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SECURITY ASSISTANCE AND INTERNATIONAL PROGRAMS

Report No. 97-132

April 18, 1997

Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
DIFS	Defense Integrated Financial System
DSAA	Defense Security Assistance Agency
FMS	Foreign Military Sales
NAPMO	North Atlantic Treaty Organization Airborne Early Warning and Control Program Management Organization
NATO	North Atlantic Treaty Organization
OSD	Office of the Secretary of Defense
SAIP	Security Assistance and International Programs

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
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April 18, 1997

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY

SUBJECT: Audit Report on the Security Assistance and International Programs Account (Report No. 97-132)

We are providing this report for your information and use. This audit supports our audit of the FY 1996 DoD-wide financial statements required by the Federal Financial Management Act of 1994. Management comments on a draft of this report were considered in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson, Audit Program Director, at (703) 604-9582 (DSN 664-9582) or Mr. Robert E. Benefiel, Audit Project Manager, at (703) 604-9451 (DSN 664-9451). See Appendix F for the report distribution. Audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-132 **April 18, 1997**
(Project No. 6LA-2032)

Security Assistance and International Programs Account

Executive Summary

Introduction. The Department of the Treasury established the Security Assistance and International Programs deposit account on September 26, 1996, in response to a request from the Defense Finance and Accounting Service to rename an existing Defense Security Assistance Agency account. That account, established in 1978 as the North Atlantic Treaty Organization, Airborne Early Warning account, was originally intended for use only by the North Atlantic Treaty Organization E-3A program.

The Defense Finance and Accounting Service requested that the Defense Security Assistance Agency account be renamed the Security Assistance and International Programs account to encompass subaccounts added since 1988. From April 1988 through June 30, 1996, the former Security Assistance Accounting Center and the Defense Finance and Accounting Service Denver Center established a total of eight subaccounts, including a subaccount for the E-3A program. As of June 30, 1996, the account had a balance of $186.1 million.

Audit Objectives. Before the audit field work, we determined that the Security Assistance and International Programs account was needed to support current and proposed North Atlantic Treaty Organization E-3A programs through 2006. The audit objectives were to determine whether the account was administered in compliance with laws and regulations and to review applicable management controls. The audit supports our audit of the FY 1996 DoD-wide financial statements required by the Federal Financial Management Act of 1994.

Audit Results. The Defense Finance and Accounting Service Denver Center used the Security Assistance and International Programs account for contingency operations transactions that did not involve the reporting entity, the Defense Security Assistance Agency. As a result, the account overstated the dollar value of Defense Security Assistance Agency activities by $5.3 million as of June 30, 1996.

Management controls were adequate in that we identified no material weaknesses.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Denver Center, discontinue using the Security Assistance and International Programs account for contingency operations that the Defense Security Assistance Agency does not support, and transfer the contingency operations subaccount balance to an appropriate account.

Management Comments. The Director, Defense Finance and Accounting Service, concurred with discontinuing use of the Security Assistance and International Programs account for contingency operations that Defense Security Assistance Agency does not support. By June 30, 1997, the Defense Finance and Accounting Service Denver Center will transfer the balance related to contingency operations that Defense

Security Assistance Agency does not support from the Security Assistance and International Programs account to a budget clearing account. The subaccount balance will remain in the budget clearing account until properly cleared from that account.

The Defense Finance and Accounting Service partially concurred with transferring the contingency operations subaccount balance from the Security Assistance and International Programs account to an appropriate account for general contingencies. The Defense Finance and Accounting Service Denver Center will transfer the subaccount balance, by June 30, 1997, to a budget clearing account because a general contingencies account does not exist.

The Defense Security Assistance Agency coordinated on the Defense Finance and Accounting Service comments and will accept funds management responsibility for the Security Assistance and International Programs account after Defense Finance and Accounting Service transfers the subaccount balance and certifies the Security Assistance and International Programs account balance. The Defense Finance and Accounting Service Denver Center will certify, by June 30, 1997, that the balances for the remaining subaccounts are correct and that supporting documentation is being maintained. See Part I for a complete discussion of management comments and Part III for the complete text of management comments.

Audit Response. The Defense Finance and Accounting Service actions and comments are fully responsive. No additional comments are required.

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Part I - Audit Results

Audit Background

The Department of the Treasury established the Security Assistance and International Programs (SAIP) deposit account on September 26, 1996, in response to a request from the Defense Finance and Accounting Service (DFAS) to rename an existing Defense Security Assistance Agency (DSAA) account. That account, established in 1978 as the North Atlantic Treaty Organization, Airborne Early Warning account (Airborne Early Warning account), was originally intended for use only by the North Atlantic Treaty Organization (NATO) E-3A program. Appendix C discusses the predecessor Airborne Early Warning account.

On August 23, 1996, DFAS requested that the Department of the Treasury change the DSAA account name to the SAIP deposit account to better reflect the account activity. DFAS also requested changing the Treasury account designation Department 97 (DoD) to Department 11 (Executive), because all DSAA security assistance-related accounts used Department 11. That change would allow the DFAS Denver Center to continue performing financial accounting for the SAIP account, because the Denver Center was responsible for all DSAA Department 11 accounts.

Audit Objectives

Before the audit field work, we determined that the SAIP account is needed to support current and proposed NATO E-3A programs through 2006. Accordingly, the objectives were to determine whether the DSAA account was administered in compliance with laws and regulations and to review applicable management controls. The audit supports our audit of the FY 1996 DoD-wide financial statements required by the Federal Financial Management Act of 1994. Appendix A discusses the scope and methodology, prior coverage related to the audit objectives, and the review of the management control program. Appendix B discusses other matters of interest.

Use of the Security Assistance and International Programs Account

The DFAS Denver Center used the Security Assistance and International Programs account for contingency operations transactions that did not involve the reporting entity, the Defense Security Assistance Agency. The DFAS Denver Center inappropriately recorded funds in the Security Assistance and International Programs account that should have been recorded in an Office of the Secretary of Defense (OSD) account. As a result, the Security Assistance and International Programs account overstated the dollar value of Defense Security Assistance Agency activities by $5.3 million as of June 30, 1996.

Establishment of Subaccounts

The DFAS asked the Department of the Treasury to rename the DSAA account as the SAIP account to encompass subaccounts added since 1988. From April 1988 through June 30, 1996, the former Security Assistance Accounting Center (now part of the DFAS Denver Center) and the DFAS Denver Center established a total of eight subaccounts (shown in the table), including a subaccount for the NATO E-3A program, for which the DSAA account was originally established. Deposits for the eight subaccounts totaled $65.8 million from October 1, 1995, through June 30, 1996.

Security Assistance and International Programs Account

Subaccounts	As of June 30, 1996 (millions)
Advanced Medium Range Air-to-Air Missile	$ 4.2
Burdensharing	91.9
Case Funded Positions	0.1
Contingency Operations	5.3
F-5 Support	13.9
International Receivables	3.8
NATO E-3A	65.7
Parts and Repair Ordering System	1.2
Account Balance	**$186.1**

The DFAS Denver Center recorded the subaccounts in the SAIP account because the subaccounts' transactions met the criteria for use of a deposit fund account. Also, the SAIP account was the only deposit fund account that

the DFAS Denver Center maintained for the DSAA. Appendix D discusses the criteria for deposit fund accounts, and Appendix E discusses each subaccount.

DFAS personnel told us that the DSAA would be the reporting entity for the SAIP account and, therefore, we concluded that the SAIP account would not include subaccounts that did not involve the DSAA. Based on our analysis, one subaccount did not involve the DSAA and should be transferred from the SAIP account. That subaccount, totaling $5.3 million as of June 30, 1996, involved contingency operations that DSAA does not support.

Contingency Operations Included in SAIP Account

DSAA did not have a fiduciary responsibility for the contingency operations that were included in the contingency operations subaccount because DSAA was not primarily involved in those contingency operations. The OSD had fiduciary responsibility for the contingency operations that were in the subaccount. Nonetheless, the DFAS Denver Center inappropriately included OSD supported contingency operations in the SAIP account.

Establishment of Subaccount. The DFAS Denver Center began recording contingency operations transactions because of a July 18, 1994, DFAS headquarters memorandum that directed the Denver Center to perform central accounting for DoD international programs, including contingency operations. Accordingly, the DFAS Denver Center implemented policy statement 31-96-04, "Accounting for Contingency Operations," on January 31, 1996. The policy statement defines non-DSAA directed support as support based on Secretary of Defense orders that are initiated by the Office of the Under Secretary of Defense for Policy and issued through the Chairman, Joint Chiefs of Staff. Non-DSAA directed support is further defined as support that will not use the DSAA foreign military sales (FMS) network. The policy statement specifically directs the DFAS Denver Center to use the SAIP account to record transactions relating to non-DSAA directed support of contingency operations. The DFAS Denver Center established a subaccount for that purpose in November 1995, before issuing its final policy statement.

From November 1995 through June 1996, the DFAS Denver Center used the subaccount to record transactions not involving the DSAA. Those transactions were for United Nations contributions for the United Nations Protection Force in Bosnia and for contributions from the governments of Ecuador and Peru for Operation Safe Border, which is a U.S. effort operating outside the United Nations umbrella. Our analysis of all subaccount reimbursement transactions (totaling $6.4 million) that the Denver Center recorded during 4 of the 8 months identified only one transaction ($1.2 million) involving the DSAA. That transaction was for the transfer of funds from the SAIP account to the FMS Trust Fund for equipment leased through the DSAA FMS network.

Corrective Management Actions. The DSAA Comptroller coordinated with the Office of the Under Secretary of Defense (Comptroller) to affirm the DSAA

responsibility as the reporting entity for the SAIP account. The DSAA told us that the SAIP account should exclude subaccounts not involving the DSAA, if the DSAA is to act as the reporting entity for the account. The DFAS Denver Center agreed that contingency operations that DSAA does not support should be removed from the SAIP account. The DFAS Denver Center researched possible alternative accounts to use for those contingency operations.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service Denver Center:

1. Discontinue using the Security Assistance and International Programs account for contingency operations that the Defense Security Assistance Agency does not support.

2. Transfer the contingency operations subaccount balance from the Security Assistance and International Programs account to an appropriate account for general contingencies.

Management Comments. The DFAS concurred with discontinuing use of the SAIP account for contingency operations that DSAA does not support. By June 30, 1997, the DFAS Denver Center will transfer the balances related to contingency operations that DSAA does not support and international receivables from the SAIP account to a budget clearing account. The subaccount balances will remain in the budget clearing account until properly cleared from that account.

The DFAS partially concurred with transferring the contingency operations subaccount balance from the SAIP account to an appropriate account for general contingencies. The DFAS Denver Center will transfer the subaccount balance, by June 30, 1997, to a budget clearing account because an account specifically for general contingencies does not exist.

The DSAA will accept funds management responsibility for the SAIP account after DFAS transfers the subaccount balances for burdensharing, contingency operations, and international receivables, and certifies the SAIP account balance. The DFAS Denver Center will certify, by June 30, 1997, that the balances for the remaining subaccounts are correct and that supporting documentation is being maintained.

Audit Response. The DFAS actions and comments are fully responsive. No additional comments are required.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

To determine the continuing need for the SAIP account, we reviewed the projected North Atlantic Treaty Organization Airborne Early Warning and Control Program Management Organization (NAPMO) collections for the current NATO E-3A program through its scheduled end in 2000. We also reviewed collections for the proposed NATO E-3A mid-term modernization program through its proposed end in 2006. We examined DoD Regulation 7000.14-R, "DoD Financial Management Regulation," May 1993; and the Department of the Treasury Financial Manual, July 1995, to determine the legitimate uses permitted for deposit fund accounts.

We compared the June 30, 1996, SAIP account balance reported on independent Department of the Treasury records with the balance for the SAIP account shown on the DFAS Denver Center general ledger, the subsidiary ledger, and an automated spreadsheet. We also compared the collections and disbursements totals reported on the June 30, 1996, ledgers and automated spreadsheet.

We examined seven of the eight subaccounts within the SAIP account. As of June 30, 1996, the seven subaccounts represented $186.0 million (99.5 percent) of the $186.1 million SAIP account balance. We did not examine one of the subaccounts because it was not material (less than 0.05 percent) to the SAIP account. To determine how the Denver Center used the SAIP account, we examined the detailed voucher support for FY 1996 entries, dated from October 1995 through June 1996, to the SAIP account.

In addition, we interviewed officials of the DSAA, the DFAS headquarters and Denver Center, and the E-3 System Program Office. Also, we assessed corrective management actions taken regarding undistributed disbursement transactions.

Use of Computer-Processed Data. To achieve the audit objectives, we used computer-processed data in the DFAS Denver Center automated spreadsheet. We established the accuracy, but not the completeness or reliability of the computer-processed data, because we used the data for sampling selection and informational purposes only and not to make an opinion on any related financial statements. The audit results were not, however, affected. We did not use statistical sampling techniques during the audit.

Audit Period and Standards. We performed this financial-related audit from July through December 1996. We conducted this audit in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD and the Department of the Treasury. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD managers to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of those controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of the DFAS Denver Center management control techniques, including financial reporting, general ledger control, reconciliations, and audit trails. The DFAS Denver Center appropriately designated the reviewed areas as assessable units. Because we did not identify a material weakness, we did not assess management's self-evaluation.

Adequacy of Management Controls. Management controls were generally adequate as they applied to the audit objectives. The DFAS Denver Center will prepare financial statements for the SAIP account, beginning in FY 1997, as a result of recent decisions made by the Office of Management and Budget and the DoD regarding the Chief Financial Officers Act reporting requirements. Also, the DFAS Denver Center agreed with our suggestion to give the DSAA a monthly copy of the subsidiary ledger for the SAIP account to supplement the financial oversight provided through the annual financial statements and other records.

In addition, as a result of our audit inquiries, the DFAS Denver Center has initiated procedures for monitoring the undistributed disbursement transactions, which relate to reimbursed support for the NATO E-3A program. Because management is taking action to strengthen financial oversight over the account, no recommendations relating to these specific actions were made in this report.

Prior Audits and Other Reviews

Within the last 5 years, there were no audits or other reviews directly related to our audit objectives. However, one report covered a related performance control subsystem of the Defense Integrated Financial System (DIFS). The DIFS is a computer-based system primarily used to record financial information for the FMS program. Financial data for both the FMS and the commercial portions of the NATO E-3A program are recorded in the DIFS to monitor program performance. The DIFS operates independently of the automated spreadsheet supporting the subsidiary ledger for the account and is not used as a source for the accounting entries made to the automated spreadsheet.

Inspector General, DoD, Report No. 96-187, "Internal Controls and Compliance with Laws and Regulations for the FY 1995 Financial Statements of the Defense Security Assistance Agency," June 28, 1996, discussed a performance control subsystem of the DIFS. The report states that the DFAS Denver Center did not verify that all transactions rejected and suspended by a performance control subsystem of the DIFS had been corrected. The report recommended that the Director, DFAS Denver Center, establish control procedures to monitor lists of suspended transactions and follow up on actions by DoD implementing agencies to clear performance transactions rejected by the DIFS subsystem. The Under Secretary of Defense (Comptroller) concurred with the recommendation, and the DFAS Denver Center revised its procedures to ensure that rejected transactions were monitored and corrected by September 30, 1996.

Appendix B. Other Matters of Interest

Policy Regarding Burdensharing

On September 26, 1996, the Office of the Under Secretary of Defense (Comptroller) directed the DFAS to discontinue using the SAIP account for burdensharing transactions and to transfer Kuwait funds in the SAIP account to a new receipt account for burdensharing transactions for the government of Kuwait. Use of a separate account for burdensharing is required by section 1331 of the National Defense Authorization Act for FY 1996 (Public Law 104-106). Section 1331 amended United States Code, title 10, section 2350j, "Burden Sharing Contributions by Designated Countries and Regional Organizations," to add the requirement for a separate burdensharing account.

Transferring the burdensharing funds to the new receipt account will remove from the DSAA accounts the burdensharing transactions for which DSAA has no fiduciary responsibility. Because management changed its accounting policies during the audit, we are making no recommendations involving the burdensharing subaccount.

Appendix C. Airborne Early Warning Account

The Airborne Early Warning account was a DSAA deposit fund account. The Airborne Early Warning account was established to support the NATO E-3A program, which was established under the "Multilateral Memorandum of Understanding Between NATO Ministers of Defence on the NATO E-3A Cooperative Programme," December 6, 1978. The memorandum of understanding also established the NAPMO. The NAPMO collects funds from the 13 participating NATO nations, including the United States, to acquire and support the NATO E-3A program.

Following approval of the memorandum of understanding, the Air Force requested that the Department of the Treasury establish a deposit fund account for the program. In its request letter, the Air Force stated that it intended to use the deposit fund account only for collections from the NATO Airborne Early Warning and Control Program Management Agency (a subordinate activity of NAPMO) and for disbursements to the prime contractors. On December 19, 1978, the Department of the Treasury established the "NATO Airborne Early Warning Program, Office of the Secretary of Defense," account under the general authority of United States Code, title 31, section 66b. Section 66b later became section 3513, "Financial Reporting and Accounting System."

An implementing agreement specifies that the Security Assistance Accounting Center would administer the Airborne Early Warning account for NAPMO. The Security Assistance Accounting Center was a DSAA support activity and administered the Airborne Early Warning account for the DSAA. The Security Assistance Accounting Center became part of the new DFAS Denver Center on January 1, 1991. The DFAS Denver Center performed the financial accounting and maintained the official accounting records for the Airborne Early Warning account. As of June 30, 1996, the NAPMO transferred to the Airborne Early Warning account contributions totaling $2.1 billion that had been collected from participating member nations since 1978.

Appendix D. Criteria for Deposit Fund Accounts

Financial regulations establish broad legitimate uses for deposit fund accounts. Both the DoD Financial Management Regulation, volume 1, "General Financial Management Information, Systems, and Requirements," May 1993, and the Department of the Treasury Financial Manual, volume 1, part 2, July 1995, state that deposit fund accounts are established to account for receipts held by the Government as banker or agent for others. The DoD Financial Management Regulation also states that deposit fund accounts are established to account for receipts held in suspense temporarily and later refunded into some other Government fund or entity.

Appendix E. Subaccount Descriptions

Advanced Medium Range Air-to-Air Missile Subaccount. The DFAS Denver Center established the subaccount for the Advanced Medium Range Air-to-Air Missile commercial program in June 1995 to record collections from participating countries and disbursements to the prime contractor for the commercial contract. As of June 30, 1996, the Advanced Medium Range Air-to-Air Missile subaccount balance was $4.2 million.

Burdensharing Subaccount. The DFAS Denver Center established the burdensharing subaccount in November 1994 to record burdensharing contributions made by the government of Kuwait in support of its Defense Cooperation Agreement with the United States and for reimbursements to the United States Central Command for its support of the agreement. Appendix B discusses other matters of interest involving this subaccount. As of June 30, 1996, the burdensharing subaccount balance was $91.9 million.

Case Funded Positions Subaccount. We did not examine the Case Funded Positions subaccount because it was not material (less than 0.05 percent) to the SAIP account balance. As of June 30, 1996, the Case Funded Positions subaccount balance was $0.1 million.

Contingency Operations Subaccount. The DFAS Denver Center established the Contingency Operations subaccount in November 1995 to record foreign contributions received and reimbursements made for contingency operations supported by DoD agencies other than DSAA. Part I contains a detailed discussion of this subaccount. As of June 30, 1996, the Contingency Operations subaccount balance was $5.3 million.

F-5 Support Subaccount. The Security Assistance Accounting Center established the F-5 subaccount in April 1988 to safeguard FMS customer deposits that the FMS contractor returned to the U.S. Government at Air Force direction. The Air Force requested that the contractor return the funds due to the Air Force termination of FMS contracts to support its F-5 FMS customers. The Government retained the deposits, in lieu of returning the deposits to its FMS customers, so that the Air Force could honor its commitment to provide continued follow-on support services for the F-5 FMS customers. As the Air Force incurs F-5 support costs, the costs are reimbursed from the funds in the subaccount. As of June 30, 1996, the subaccount balance was $13.9 million.

International Receivables Subaccount. The DFAS Denver Center established the International Receivables subaccount in March 1995 to record collections received from foreign governments to reimburse DoD for goods and services not acquired through the FMS program. As of June 30, 1996, the subaccount balance included $3.8 million in cash collected to reimburse DoD for goods and services.

NATO E-3A Subaccount. The Security Assistance Accounting Center established the NATO E-3A subaccount to record collections from NATO and disbursements to the prime contractor for the NATO E-3A commercial contract. As of June 30, 1996, the NATO E-3A subaccount balance was $65.7 million, which includes $8.5 million of undistributed disbursement transactions relating to reimbursable support for the NATO E-3A program.

Parts and Repair Ordering System Subaccount. The Air Force Parts and Repair Ordering System is a contractor-operated system that the air logistics centers use to fill requisitions for nonstandard items. FMS customers are permitted to use that system to acquire nonstandard items and to provide advance funding to support the acquisitions. The advance funding covers both the purchase price of the requisitioned item and the contractor fee for processing each requisition. The DFAS Denver Center records the FMS customer funds to purchase each requisitioned item in the FMS Trust Fund. In May 1996, the DFAS Denver Center began accumulating the FMS customers' funds relating to the contractor fee in the Parts and Repair Ordering System subaccount. As of June 30, 1996, the subaccount balance was $1.2 million.

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Part III - Management Comments

Defense Finance and Accounting Service Comments

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APR 8 1997

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DOD

SUBJECT: Audit Report on the Security Assistance and International Programs Account (Project No. 6LA-2032)

Provided below are our management comments to the recommendations of the subject audit report.

Recommendation 1. Discontinue using the Security Assistance and International Programs (SAIP) account for contingency operations that the Defense Security Assistance Agency (DSAA) does not support.

Comment: Concur. By June 30, 1997, DFAS-DE will transfer the subaccount balances related to non-DSAA directed contingency operations and international receivables from the SAIP account to the budget clearing account (suspense-F3875) until properly cleared from the account.

In addition, DSAA will accept funds management responsibility, prospectively upon exclusion of the burden sharing, contingency operations and the international receivables and certification of the 6147 account balance. DSAA has requested that a certification of the remaining account balance be provided prior to including the SAIP account under the DSAA financial statements. As a result, by the same date, the DFAS-DE will also certify for DSAA that the account balance for the remaining subaccounts are correct and that supporting documentation is being maintained.

Recommendation 2: Transfer the contingency operations subaccount balance from the Security Assistance and International Programs account to an appropriate account for general contingencies.

Comment: Partially concur. No account for general contingencies currently exists. DFAS-DE will use the budget clearing account (suspense-F3875) for non-DSAA activity of this nature following the transfer of funds until properly cleared from that account.

The action officer for this audit response is Mr. Tom McIntire, (703) 607-5071.

Edward A. Harris
Deputy Director for
Accounting

cc:
DSAA Comptroller
DCFO/AP

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This report was produced by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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