Inspector General, Draft Report on Fees and Surcharges Assessed on Afghanistan Security Forces Orders Need Improved Cost Accounting (Project No. D2011-D000FD-121.000), June 14, 2012

I am responding to your June 14, 2012, request to review the draft subject report.

I have conducted a thorough review of the report and do not concur with your finding or recommendation. My detailed comments are attached.

I thank you for your detailed assessment and hope that this information provides further clarification on the current efforts to improve the Foreign Military Sales financial systems.

A handwritten signature in black ink, reading "William E. Landay III".

Attachment:
As stated

William E. Landay III
Vice Admiral, USN
Director



**DoDIG, Draft Report, Project No. D2011-D000FD-0121.000,
Fees and Surcharges Assessed on Afghanistan Security Forces Fund Orders
Need Improved Cost Accounting**

Defense Security Cooperation Agency Comments:

This document provides the Defense Security Cooperation Agency (DSCA) response to the draft audit report referenced above. DSCA non-concurs with the finding and recommendation presented in this draft report. The report is based on the incorrect assumptions that charging general administrative costs on an average percentage basis is an impermissible cost allocation system. In 2005, Deputy Secretary of Defense (DepSecDef) England directed DSCA to execute the Afghanistan Security Forces Fund (ASFF) program to immediately provide defense articles and services to Afghan Forces. At no time during the life of the program was DSCA directed, authorized, or funded to build a separate cost accounting system to capture the actual general administrative costs of the ASFF program (one of the many programs managed through the FMS system). DSCA was assigned the mission to procure goods and services for DoD because it had an existing resource management and logistics delivery system. Delaying execution of this mission to plan, design, and construct a separate cost accounting system connecting the Military Departments (MLDEPs), the Defense Finance and Accounting Service (DFAS), and DSCA would not meet the mission timelines, would create duplication of effort requiring the community to manage the FMS and the ASFF component through separate systems, increase expenses, and would create capital expenses for DoD for the simple purpose of substituting one method of authorized cost recovery for another. Further detailed comments follow.

Charging general administrative costs on an average percentage basis to recover the full estimated cost of administering FMS sales is the method required by the Arms Export Control Act (AECA), Section 21 (e)(1)(A). Application of this method to DoD funded orders placed through the FMS process is an appropriate method of recouping these costs, and specifically found to be legally permissible by the DoD Deputy General Counsel (Fiscal) who provided this position via e-mail to DoD Inspector General Counsel on July 6, 2009.

Legal Authority

The FMS program relies upon unambiguous legal requirements for charging the general administrative costs on an average percentage basis. The FMS Trust Fund was established as an outgrowth of the Mutual Defense Assistance Act of 1949, the statutory predecessor of the Arms Export Control Act (AECA); charges for FMS program are authorized by the AECA. Section 21(e) (1) of the AECA of 1976, as amended (22 USC 2761(e) (1) (A)), provides that FMS sales include "appropriate charges for administrative services, calculated on an average percentage basis to recover the full estimated costs (excluding a pro rata share of fixed base administrative costs) of administration of sales..." It is this authority that DSCA uses in its computation/application of the FMS Administrative Surcharge.

The percentage rate of the FMS surcharge is set so that costs are recovered, but a profit is not made by DSCA. Significant research and analysis goes into determining the appropriate FMS Administrative Surcharge as detailed in subsequent sections of this paper.

The Deputy General Counsel (Fiscal) has been delegated authority from the DoD General Counsel to establish DoD policy on general fiscal law issues and determine the DoD position on specific fiscal law problems.¹ By e-mail dated July 6, 2009, the Deputy General Counsel (Fiscal) related to the DoD IG Assistant General Counsel that "the Economy Act provides a legal basis for its [DSCA's] management of ASFF and ISFF (including the charging of fees that are calculated to cover the actual costs DSCA incurs in providing management services."

Department of Defense Financial Management Regulation (DoD FMR)

The FMS program is implemented/executed using the guidelines in the DoD Financial Management Regulation. The establishment and application of rates are found in Volume 15, Chapter 7, and the management of the surcharge accounts mentioned in the DoD IG report is consistent with the DoD FMR, Volume 15, Chapter 3, which states that activity in the surcharge accounts will be analyzed by DSCA and DFAS. This analysis serves as the basis for decisions by DSCA to redistribute surcharge account balances between these accounts or to revise rates. DSCA coordinates with DFAS and the Under Secretary of Defense (Comptroller) any rate change or redistribution of funds between accounts.

The FMR also provides guidance on Economy Act transfers in Volume 11A, Chapter 3. Paragraph 030601 of that chapter provides that, "Reimbursement under the Economy Act is to be made on the basis of actual cost determined by the servicing agency." Actual costs include "all direct costs attributable to providing the goods or services" and "indirect costs (overhead) to the extent they have a significant relationship to providing the goods or services".

The DoD IG recommends that DSCA implement DoD FMR Volume 4, Chapter 19. Volume 4, Chapter 19 addresses the Federal Accounting Standards Advisory Board (FASAB) Concepts and Standards applicable to Statement of Federal Financial Accounting Standards (SFFAS) 4. The surcharge approach is consistent with DoD FMR Volume 4, Chapter 19, paragraph 190405, which provides that a permissible cost assignment method includes "allocating costs on a reasonable and consistent basis." The FMS Administrative Surcharge represents a method that allocates cost on a reasonable and consistent basis. The SFFAS 4, Concept 3 allows that entities "can develop standard rates as a tool to estimate future costs and conduct variance analysis...cost data should be consistent with the basis of accounting and recognition/measurement used in financial reporting, but may be adjusted to meet budgetary information needs." While the basis for application of the 3.8% administrative surcharge fee is found in the Arms Export Control Act, its application also is in line with this concept. SFFAS 4, Standard 1, does not specify the degree of complexity or sophistication of any managerial cost accounting process. Further, it allows for each reporting entity to determine the appropriate detail for its "processes and procedures based on several factors." Within these factors, there are several that are considered by DSCA: (1) nature of the operations, (2) precision desired and

¹ DoD Directive 5145.01, May 2, 2001

needed in cost information, (3) practicality of data collection and processing, and (4) cost of installing, operating, and maintaining the cost accounting process.” Lastly, Standard 1 recognizes that organization enterprise resource planning (ERP) systems should be leveraged to support this cost collection.

Financial Process

FMS has a well developed resource management structure for defining activities funded with the FMS Administrative Surcharge, for determining requirements for the annual Program Objective Memorandum (POM) and budget execution process, for accounting for program direct costs, and for determining proper surcharge rates and expenses. Requirements determination for the FMS enterprise mirrors existing USG and DoD processes for appropriated funds. All recipients of FMS Administrative Surcharge funds are required to present and defend to the Director, DSCA, complete resource needs for a three-year POM period. DSCA evaluation of the resource requests is comprehensive and built upon detailed analysis of existing and projected FMS case workload for each claimant in the enterprise. Once a consolidated DSCA POM request for FMS Administrative Surcharge funds is assembled, the request is presented for information to the Department of State, Assistant Secretary for Political Military Affairs, and then for approval to the Office of Management and Budget (OMB), National Security Programs, International Affairs Division. Following OMB evaluation of the requested annual FMS Administrative Surcharge Ceiling, the approved ceiling amount is reflected in the Foreign Operations Annual Appropriation annual appropriation submission of the Department State and approved by Congress.

The FMS Administrative Surcharge is developed also to account for the use of the FMS process by appropriated fund authorities such as ASFF. Budget management and execution of approved FMS Administrative Surcharge funds mirrors USG and DoD budget processes for appropriated funds. Prior to the budget year, DSCA evaluates detailed budget submissions from all recipients of FMS Administrative Surcharge Funds for a standard level of service of case-related tasks or for support to the overall FMS enterprise. At the beginning of each budget year, the Director, DSCA, approves the allocation of funds to each Implementing Agency within the ceiling level approved in the Foreign Operations Annual Appropriation. The allocated funds allow each Implementing Agency to manage and execute their overall program. During year of execution, financial management staffs at DSCA and throughout the FMS enterprise closely monitor and report the execution of FMS Administrative Surcharge Funds by both activity and object class. Expenditures are compared to resource plans to assess overall performance. Business Process Reviews across the community assess compliance with FMS management procedures and policies to ensure operations are conducted as efficiently as possible. Finally, the FMS community employs rigorous management controls to safeguard the use of resources and provide reasonable assurances that measures are in place to protect those resources. It should be noted, however, that the requirement for this level of reporting is not at a specific program or country level; it is reported for the FMS program, in total.

Creating a separate accounting system for tracking FMS Administrative Surcharge funds applicable to ASFF would require specific direction and DoD funding, and would create waste,

by not utilizing the existing Implementing Agencies' systems. Further, a separate accounting system would jeopardize and delay the procurement and delivery of articles and services to the ASFF program. The DoD IG assessment of ASFF activities, and specifically the recommendation that DSCA implement policy (and processes) to reflect actual costs for ASFF FMS Administrative Surcharge support, would drastically increase support and operating costs for ASFF activities if implemented. As noted earlier in this document, then DepSecDef Gordon England, on 26 July 2005, directed that ASFF be executed by the Department of the Army through systems and processes managed by DSCA. In so directing, DepSecDef England intended ASFF to benefit from the lower operating costs made available by the much larger and already fully functioning FMS management enterprise. Had DepSecDef England instead directed ASFF FMS Administrative Surcharge funds be managed/tracked in accordance with the DoD IG recommendation as a completely insulated and separate enterprise, the DoD would have had to build, at considerable expense, systems and processes to do so. The costs of an insulated and dedicated ASFF FMS Administrative Surcharge fund management system would have involved: (1) significant start-up cost to DoD to build a management and support, (2) higher overhead costs than the current FMS Administrative Surcharge Rate of 3.8%, and (3) delayed implementation, potentially by years, of ASFF as a result of building an isolated process. Instead of providing DoD funding to stand-up a management and execution system to track actual FMS Administrative Surcharge funds applicable to ASFF, DepSecDef England's direction to use existing DSCA-managed FMS processes for the program in total saved time, capital investment resources needed to build a stand-alone process, and operating funds required to sustain an independent ASFF enterprise that could never approach economies of scale and operating efficiencies available through the existing FMS process.

Transportation Cost Accounting

The application and management of transportation expenses complies with governing direction found in DoD Financial Management Regulation, Volume 15, Chapter 7, Section 070503, and the Security Assistance Management Manual, Chapter 9, Table C9.T4a. The report addressed the collections into this account, which are based on Delivery Term Code (DTC) rates applied to the LOAs. The DTC corresponds to the amount of transportation expected to be provided (e.g., port-to-port, depot-to-in-country destination); the rate zone corresponds to the geographic area where articles are being delivered. When the transporters/carriers submit a bill, actual transportation costs are paid from the transportation account. This information (actual cost data) is used by the Implementing Agencies to conduct their annual review of the DTC rates.

Contract Administration Surcharge

Contract Administration Surcharges (CAS) rates are prescribed in the DoD Financial Management Regulation, Volume 15, Chapter 3, Section 030308.C., and Chapter 7, Section 070405. CAS rates fund three types of services: (1) quality assurance and inspections, (2) contract audit, and (3) contract management. The CAS is only assessed to LOA lines associated with contracted services.

Afghanistan Security Forces Fund (ASFF) Management Through the FMS Process

The FMS Process

The U.S. Congress passes legislation that authorizes programs and appropriates funds, and also has an oversight role for FMS sales. The FMS responsibilities provided in statutes fall to the Department of State (DoS) and DoD. The Secretary of State provides continuous supervision and general direction for FMS, including determining whether the United States may provide defense articles and services to a given country using the FMS process, as well as the scope and content of the country's program(s). The Secretary of Defense implements programs to transfer defense articles and services on a government-to-government basis.

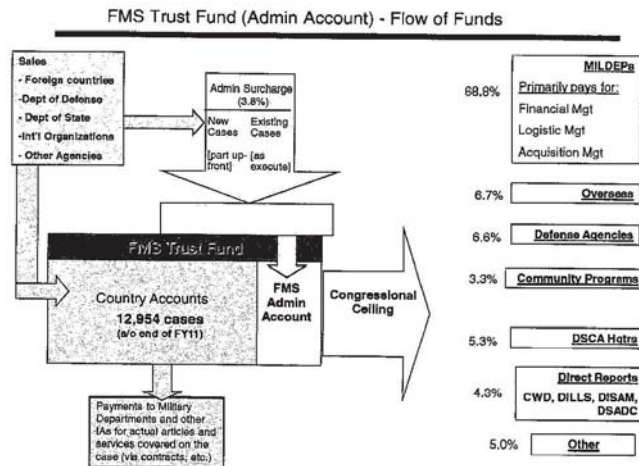
By law and policy, FMS is managed and operated by DoD on a no-profit and no-loss basis. Countries and international organizations participating in the FMS program pay for defense articles and services at prices that recoup the actual costs incurred by the United States. This includes the direct cost of the article or service being purchased and a fee (currently 3.8% of what the defense articles and/or services cost) to cover the cost of administering the program. As previously stated, this method of charging the administrative cost is mandated in the legislation that governs the FMS program – the Arms Export Control Act.

DSCA is the principal DoD organization through which the Secretary of Defense carries out responsibilities for FMS. Sales can be conducted using host nation funds, donor funds, or Foreign Military Financing (FMF) funds. FMS programs allow the transfer of defense articles and services to international organizations and friendly foreign governments via sales, grants, leases, or loans to help friendly nations and allies deter and defend against aggression, promote the sharing of common defense burdens and help foster regional stability. Letters of Offer and Acceptance (LOAs) may include such diverse efforts as the delivery of defense weapon systems to foreign governments, U.S. Service school training to international students, and in-country sustainment activities.

Within DoD, DSCA oversees financial management of the accounts for 224 countries and international organizations at the country and program level. DSCA also manages the FMS Administrative Surcharge budget that funds the FMS sales management structure for the entire FMS operation. The MILDEPs and other Implementing Agencies (IAs) manage individual sales, including the development of the LOAs, and the delivery of defense articles and services under those LOAs. When defense articles and/or services are required, the requesting country's representative provides a Letter of Request (LOR) to their U.S. counterpart. Copies are sent to DoS, Bureau of Politico-Military Affairs, and to DSCA. The original is furnished to the DoD MILDEP or other IA that will prepare the response in the form of the LOA. The articles and services are then provided by the MILDEPs/IAs from stock or through procurement from commercial contracts. Financial management of accepted LOAs is a responsibility of DFAS.

Afghanistan Security Forces Fund (ASFF) Funds Management

ASFF procurements are executed through the FMS system; funds are managed pursuant to the processes and procedures applicable to that system. The following chart provides an overview of the FMS Trust Fund. The FMS Administrative Surcharge account is a sub-account of the FMS Trust Fund and is used to fund the activities necessary to develop, implement, execute, and close FMS or Building Partner Capacity (BPC) cases such as ASFF.



Afghanistan Security Forces Fund (ASFF) Direction

In 2005, DepSecDef England mandated specific responsibilities for the execution and control of ASFF funds. The Secretary of the Army was assigned responsibility for providing ASFF distribution and accounting support to the Combined Security Transition Command – Afghanistan (CSTC-A) through DSCA. As part of these duties, the Secretary of the Army is responsible for proper financial management, fiscal controls, and accountability in accordance with statute and DoD policies, including the DoD Financial Management Regulation (FMR). Additional guidance concerning the execution of ASFF was provided by the Under Secretary of Defense (Comptroller). Further, although he could have directed the establishment of a separate procurement system, then DepSecDef England elected to execute the urgent and critical needs of the ASFF program through the existing FMS procurement system.

The same FMS Administrative Surcharge rate was charged to the ASFF program as was charged to our other 223 countries and international organizations. Since the initial mandate to execute ASFF procurement through the FMS system, DoD has not authorized/directed a separate accounting system be established to track ASFF FMS Administrative Surcharge transactions or

provided appropriated funds to the MILDEPs and DSCA to do so. As of July 2012, the ASFF program has executed 842 cases with an estimated value of \$26 billion. The total value of FMS sales for 2005 to 2011 including ASFF was \$193.65 billion; ASFF cases never exceeded 20% of any one year's sales totals.

Summary

Based on the information provided in this paper and our response to the Finding and Recommendation provided, DSCA has substantiated its non-concurrence by addressing the specific areas of concern and pointing out where reconsideration or a better understanding is required on the part of the DoD IG before finalizing its report.

FINDING

Improvement Needed in DSCA Cost Accounting for Surcharges Assessed on Afghanistan Security Forces Fund Orders. The U.S. Army Corps of Engineers (USACE) and the Air Force Center for Engineering and the Environment (AFCEE) generally had appropriate cost accounting procedures when they assessed fees and surcharges while fulfilling Afghanistan Security Forces Fund (ASFF) orders. However, the Defense Security Cooperation Agency (DSCA) did not maintain adequate cost accounting records that show whether three of its surcharge rates represent reasonable estimates of actual cost on Foreign Military Sales (FMS) cases funded by ASFF appropriations (ASFF cases). Specifically, DSCA collected:

- *Administrative surcharges of approximately \$848 million on cases funded by FY 2005 through FY 2011 ASFF appropriations, but did not maintain adequate cost records that directly support the surcharge*
- *Contract administrative service (CAS) surcharge of unknown amount on ASFF cases and lacked adequate cost accounting to compare actual expenses to surcharges collected.*
- *Transportation expenses surcharges on an unknown amount on ASFF cases did not have cost accounting information to identify the expenses for each ASFF case.*

DSCA non-concurs with this finding for the following reasons:

In 2005, Deputy Secretary of Defense England assigned Secretary of the Army the responsibility of providing ASFF distributing and accounting support to the Combined Security Transition Command-Afghanistan (CSTC-A), through DSCA. Deputy Secretary of Defense England did not direct the Army to establish a new accounting mechanism for tracking actual surcharges applicable to ASFF, and did not authorize funds to be expended for such purposes, but rather directed that distributing and accounting support for ASFF be done through DSCA. Pursuant to this direction, ASFF funds are transferred to DSCA to execute under the Economy Act using the systems and procedures that support the FMS Trust Fund. This complies with the June 6, 2009, DoD General Counsel advice “that the Economy Act provides a legal basis for its management of ASFF and ISFF (including the charging of fees that are calculated to cover the actual costs DSCA incurs in providing management services),” and with Economy Act procedures as identified in the DoD Financial Management Regulation. DSCA does not have any other process for the provision of support to foreign governments. FMS programs are executed through the Military Departments and Defense Agencies’ (Implementing Agencies) financial and logistics systems. Use of these systems and procedures facilitates efficient execution of the funds in a cost-effective manner.

The establishment, application and management of the surcharge accounts mentioned in the DoDIG report, are in compliance with the DoD Financial Management Regulation, Volume 15, Chapters 3 and 7. Specifically:

- DSCA conducts annual reviews of the FMS Administrative Surcharge Account and further analyzes it every five years to determine whether a rate change is warranted.

Any change is reviewed, staffed, and approved/disapproved by the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)).

- Development of the CAS rates is an OUSD(C) responsibility. The rates are prescribed in the DoD Financial Management Regulation, Volume 15, Chapter 3, Section 030308.C., and Chapter 7, Section 070405. CAS rates fund three types of services: (1) quality assurance and inspections, (2) contract audit, and (3) contract management. The CAS is only assessed to LOA lines associated with contracted services. DSCA implements guidance as prescribed in the DoD Financial Management Regulation.
- The application and management of transportation expenses complies with governing direction found in DoD Financial Management Regulation, Volume 15, Chapter 7, Section 070503, and the Security Assistance Management Manual, Chapter 9, Table C9.T4a. The report addressed the collections into this account, which are based on Delivery Term Code (DTC) rates applied to the LOAs. The DTC corresponds to the amount of transportation expected to be provided (e.g., port-to-port, depot-to-in-country destination); the rate zone corresponds to the geographic area where articles are being delivered. When the transporters/carriers submit a bill, actual transportation costs are paid from the transportation account. This information (actual cost data) is used by the Implementing Agencies to conduct their annual review of the DTC rates. DSCA has taken steps to improve the management and monitoring of the transportation surcharge account. In March 2012, we implemented separate transportation surcharge accounts for programs funded with U.S. appropriated funds, to include the ASFF program. This change was also coordinated with OUSD(C).

DSCA's position is that a separate system for tracking the actual surcharge amounts specific to the ASFF program is not authorized, funded, warranted, or cost effective. The Agency maintains an adequate resource management system to support the application of these surcharges in compliance with direction provided in the DoD Financial Management Regulation and the Security Assistance Management Manual.

RECOMMENDATION # 2

We recommend that the Director, Defense Security Cooperation Agency, implement the DOD Financial Management Regulation, volume 4, chapter 19, and establish policies and standard operation procedures for maintaining cost accounting records for the administration services, and transportation surcharges that ensures that DSCA:

(a) Assesses an administrative Surcharge rate on cases funded by Afghanistan Security Forces Fund appropriations supported by analysis that shows the rate is an accurate estimate of the actual cost.

(b) Adequately identifies the actual contract administration surcharge and transportation expenses for reimbursement from the appropriate Afghanistan Security Forces Fund cases.

(c) Establish controls to ensure segregation between appropriated and foreign county funds in the surcharge accounts to prevent Afghanistan Security Forces Fund appropriations from being used to subsidize cost of Foreign Military Sales cases.

DSCA non-concurs with the recommendation for the following reasons:

As stated in the response to the Finding, FMS programs are executed through the Implementing Agencies' financial and logistics systems. Costs of supporting the FMS program, in total, are also captured in those financial systems. As noted in this document, DepSecDef Gordon England directed that ASFF be executed by the Department of the Army through existing systems and processes managed by DSCA. In so directing, DepSecDef England availed ASFF of lower operating costs made available by the much larger and already fully functioning FMS management enterprise.

DoD Financial Management Regulation (FMR), Volume 4, Chapter 19, "Managerial Cost Accounting," addresses the Federal Accounting Standards Advisory Board (FASAB) Concepts and Standards applicable to Statement of Federal Financial Accounting Standards (SFFAS) 4. SFFAS 4, Concept 3, "Relationship to Budgetary Accounting," and provides that entities "can develop standard rates as a tool to estimate future costs and conduct variance analysis...cost data should be consistent with the basis of accounting and recognition/ measurement used in financial reporting, but may be adjusted to meet budgetary information needs." While the basis for application of the 3.8% administrative surcharge fee is found in the Arms Export Control Act, its application in the case of ASFF-funded activities also is consistent with this concept.

SFFAS 4, Standard 1, "Accumulate and Report Costs of Activities on a Regular Basis for Management Information Purposes," provides that "each entity's managerial cost accounting should meet the basics discussed above ... this standard does not specify the degree of complexity or sophistication of any managerial cost accounting process." Further, it allows for each reporting entity to determine the appropriate detail for its "processes and procedures based on several factors." Within these factors, there are several that are considered by DSCA: (1) nature of the operations, (2) precision desired and needed in cost information, (3) practicality of data collection and processing, and (4) cost of installing, operating, and maintaining the cost accounting process." Lastly, Standard 1 recognizes that organization ERPs should be leveraged to support this cost collection.

In its oversight role, DSCA does not mandate the specific systems or level of detail by which an Implementing Agency must collect and report data – in particular as it relates to its surcharge computations. The surcharges are not developed on a program, country, or case level; they are developed at an overall FMS program level based on data obtained from the Implementing Agencies and internally at DSCA. That is the appropriate level of detail and precision desired and is consistent with the requirements set forth in the AECA.

Priorities have been established, however, for DoD improvement efforts of the accounting procedures, internal controls, and Information Technology (IT) systems that produce,

track and report the Department's financial information. The Department's path to achieving these priorities, and eventually auditable annual financial statements, is contained in the DoD Financial Improvement and Audit Readiness (FIAR) Plan and Component Financial Improvement Plans (FIPs), to include the DSCA FIP. In support of these priorities, Department leadership is promoting several key initiatives designed to improve the internal controls, management and transparency of financial budget and cost data in support of achieving the Department's strategic goals and objectives, to include the FMS program.

DSCA is developing the Security Cooperation Enterprise Solution (SCES) enterprise resource planning (ERP) system to expand the integration of financial and logistics systems across the enterprise. The SCES governing body coordinates the implementation of the MILDEP ERPs with the SCES requirements to improve transparency across the community.

Therefore, DSCA non-concurs with establishing any specific standard operating procedures outside its current processes, and SCES development efforts, to provide a level of detail at a specific country/program level in support of managing surcharge costs.



Inspector General Department of Defense

