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

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-174901

NCJRS SEPTEMBER 29, 1978

The Honorable
The Secretary of Defense

SEP 19 1978

Dear Mr. Secretary:

ACQUISITIONS

This report discusses the results of our review of the military departments' programs for repair and replacement of equipment previously sold to foreign governments.)

The systems used by the Army and Navy are, for the most part, working satisfactorily. The Air Force, however, has been accepting all unserviceable equipment and giving foreign governments credit (75 percent of the equipment's current inventory price) for it without determining whether the Air Force had a need for it, as required. As a result, the Air Force accepted for credit millions of dollars of unneeded worn and broken equipment for which the Air Force has no use.

Although we brought the deficiencies in controls and procedures to Air Force officials' attention on several occasions, the Air Force will not fully implement an improved system similar to those of the Army and Navy until October 1, 1978. We believe that the new improved system, if effectively implemented, will save the U.S. Government as much as \$28 million annually and will eliminate much of the cost incurred in repairing unneeded items.

SCOPE OF REVIEW

We reviewed the military services' systems of accounting for unserviceable equipment returned by foreign governments under the foreign military sales program. Our review included an examination of legislation, policies, procedures, documents, and transactions dealing with systems of accounting for unserviceable returns.

We made our review at the following military departments and organizations:

- Department of the Air Force,
- San Antonio Air Logistics Center, San Antonio, Texas,

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- Warner Robins Air Logistics Center, Warner Robins, Georgia,
- Navy International Logistics Control Office, Philadelphia, Pennsylvania,
- Navy Aviation Supply Office, Philadelphia, Pennsylvania,
- Navy Ships Parts Control Center, Mechanicsburg, Pennsylvania,
- U.S. Army Tank-Automotive Readiness Command, Warren, Michigan,
- U.S. Army Missile Readiness Command, Huntsville, Alabama, and
- U.S. Army Aviation Research and Development Command, St. Louis, Missouri.

We also discussed pertinent procedures and activities with officials at the Air Force Logistics Command, Dayton, Ohio; Oklahoma City Logistics Center, Oklahoma City, Oklahoma; and Ogden Air Logistics Center, Ogden, Utah.

BACKGROUND

The foreign military sales program is administered under authority of the International Security Assistance and Arms Export Control Act of 1976 (22 U.S.C. 2151). The legislative history of the act indicates that the Congress intended that the program not be subsidized by Defense Department appropriations.

In fiscal year 1977, foreign military sales amounted to over \$11 billion and, according to Defense officials, equipment accounts for a substantial portion of that amount.

The Defense Department's foreign military sales program provides for the repair of military equipment sold to foreign governments when the equipment or its component parts become worn or broken (commonly referred to as unserviceable equipment). Foreign governments are permitted to return the unserviceable equipment for repair directly to the military services' repair facilities.

The Army and Navy offer foreign governments two options for having unserviceable equipment repaired. These governments may either (1) contract with the military service to

have the equipment repaired and returned or (2) exchange their unserviceable equipment for serviceable equipment, if available from the services' inventories. In both cases, the foreign government is charged. The Air Force, on the other hand, has allowed the Air Force Logistics Command's five air logistics centers to give credit for unserviceable equipment if the Air Force had a foreseeable requirement for the equipment.

The credit allowed by the Air Force was not contingent on the foreign government's receiving a replacement item as required by the Army and Navy. Foreign governments received credit for their returned items at a rate of 75 percent of the equipment's current inventory price. The amount was credited to foreign government sales cases (thereby reducing the amount to be paid by the foreign government for its purchases under the foreign sales program and the amount of reimbursement to the Air Force's appropriations). From July 1975 to January 1978, the Air Force made such credits to foreign governments for over \$70 million.

CREDITS GRANTED FOR UNNEEDED
UNSERVICEABLE EQUIPMENT FROM
FOREIGN GOVERNMENTS

The Air Force's management and control of the program for the return of unserviceable equipment by foreign governments was not effective. Although Air Force regulations required that there be a specific need for the returned unserviceable equipment, the air logistics centers were accepting all such equipment for credit regardless of need. As a result, large quantities of equipment accepted from foreign governments for credit were unneeded. Further, in many instances, the cost of repairing unserviceable equipment, when added to the return credit given the foreign government, exceeded the current inventory price of the equipment.

In February 1976, we told San Antonio Air Logistics Center officials that, under their unserviceable return program, foreign governments were returning equipment for which the Air Force had no need. Our review of selected unserviceable equipment credits totaling \$237,000 showed that equipment costing \$126,000 was not needed.

In April 1976, San Antonio officials said that a verification process would be implemented to assure that only needed items were returned. We reevaluated the San Antonio program in March 1977 and noted that the verification process was followed only in April 1976 when \$252,000

of unserviceable equipment credits were cancelled because the items were not needed. After April 1976, unneeded unserviceable equipment was again being returned. Our review of 563 selected unserviceable items showed that 246 items costing \$263,000 were not needed by the Air Force. Further, the cost of repairing 256 of the 317 items that were needed, when added to the return credit given the foreign government, exceeded the current inventory prices of the equipment. For instance, the Air Force gave a \$430 sales credit to a foreign government for an unserviceable item for which the Air Force had no need. In addition, the cost to repair and transport the item totaled \$3,376. At the time the Air Force gave the credit, the inventory price of the item was only \$573.

In effect, the Air Force system provided incentives for foreign countries to return unserviceable items and for Air Force managers to accept them. Because of rapidly escalating prices, foreign governments can be credited for more than they had originally paid for the item. Also, they were able to readily dispose of unserviceable equipment for which they no longer have a need. Air Force item managers, by giving foreign governments sales credits instead of using Air Force appropriated funds for which they were directly responsible to purchase unserviceable equipment, were not held accountable for the cost of unserviceable equipment credits. As a result, they readily approve the return of all unserviceable equipment.

AIR FORCE ACTIONS TO
IMPLEMENT A NEW SYSTEM
FOR ACCEPTING UNSERVICEABLE
RETURNS WERE INEFFECTIVE

The Air Force, while agreeing with our suggestion that the system be changed, has experienced difficulty in making needed changes. Coordination among responsible Air Force organizations was ineffective resulting in confusion and extensive delays in improving the system.

In April 1977, acting on our suggestions, Air Force headquarters directed changes to the system for unserviceable equipment returns in an effort to correct the problems we identified. In January 1978, we again reviewed the effectiveness of the system and found that attempts to correct it had largely failed. Of the Oklahoma City, the Ogden, and the Warner Robins Air Logistics Centers, none had properly implemented the changes directed by Air Force headquarters.

Oklahoma City did not, as directed by headquarters, suspend approved credits in process until a high-level review team could independently verify the need for the equipment. Instead, it analyzed only new returns of un-serviceable equipment submitted for approval. We noted that un-serviceable equipment credits in the 7 months prior to May 1977 averaged \$735,000 per month, whereas by January 1978 average monthly credits had increased to \$947,000. Also, because responsible officials had not received the headquarters directive to correct the system, Oklahoma City had not implemented a requirement to accept un-serviceable equipment only if the Air Force would have otherwise had to purchase a new item to satisfy its needs. After we told officials of the requirement, they reevaluated selected approved un-serviceable equipment returns amounting to \$151,666 and found that \$35,313 should not have been approved. They planned to reevaluate all un-serviceable equipment returns since October 1, 1977.

On the other hand, the San Antonio Air Logistics Center had effectively implemented corrective actions. San Antonio, through its verification procedure, reduced its un-serviceable equipment credits from about \$544,000 a month to \$100,000 a month. Further, through its verification of approved returns in process, San Antonio, according to its records, cancelled planned credits for un-serviceable equipment valued at \$24.9 million.

PRESENT AIR FORCE PLANS TO IMPROVE ITS SYSTEM

In February 1978, we told Air Force headquarters and Air Force Logistics Command officials that the system changes had not been effectively or consistently implemented and suggested that immediate corrective action be taken. Air Force headquarters, in March 1978, decided to completely discontinue the credit program effective October 1, 1978, and to adopt a repair and replacement system similar to the systems used by the Army and Navy which, for the most part, are working satisfactorily.

Under the planned system foreign governments may contract with the Air Force to have equipment repaired and returned or they may exchange their un-serviceable equipment for like serviceable replacement items from the Air Force's inventory. In either case, they will be required to pay all repair and related costs. In those cases where a foreign government does not want the equipment repaired or replaced

and where the Air Force has a need for the equipment, the new system provides that the equipment can be bought back using Air Force appropriated funds. Item managers will no longer be allowed to grant credits for the equipment but must use appropriated funds for which they are directly accountable. Based on the average yearly credits granted from July 1975 to January 1978, the new system could save as much as \$28 million annually and will eliminate the significant costs incurred in repairing unneeded items.

CONCLUSIONS

The new system to be fully implemented by October 1, 1978, could significantly improve the Air Force's management of unserviceable equipment returned by foreign governments. It is dependent, however, on effective coordination and management oversight to assure that the new system is properly and consistently implemented and that further delays do not occur. Further, the Air Force should have adequate controls to assure that foreign governments are properly charged for repair costs incurred under the new system.

RECOMMENDATIONS

We therefore recommend that you direct that the Secretary of the Air Force:

- Designate a representative to see to it that the system is effectively implemented by visiting each involved Air Force organization, explaining the objectives of the new system, and seeing that the necessary procedural changes are made.
- Require that the Air Force Audit Agency review the system after it becomes operational to determine its effectiveness.

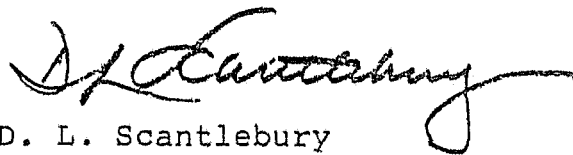
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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee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

We discussed our findings with Defense and Air Force headquarters officials and included their comments in the report where appropriate. We would appreciate being informed of actions taken or planned on our recommendations and would be pleased to discuss these matters with you or your representatives.

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

Sincerely yours,

A handwritten signature in cursive script, appearing to read "D. L. Scantlebury".

D. L. Scantlebury
Director