Report No. DODIG-2019-085

INSPECTOR GENERAL

U.S. Department of Defense

MAY 8, 2019

# Audit of the Defense Security Cooperation Agency—Security Assistance Accounts

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE

INSPECTOR GENERAL

INTEGRITY EFFICIENCY

DEPARTMENT OF DEFENSE

# Results in Brief

*Audit of the Defense Security Cooperation Agency—Security Assistance Accounts*

**May 8, 2019**

## Objective

We determined whether the Defense Security Cooperation Agency (DSCA)—Security Assistance Accounts (SAA) September 30, 2017, balance sheet was accurate and whether the DSCA and Defense Finance and Accounting Service (DFAS) implemented effective controls over financial reporting for the SAAs.

## Background

The DSCA-SAA financial statements are unaudited and were included in Appendix A of the FY 2017 DoD Agency Financial Report. The SAAs are a group of Treasury accounts the DoD uses to execute the security assistance programs for which the DoD has responsibility. These programs include the Foreign Military Sales Trust Fund and the Special Defense Acquisition Fund (SDAF). Foreign Military Sales is a process through which eligible foreign customers purchase defense articles and services from the U.S. Government. The SDAF is used to acquire defense articles and services in anticipation of their sale through the Foreign Military Sales process. The Foreign Military Sales Trust Fund and SDAF FY 2017 Fund Balance With Treasury ending balances were $33.1 billion and $739.8 million, respectively.

## Findings

We determined that the DSCA and DFAS-Indianapolis misstated assets and liabilities on the September 30, 2017, DSCA-SAA balance sheet. Specifically, DSCA and DFAS-Indianapolis personnel did not:

- report up to $410.7 million in SDAF inventory;

### *Findings (con't)*

- transfer up to $745.5 million in available collections received in DoD Miscellaneous Receipt accounts to the SDAF; and
- report Accrued Unfunded Annual Leave balances for Army, Air Force, and Other Defense Organization personnel who support the security assistance programs.

Additionally, DSCA and DFAS-Indianapolis personnel overstated the Navy Accrued Unfunded Annual Leave balance by $1.3 million.

These conditions occurred because DSCA personnel did not maintain complete and accurate inventory accounting records and DFAS-Indianapolis did not design the Defense Departmental and Reporting System to collect and report SDAF inventory accounting records. In addition, DSCA personnel did not provide detailed guidance to the implementing organizations or enforce requirements for recording and reporting SDAF collections.[1] Furthermore, DSCA and DFAS-Indianapolis personnel did not design internal controls so that all transactions, such as Accrued Unfunded Annual Leave, were recorded completely and accurately.

The DoD needs complete and accurate accounting records to determine whether it is effectively executing the mission of each security assistance program. Without reliable accounting records, the DoD cannot be sure that SDAF inventory is readily available for its foreign customers so the foreign customer can develop military capabilities that are consistent with U.S. strategy, priorities, and defense objectives. The SDAF also reduces the need to divert equipment and material from U.S. inventory when foreign partners have urgent requirements that cannot otherwise be satisfied. Without its full level of funding, the SDAF may not achieve these objectives. We consider the $745.5 million in available collections that the DSCA and DFAS-Indianapolis did not transfer to the SDAF to represent a potential monetary benefit to the DoD.

[1] An implementing organization is a Military Department or Defense agency responsible for delivering the materials or services requested by the foreign customer.

# Results in Brief

*Audit of the Defense Security Cooperation Agency—Security Assistance Accounts*

***Findings (cont'd)***

Furthermore, without reliable data for Accrued Unfunded Annual Leave, the DSCA will not be able to determine the amount the DoD should be reimbursed by foreign customers to recoup the DoD's security assistance personnel costs.

We also determined that DSCA and DFAS-Indianapolis personnel did not have effective controls over financial reporting for the SAAs. Specifically, DSCA and DFAS-Indianapolis personnel did not:

- perform Fund Balance With Treasury reconciliations of the SAA accounting records;
- document the complete consolidation, reconciliation, and reporting processes for all SAA financial activity in standard operating procedures, process narratives, or process maps; or
- comply with the mission work agreement established between them.[2]

These conditions occurred because DSCA personnel did not exercise prudent financial management over the SAAs. Specifically, the DSCA delegated financial management tasks to DFAS-Indianapolis, such as documenting financial processes and performing reconciliations. However, the DSCA did not establish a process for monitoring DFAS-Indianapolis personnel who performed the financial management tasks. Additionally, DSCA and DFAS-Indianapolis personnel did not perform Fund Balance With Treasury reconciliations because DFAS-Indianapolis personnel did not design the Defense Departmental and Reporting System to collect, reconcile, and report the SAA accounting records.

The DSCA and DFAS-Indianapolis need effective controls over financial reporting for the SAAs in order to produce accurate accounting records. The DoD relies on accurate accounting records to prepare budget requests and calculate overhead fees to recover the DoD's operating costs associated with executing the SAAs. Without effective internal controls, the DoD will be unable to determine whether it is incurring a gain or loss on individual cases on its business transactions with its foreign customers, which may result in DoD appropriations being spent on SAA operations.[3]

## Recommendations

Among other recommendations, we recommend that the DSCA Director:

- provide the implementing organizations with detailed accounting and reporting guidance for the SDAF inventory that complies with accounting standards;
- update the Security Assistance Management Manual to require the implementing organizations to report the value and location of SDAF inventory quarterly;
- work with the Directors of the implementing organizations to develop and implement a comprehensive end-to-end accounting and reporting process for SDAF inventory;
- perform annual inspections of DoD and contractor facilities to determine the location, identification numbers, quantities, and values of the inventory on hand;
- establish definitions for all SDAF collection sources and issue detailed accounting and reporting guidance to the implementing organizations for the transactions;
- review and provide written approval for each reconciliation performed by DFAS-Indianapolis to the SAAs;
- review and provide written approval for each adjustment made by DFAS-Indianapolis to the SAAs; and

[2] The mission work agreement describes the work DFAS performs for the DSCA.

[3] Generally, the foreign customer is responsible for paying for all costs incurred by the DoD to execute the security assistance programs.

*Recommendations (cont'd)*

- develop and implement detailed standard operating procedures, process narratives, and process maps for each of the SAAs.

## Management Comments and Our Response

The DSCA Director agreed with 25 of the 26 recommendations, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller) and the implementing organizations, has developed corrective action plans to address the recommendations. The Director plans to implement all of the corrective action plans by September 30, 2020. Therefore, the recommendations are resolved but will remain open. We will close these 25 recommendations when we verify that the Director has implemented the corrective action plans.

The DSCA Director did not agree with the DoD OIG's methodology and calculation used to determine the $745.5 million in potential monetary benefit. The Director stated that the DoD OIG's position is unsubstantiated because the DoD OIG did not account for the offsetting collections recorded in the DoD Miscellaneous Receipt accounts, which would have reduced the potential monetary benefit. In addition, the Director stated that the DoD OIG incorrectly included lease payments, which are not authorized SDAF collections. Therefore, the DSCA Director did not agree with our recommendation to recover and transfer into the SDAF all lease payments dating back to FY 2012 that DFAS had not transferred into the SDAF account.

We disagree with the Director's response. We acknowledge in Appendix A of the report that offsetting collections were recorded in the DoD Miscellaneous Receipt accounts, which may have reduced the $745.5 million in potential monetary benefit. DFAS-Indianapolis personnel did not provide the documentation needed to justify reducing the potential monetary benefit.

We also disagree with the Director's comments that lease payments are not authorized SDAF collections. According to the Arms Export Control Act, "the [SDAF] shall consist of collections from sales representing the value of asset use charges." Asset use charges are charges collected on an FMS case when a foreign customer or DoD contractor rents or leases defense articles. Additionally, the DoD Financial Management Regulation states that lease rental payments should be collected and posted to the SDAF account. Therefore, the recommendation is unresolved. We ask that the Director provide additional comments on the final report. The Director should explain how the DSCA will comply with the DoD FMR requirement to collect and post all lease rental payments to the SDAF.

Although not required to comment, the Assistant Deputy Chief Financial Officer for the Office of the Under Secretary of Defense (Comptroller) disagreed with the recommendation for the DSCA and DFAS-Indianapolis to report all SAA balances in the DoD Agency Financial Report. The Assistant Deputy Chief Financial Officer stated that the DSCA-SAAs should be considered a stand-alone entity and not included in the DoD Agency Financial Report.

We disagree with the Assistant Deputy Chief Financial Officer's response. Statement of Federal Financial Accounting Standards 47 requires the DoD to consolidate and report on all entities for which it is administratively accountable in the DoD Agency Financial Report. The DoD was assigned administrative responsibilities for the SAAs in the Foreign Assistance Act, Arms Export Control Act, and Executive Orders 12163 and 13637. DoD Directives 5105.65 and 5132.03 established the DSCA as the DoD agency responsible for the execution of DoD security assistance programs and activities. By not consolidating and reporting the financial activity of the DSCA's security assistance programs, the DoD is not complying with Standard 47 requirements.

Please see the Recommendations Table on the next page for the status of recommendations.

## *Recommendations Table*

| Management | Recommendations Unresolved | Recommendations Resolved | Recommendations Closed |
|---|---|---|---|
| Director, Defense Security Cooperation Agency | A.1.f.7 | A.1.a through A.1.f.6; A.1.f.8 through A.1.f.12; B.1.a through B.1.d.6 | None |

Please provide Management Comments by June 7, 2019.

**Note:** The following categories are used to describe agency management's comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.

**INSPECTOR GENERAL**
**DEPARTMENT OF DEFENSE**
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May 8, 2019

MEMORANDUM FOR DIRECTOR, DEFENSE SECURITY COOPERATION AGENCY

SUBJECT: Audit of the Defense Security Cooperation Agency–Security Assistance Accounts (Report No. DODIG-2019-085)

We are providing this report for your review and comment. We conducted this audit in accordance with generally accepted government auditing standards.

We considered management comments from the Assistant Deputy Chief Financial Officer for the Office of the Under Secretary of Defense (Comptroller) and the Director of the Defense Security Cooperation Agency. DoD Instruction 7650.03 requires that recommendations be resolved promptly. Comments from the Director of the Defense Security Cooperation Agency did not fully address Recommendation A.1.f.7. Therefore, the recommendation is unresolved. We request additional comments on Recommendation A.1.f.7 by June 7, 2019. Additionally, we ask that the Director of the Defense Security Cooperation Agency to reconsider his position on the $745.5 million in potential monetary benefit and provide additional comments in response to the final report.

Please send a PDF file containing your comments on the recommendations and public release review to audfmr@dodig.mil by June 7, 2019. Copies of your comments must have the actual signature of the authorizing official for your organization. We appreciate the cooperation and assistance received during the audit. Please direct questions to me at (703-601-5945).

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# Contents

# Introduction

## Objective

We determined whether the Defense Security Cooperation Agency (DSCA)—Security Assistance Accounts (SAA) September 30, 2017, balance sheet was accurate and whether the DSCA and Defense Finance and Accounting Service (DFAS) implemented effective controls over financial reporting for the SAAs.[4]

## Background

The SAAs are a group of Department of the Treasury (the Treasury) accounts the DoD uses to execute the security assistance programs for which the DoD has responsibility. Through these security assistance programs, the United States provides foreign customers with defense articles, military education and training, and other defense services by cash sales, credit, grant, loan, or lease, in furtherance of national policies and objectives.

The DSCA was established in 1971 by DoD Directive 5105.38 and is responsible for the management of the SAAs.[5] The DSCA directs, administers, and provides guidance to the DoD and DoD representatives for the execution of DoD security assistance and security cooperation programs. The DSCA Director can delegate the administration of security cooperation programs to the Military Departments and Defense agencies, as appropriate. DFAS-Indianapolis is responsible for consolidating and reconciling the financial activity of the SAAs and for preparing the DSCA-SAA financial statements.

The DSCA-SAA financial statements were included in Appendix A of the FY 2017 DoD Agency Financial Report. The statements were separated from the DoD's financial statements and financial statement audits because the Under Secretary of Defense (Comptroller)/Chief Financial Officer did not accept the responsibility for reporting the financial activity of the SAAs. See Appendix C for additional details on the financial reporting of the SAAs. The SAA financial statements include the balances for the DoD's four security assistance programs—the Foreign Military Sales (FMS) Trust Fund, the Foreign Military Financing program, International Military Education and Training, and the Special Defense Acquisition Fund (SDAF).

4 Effective controls ensure that data recorded in an accounting system and used in a financial report are accurate, complete, and supportable.

5 DoD Directive 5105.38, "Defense Security Assistance Agency," August 11, 1971, establishes the DoD organizational structure for carrying out the responsibilities of the Secretary of Defense relating to the administration of Military Assistance and Foreign Military Sales. Additionally, DoD Directive 5132.03, "DoD Policy and Responsibilities Relating to Security Cooperation," December 29, 2016, establishes policy and assigns responsibilities for the administration of security cooperation to encourage and enable allied and partner nations to apply their military capabilities and capacities, consistent with U.S. strategy, priorities, and defense objectives.

The Fund Balance With Treasury (FBWT) balance for the FMS Trust Fund represented 32 percent of the total assets reported on the September 30, 2017, DSCA-SAA balance sheet.[6]

FMS is a process through which eligible foreign customers purchase defense articles and services from the U.S. Government through sales of DoD inventory or new procurements under DoD-managed contracts. FMS is a fundamental tool of U.S. foreign policy. The Foreign Assistance Act and the Arms Export Control Act authorize the security assistance programs.[7] The U.S. Government uses the existing DoD acquisition system to procure defense articles and services on behalf of its foreign customers. Eligible foreign customers may purchase defense articles and services with their own funds, or with U.S. Government funds provided through U.S. Government-sponsored assistance programs, such as the Foreign Military Financing program. See Appendix B for a detailed description of the FMS process.

## The Security Assistance Accounts

### Foreign Military Sales Trust Fund

The FY 2017 FBWT ending balance of the FMS Trust Fund was $33.1 billion. The FMS Trust Fund account is used for collecting and disbursing funds associated with the FMS program. DFAS personnel established an FMS Trust Fund sub-account for each foreign customer that purchases defense articles and services through the FMS process in order to record the collections and disbursements for that customer's cases. While some accounts contain only foreign customer deposits, others contain foreign customer deposits mixed with U.S. Government appropriated funding provided through grants and loans.

### Foreign Military Financing Program

The Foreign Military Financing program provides funding to eligible foreign customers to purchase defense articles, services, and training through the FMS process. Funded through U.S. Government appropriations, the Foreign Military Financing program uses non-repayable grants, repayable loans, and loan guarantees to further U.S. security assistance objectives. The following table describes the accounts that comprise the Foreign Military Financing program.

[6] The FBWT is an asset account that reflects available funds in the entity's accounts with the Treasury that the entity uses to pay liabilities.

[7] The Foreign Assistance Act and the Arms Export Control Act are codified in Chapters 32 and 39, Title 22, "Foreign Relations and Intercourse," United States Code. The Foreign Assistance Act is the U.S. law providing the authority and general rules for the management of military assistance and International Military Education and Training. The Arms Export Control Act is the U.S. law providing the authority and general rules for the management of FMS and commercial sales of defense articles, defense services, and training.

*Table. FY 2017 FBWT Ending Balances for the Foreign Military Financing Program Accounts*

| Account Title | FY 2017 FBWT Ending Balance | Description of Account |
|---|---|---|
| Foreign Military Financing Program Account | $5,966.3 | This account is used to record the receipt and use of U.S. Government appropriated grant funding that is provided to selected foreign customers. Foreign customers use the Foreign Military Financing non-repayable grant funds to purchase defense articles and services through the FMS process. |
| Foreign Military Financing Direct Loan Financing Account | $94.5 | This account is a financing account used to make disbursements of Foreign Military Financing loans to foreign customers. The account also receives foreign customer repayments of Foreign Military Financing loans, which are then used to repay the Treasury. |
| Foreign Military Financing Direct Loan Program Account | $150.0 | This account is used to provide a subsidy to Foreign Military Financing loans. |
| Foreign Military Loan Liquidating Account | $0.0 | This account is used to record the receipt and use of U.S. Government appropriated funds to finance pre-1992 foreign customer Foreign Military Financing loans and the DSCA Foreign Military Financing loan guaranties. This account receives collections from foreign customers as repayments to the DSCA. |
| Military Debt Reduction Financing Account | $11.8 | This account is a financing account established for the debt relief of certain countries. This account buys the portfolio of loans from the Foreign Military Loan Liquidating Account, and may restructure or completely forgive the loans amounts based on agreements between the U.S. Government and the foreign customer. |
| **Total** | **$6,222.5*** | |

Note: Dollars in millions.

* Difference due to rounding.

Source: We obtained the account titles from the Federal Account Symbols and Titles Book; the FBWT ending balances from the Treasury's Central Accounting and Reporting System; and the account descriptions from the DoD Financial Management Regulation.

## *International Military Education and Training*

The FY 2017 FBWT ending balance of the International Military Education and Training account was $153.8 million. The DSCA uses the account to record the receipt of U.S. Government appropriated grant funding for the military education and training of selected international military and civilian personnel. The DSCA issues International Military Education and Training funding to the Military Departments, which in turn provide education and training to foreign military students. International Military Education and Training grants represent foreign assistance provided by Congress, and are allocated among countries based on congressional limits. The U.S. Government does not expect the foreign customers to repay the cost of training.

### *Special Defense Acquisition Fund*

The FY 2017 FBWT ending balance of the SDAF was $739.8 million. The SDAF is a DoD-controlled revolving fund used to acquire defense articles and services in anticipation of their sale through the FMS process. The DSCA uses the SDAF to procure inventory through the DoD acquisition system. The SDAF is funded through reimbursements when existing SDAF inventory is sold. The SDAF receives additional funding through collections from one of three sources described in the Arms Export Control Act.[8] These sources consist of asset use charges and rental payments, sales of assets not intended to be replaced, and research, development, and production costs.

## Review of Internal Controls

DoD Instruction 5010.40 requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls.[9] We determined that DSCA and DFAS-Indianapolis personnel misstated assets and liabilities on the September 30, 2017, DSCA-SAA balance sheet. We also determined that the DSCA and DFAS-Indianapolis did not have effective internal controls over financial reporting for the SAAs. Specifically, DSCA and DFAS-Indianapolis personnel did not perform FBWT reconciliations of the SAA accounting records; did not document the complete consolidation, reconciliation, and reporting processes for all SAA financial activity in standard operating procedures, process narratives, or process maps; and did not comply with the mission work agreement established between them. We will provide a copy of the report to the senior official responsible for internal controls in the DSCA and DFAS.

[8] Chapter 39, Title 22, "Foreign Relations and Intercourse," Section 2795(b).

[9] DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013.

# Finding A

## The September 2017 DSCA-SAA Balance Sheet Misstated Assets and Liabilities

We determined that the DSCA and DFAS-Indianapolis misstated assets and liabilities on the September 30, 2017, DSCA-SAA balance sheet.

DSCA and DFAS-Indianapolis personnel did not report up to $410.7 million in SDAF inventory on the September 30, 2017, DSCA-SAA balance sheet because:

- DSCA personnel stated that they were unaware that the DSCA was required to report the value of SDAF inventory;
- DSCA personnel did not maintain complete and accurate inventory accounting records, including the value of SDAF items on hand; and
- DFAS-Indianapolis personnel did not design the Defense Departmental Reporting System to collect and report SDAF inventory accounting records.[10]

DSCA and DFAS-Indianapolis personnel did not transfer all available collections authorized by the Arms Export Control Act from DoD Miscellaneous Receipt accounts to the SDAF account. Instead, the available collections were transferred to a Treasury Miscellaneous Receipts account at the end of the fiscal year and unavailable for the DSCA to purchase SDAF inventory. Therefore, DSCA and DFAS-Indianapolis personnel understated the SAA FBWT balance by up to $745.5 million on the September 30, 2017, balance sheet. This occurred because DSCA personnel did not provide detailed guidance to the implementing organizations and enforce requirements for recording and reporting SDAF collections.[11]

DSCA and DFAS-Indianapolis personnel did not report a complete and accurate balance for Accrued Unfunded Annual Leave. Specifically, DSCA and DFAS-Indianapolis personnel did not report any balances for Army, Air Force, and Other Defense Organizations personnel who support the security assistance programs.

[10] The Defense Departmental Reporting System is the system used to prepare the DoD's financial statements.

[11] An implementing organization is a Military Department or Defense agency responsible for delivering the materials or services requested by the foreign customer.

Additionally, DSCA and DFAS-Indianapolis personnel overstated the Navy balance for Accrued Unfunded Annual Leave by $1.3 million. This occurred because DSCA and DFAS personnel did not design internal controls so that transactions related to Accrued Unfunded Annual Leave were recorded completely and accurately.

The DoD needs complete and accurate accounting records to determine whether it is effectively executing the mission of each security assistance program. Without reliable accounting records, the DoD cannot be sure that SDAF inventory is readily available for its foreign customers so the foreign customers can develop military capabilities that are consistent with U.S. strategy, priorities, and defense objectives. Additionally, the SDAF reduces the need to divert equipment and material from DoD inventory when foreign partners have urgent requirements that cannot otherwise be satisfied. Without its full level of funding, the SDAF may not achieve these objectives. Furthermore, without reliable data for Accrued Unfunded Annual Leave, the DSCA will not be able to determine the amount the DoD should be reimbursed by foreign customers to recoup the DoD's security assistance personnel costs.

## The SAAs Assets and Liabilities Were Misstated

### *SDAF Inventory Account Balances Were Not Reported*

DSCA and DFAS-Indianapolis personnel did not report up to $410.7 million in SDAF inventory on the September 30, 2017, DSCA-SAA balance sheet. The Statement of Federal Financial Accounting Standards 3 defines inventory as tangible personal property that is held for sale and requires inventory to be recorded either when the titles pass or when the goods are delivered to the purchasing entity.[12] The DoD Financial Management Regulation (FMR) states that DoD Components are responsible for ensuring that data generated and input into finance and accounting systems is accurate, complete, timely, and supported by documentation. Additionally, DoD Components are responsible for submitting the data to DFAS for input and recording in the finance and accounting systems and financial reports.[13] The DoD uses the SDAF to purchase articles to sell to foreign customers at a future date. This allows the DoD to have defense articles readily available to meet the needs of its foreign customers, and reduces the need to divert DoD inventory to meet urgent foreign customer demand.

[12] Statement of Federal Financial Accounting Standards 3, "Accounting for Inventory and Related Property," October 27, 1993.

[13] DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 6A, "Reporting Policy," Chapter 2, June 2017.

DSCA and DFAS-Indianapolis personnel did not report any inventory on the DSCA-SAA balance sheet. According to Appendix A of the FY 2017 DoD Agency Financial Report, the SAAs do not maintain inventory—the defense articles sold from the SDAF are assets of the implementing organization until title is transferred to the foreign customer. However, we determined that the DSCA-SAAs did maintain SDAF inventory as of September 30, 2017. Additionally, the implementing organizations stated that they did not report any of the SDAF inventory balances on their respective balance sheets. Therefore, the value of SDAF inventory was not knowingly reported on any DoD financial statements.

The National Defense Authorization Act for FY 2017 required the DSCA to report to Congress on the inventory of defense articles and services that DoD acquired, possessed, and transferred through the SDAF in FY 2017.[14] Therefore, DSCA personnel performed a manual data call to collect inventory quantities and item descriptions for inventory on hand as of September 30, 2017. According to the report the DSCA provided to Congress, the DoD held 2.7 million items on hand, which contradicts the DoD financial statements because none of the statements included SDAF inventory. The DSCA could not provide us values for the items on hand that were reported to Congress, such as ammunition, boats, vehicles, and weapons.

DSCA and DFAS-Indianapolis personnel did not provide us complete and accurate accounting records for the values of the SDAF items on hand. According to DSCA personnel, the DoD procured $646.3 million in SDAF inventory between FYs 2012 and 2017. The DoD sold $235.6 million of the SDAF inventory during the same period. Therefore, the DSCA should have reported the remaining $410.7 million as inventory on its September 30, 2017, balance sheet. Without complete and accurate accounting records, DSCA personnel cannot provide Congress with reliable information needed to make decisions regarding the SDAF, such as determining the appropriate funding level and authorized use of the funds.

DSCA and DFAS-Indianapolis personnel did not report inventory on the DSCA-SAA balance sheet for three reasons. First, DSCA personnel stated that they were unaware that the DSCA was required to report the value of SDAF inventory on the DSCA-SAA balance sheet. Second, DSCA personnel stated that they do not maintain complete and accurate inventory accounting records, including the value of SDAF items on hand. According to the Security Assistance Management Manual (SAMM), the implementing organizations are required to submit quarterly SDAF inventory reports to the DSCA.[15] The SDAF inventory reports are required to contain data

[14] National Defense Authorization Act for Fiscal Year 2017, Section 1202 "Special Defense Acquisition Fund Matters," December 23, 2016.

[15] SAMM, Section C11.9.5.3, "Inventory Reporting."

elements, such as stock numbers and the quantity of items in stock, on order, sold, or loaned to Military Departments. The SAMM does not require the quarterly reports to include value or location of items. DSCA personnel stated that they have not enforced the SAMM inventory reporting requirements and could not provide an explanation for why they have not enforced the requirement. According to DSCA personnel, the DSCA is developing instructions to enforce the SAMM inventory reporting requirements. As of August 2018, the DSCA had yet to receive quarterly inventory reports from the implementing organizations. Therefore, we recommend that the DSCA Director:

- provide the implementing organizations with detailed accounting and reporting guidance for the SDAF inventory that complies with the Statement of Federal Financial Accounting Standards 3;
- update the SAMM to require the implementing organizations to report the value and location of SDAF inventory quarterly; and
- work with the Directors of the implementing organizations to develop and implement a comprehensive end-to-end accounting and reporting process for SDAF inventory. The DSCA should require the implementing organizations to report the following attributes quarterly: item quantities, location, identification number, and value. The DSCA should have this information readily available for management and stakeholders.

Lastly, DFAS-Indianapolis personnel did not design the Defense Departmental Reporting System to collect and report SDAF inventory accounting records. DFAS-Indianapolis personnel stated that they could not identify which accounting systems contain SDAF accounting records and whether the accounting systems are submitting complete and accurate data to the Defense Departmental Reporting System for financial reporting purposes. DFAS-Indianapolis personnel stated that they are researching a solution for these consolidation deficiencies. Therefore, we recommend that the DSCA Director work with the DFAS-Indianapolis Director to:

- determine which accounting systems contain SDAF accounting records;
- test the completeness and accuracy of the SDAF accounting records in the systems identified;
- develop a corrective action plan to remedy any deficiencies identified during testing; and
- correct the Defense Departmental Reporting System to accept, consolidate, reconcile, and report SDAF accounting records.

We also recommend that the DSCA Director perform annual inspections of DoD and contractor facilities to determine the location, identification numbers, quantities, and values of the inventory on hand.

## *The FBWT Account Balance Was Understated*

DSCA and DFAS-Indianapolis personnel did not transfer all available collections authorized by the Arms Export Control Act from DoD Miscellaneous Receipt accounts to the SDAF account. Instead, the available collections were transferred to a Treasury Miscellaneous Receipts account at the end of the fiscal year and unavailable for DSCA to purchase SDAF inventory. Therefore, DSCA and DFAS-Indianapolis personnel understated the DSCA-SAA FBWT balance by up to $745.5 million on the September 30, 2017, balance sheet.

According to the Arms Export Control Act, the SDAF receives reimbursements from sales of existing SDAF inventory on FMS cases and receives new collections from the following three sources.[16]

1. Asset use charges and rental payments. These are charges collected on an FMS case when a foreign customer or DoD contractor rents or leases defense articles, but the DoD retains ownership of those articles.
2. Assets sold and not intended to be replaced. These are defense articles that the DoD does not plan to replace.
3. Research, development, and production recovery costs. These costs are added to FMS cases to recoup a portion of the DoD's cost for the research, development, and production of the equipment being sold.

Reimbursements and collections from any of the sources described above will increase the SDAF FBWT balance, which will also increase the SAA FBWT balance reported on the balance sheet. However, DSCA and DFAS personnel did not transfer all available collections from the three authorized sources described above to the SDAF. Instead, DSCA and DFAS personnel recorded some of the collections in DoD Miscellaneous Receipt accounts at the Treasury, which represents a loss of funding for the SDAF.

DFAS personnel stated that, between FYs 2012 and 2017, they collected $9.5 million in payments from foreign customers in exchange for leased DoD articles. DSCA and DFAS-Indianapolis personnel did not transfer any of the lease payments to the SDAF. Instead, DoD personnel recorded the $9.5 million into an Air Force Miscellaneous Receipts account. DFAS-Columbus personnel stated that they do not report the Miscellaneous Receipt balances on the Air Force financial statements. Instead, at the end of each fiscal year, Treasury personnel transfer the balance from the Air Force account to a Treasury Miscellaneous Receipts account. According to DFAS-Indianapolis personnel, the lease payment collections are recorded in the Air Force's Miscellaneous Receipts account because the Air Force accounting

[16] Chapter 39, Title 22, "Foreign Relations and Intercourse," Section 2795(B) describes the funding sources of the SDAF.

system was the only accounting system capable of recording the lease payments. Therefore, the DoD rented assets to foreign customers through the FMS process but never reported the collections received on any DoD financial statements. Additionally, because funds were transferred to a Treasury Miscellaneous Receipts account at the end of the fiscal year, the DoD did not maximize the funds available to purchase additional SDAF inventory.

For example, in March 2010, the Navy leased nine storage pods to the Canadian government for $414,512 between FYs 2011 and 2013. The Navy purchased the storage pods with the Navy's appropriated dollars and retained the title of the pods once the lease was complete. DFAS-Indianapolis collected the lease payments from the Canadian government on behalf of the Navy and recorded the funds in an Air Force Miscellaneous Receipts account. DFAS-Indianapolis personnel should have recorded the lease payments in the SDAF because the payments were an asset use charge. Instead, the funds were transferred from the Air Force Miscellaneous Receipts account to a Treasury Miscellaneous Receipts account and unavailable to the DSCA to purchase additional SDAF inventory.

According to DSCA personnel, the DSCA and DFAS have not considered lease payments as asset use charges because the Arms Export Control Act does not specifically identify leases as an authorized collection. However, the DoD FMR states that amounts recovered from the operation of the FMS program, including rental payments, are to be recorded in the SDAF. We consider rental payments synonymous with lease payments.

In addition, between FYs 2012 and 2017, DoD personnel recorded another $736 million in collections in Army, Navy, Air Force, and DoD Miscellaneous Receipt accounts rather than the SDAF account. These funds were transferred to a Treasury Miscellaneous Receipts account at the end of each fiscal year and were unavailable to the DSCA to purchase additional SDAF inventory.

DoD personnel may have recorded more collections in these accounts; however, the implementing organizations do not always apply the correct coding structure for cases and transactions. Therefore, DSCA and DFAS personnel could not provide a complete and reliable list of cases or transactions that may have impacted or been recorded in the DoD Miscellaneous Receipt accounts. When an FMS case is established, the implementing organization codes the case based on requirements in the SAMM and DoD FMR.[17] When an FMS transaction is executed, the codes established on the case will dictate in which account the transaction is recorded. For example, if the implementing organization establishes an FMS lease case, but

[17] DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 15, "Security Cooperation Policy," Chapter 3, "Accounting" February, 2016.

codes the case as a service to be performed for the foreign customer rather than a lease case, the payments received from the lease will not be recorded in the SDAF. In another example, for FMS sales of DoD-owned articles that the DoD does not plan to replace, the inventory managers must enter the correct source code into the accounting system so that the proceeds from the sale of the article are correctly recorded in the SDAF. The SDAF does not receive the full level of funding that it should when information is miscoded.

If the SDAF is not fully funded, the DoD may not maximize its ability to purchase SDAF inventory, which may cause the DSCA to not have the correct SDAF inventory readily available for its foreign customers to meet future demands. The DSCA has issued multiple administrative instructions to the implementing organizations that describe the correct coding procedures. However, the implementing organizations are not following these procedures and the DSCA and DFAS-Indianapolis personnel are not enforcing the requirements; therefore, the SDAF is at risk of not collecting all funds as authorized by the Arms Export Control Act.

DSCA and DFAS-Indianapolis personnel did not transfer all authorized collections received to the SDAF because the DSCA did not provide detailed guidance to the implementing organizations and enforce requirements for recording and reporting SDAF collections.

On November 2, 2016, the DSCA Comptroller issued a memorandum prohibiting the recording of SDAF collections to the Miscellaneous Receipts accounts and required organizations to record the collections in the SDAF. In September 2017, based on the DSCA Comptroller memorandum, DFAS-Indianapolis personnel revised the DoD FMR to require that collections, such as asset use charges and rental payments, be recorded in the SDAF account instead of the Miscellaneous Receipts accounts.[18] However, as of September 2018, the implementing organizations continue to record SDAF collections into the Miscellaneous Receipts accounts. Even though DFAS-Indianapolis personnel revised the DoD FMR, they did not record the SDAF collections in accordance with the DoD FMR. Additionally, the DSCA has not updated the SAMM to require the implementing organizations to record authorized collections in the SDAF in accordance with the memorandum and the DoD FMR. The SDAF collections should be recorded directly in the SDAF so the funds can be put to better use, such as having items readily available for our foreign customers.

[18] DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 15, "Security Cooperation Policy," Chapter 1, Table 1-2, "Miscellaneous Receipts to SDAF Account Crosswalk," September 2017.

We consider the $745.5 million in available collections that the DSCA and DFAS-Indianapolis did not transfer to the SDAF to represent a potential monetary benefit to the DoD. The SDAF reduces the need to divert equipment and material from U.S. inventory when foreign partners have urgent requirements that cannot otherwise be satisfied. Without its full level of funding, the SDAF may not achieve this objective. If the DSCA and DFAS do not change their accounting and financial reporting practices, the SDAF may not have the maximum level of authorized funding in future years. Therefore, we recommend that the DSCA Director work with the DFAS-Indianapolis Director to:

- analyze all FMS cases dating back to FY 2012 to identify the correct number of lease cases;
- analyze all open and closed FMS cases to determine whether the cases were properly coded in accordance with the SAMM;
- recover and transfer into the SDAF account all lease payments dating back to FY 2012 that DFAS did not transfer into the SDAF account;
- recover and transfer into the SDAF account all authorized collections dating back to FY 2012 that DFAS did not transfer into the SDAF account; and
- develop and implement internal controls to prevent the implementing organizations from improperly coding FMS cases.

Additionally, we recommend that the DSCA Director establish definitions for all SDAF collection sources and issue detailed accounting and reporting guidance to the implementing organizations for the transactions.

## *Accrued Unfunded Annual Leave Was Misstated*

DSCA and DFAS-Indianapolis personnel did not report a complete and accurate balance for Accrued Unfunded Annual Leave. Specifically, the DSCA and DFAS-Indianapolis did not report any balances for Army, Air Force, and Other Defense Organizations personnel who support the security assistance programs. Additionally, DSCA and DFAS-Indianapolis personnel overstated the Navy balance for Accrued Unfunded Annual Leave by $1.3 million. According to the Treasury Financial Manual, the Accrued Unfunded Annual Leave amounts represent unpaid leave that employees earn and are entitled to upon separation.[19]

According to the DoD FMR, agencies are required to accrue the cost of unused Annual Leave, including restored leave, compensatory time, and credit hours earned as well as the costs associated with the leave. Agencies are required to obtain the accrued leave amounts from the Defense Civilian Payroll System. The liability balance for Annual Leave and other leave, including costs associated

[19] Treasury Financial Manual, Section II, "U.S. Standard General Ledger Accounts and Definitions," December 2017.

with the leave must be assessed at least quarterly for financial statement purposes.[20] However, DSCA and DFAS-Indianapolis personnel did not report any Accrued Unfunded Annual Leave balances for the Army, Air Force, or Other Defense Organization personnel who support the SAAs. DSCA and DFAS-Indianapolis personnel were unable to provide the balances of Accrued Unfunded Annual Leave that the DSCA should have reported on the FY 2017 DSCA-SAA balance sheet.

DSCA and DFAS-Indianapolis personnel inaccurately reported $2.7 million in Accrued Unfunded Annual Leave on the FY 2017 DSCA-SAA balance sheet for Navy personnel. Rather than obtaining accrued leave amounts from the Defense Civilian Payroll System, DFAS-Cleveland personnel obtained the Accrued Unfunded Annual Leave from the Navy's Standard Accounting, Budgeting, and Reporting System. The balance obtained from the Navy's system was $1.3 million; however, DFAS-Cleveland personnel recorded the balance twice.[21] DFAS-Cleveland personnel later identified that the balance was duplicated, but did not correct the error on the FY 2017 DSCA-SAA balance sheet.

DSCA and DFAS-Indianapolis personnel did not report a complete and accurate Accrued Unfunded Annual Leave balance because the DSCA and DFAS did not design internal controls so that all transactions were recorded completely and accurately. DFAS-Indianapolis personnel stated that gaps existed in their internal controls to detect the missing balances and they are researching the root cause and developing corrective actions. Furthermore, DFAS-Cleveland personnel were unaware of how to correctly post the transactions and resolve the duplicate entry. According to DFAS personnel, September 2017 was the first time DFAS received the Accrued Unfunded Annual Leave balances. DFAS-Cleveland personnel did not have any standard operating procedures, process narratives, or process maps in place to provide instructions for recording and correcting the transactions. Therefore, we recommend that the DSCA Director work with the DFAS-Indianapolis Director to:

- obtain transaction-level detail for the Accrued Unfunded Annual Leave liability balance for all DoD employees who support the SAAs;
- develop and implement standard operating procedures, process narratives, and process maps to instruct DFAS personnel on how to record the Accrued Unfunded Annual Leave balance correctly; and
- develop and implement internal controls to ensure that all Accrued Unfunded Annual Leave transactions are recorded completely and accurately.

[20] DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 4, "Accounting Policy," Chapter 10, Section 1003, "Accounting Policy for Accruals," February 2016.

[21] This amount is $2.7 million due to rounding.

## Inaccurate DSCA-SAA Balance Sheet Leads to Adverse Impact on the DSCA-SAA Mission

The DoD needs complete and accurate accounting records to determine whether it is effectively executing the mission of each security assistance program.  Without reliable accounting records, the DoD cannot be sure that SDAF inventory is readily available for its foreign customers so the foreign customers can develop military capabilities that are consistent with U.S. strategy, priorities, and defense objectives. Additionally, the DSCA and the Secretary of Defense will not be able to provide Congress critical information, such as a detailed spending plan and inventory levels, necessary for Congress to make decisions regarding the SDAF budget.

The objective of the SDAF is to have an inventory readily available for its foreign customers and provide faster delivery times of items purchased on FMS contracts. Additionally, the SDAF reduces the need to divert equipment and material from DoD inventory when foreign partners have urgent requirements that cannot otherwise be satisfied.  Between FYs 2012 and 2017, DSCA and DFAS-Indianapolis personnel did not transfer all available collections authorized by the Arms Export Control Act to the SDAF.  Therefore, the SDAF did not receive up to $745.5 million in funding.  We consider the $745.5 million in available collections that the DSCA and DFAS-Indianapolis did not transfer to the SDAF to represent a potential monetary benefit to the DoD.  Without its full level of funding, the SDAF may not achieve its objectives.  Furthermore, unless the DSCA implements the report recommendations, the DSCA will continue to underfund the SDAF and miss opportunities to maximize SDAF inventory levels.

Lastly, without reliable data for Accrued Unfunded Annual Leave, the DSCA will not be able to determine the amount the DoD should be reimbursed by foreign customers to recoup the DoD's security assistance personnel costs.

## Management Comments on the Finding and Our Response

### *Defense Security Cooperation Agency Comments*

The DSCA Director did not agree with the DoD OIG's methodology and calculation used to determine the $745.5 million in potential monetary benefit.  The Director stated that the Arms Export Control Act does not require the DSCA and DFAS-Indianapolis to transfer all collections to the SDAF.

The Director also stated that the DoD OIG's position is unsubstantiated because the DoD OIG did not account for the offsetting collections recorded in the DoD Miscellaneous Receipt accounts, which would have reduced the

$745.5 million in potential monetary benefit. Lastly, the DoD OIG's calculation incorrectly included lease payments, which are not authorized SDAF collections, as referenced in the legal opinion received from both the DSCA and DoD Offices of General Counsel. The DSCA and DFAS are working to implement corrective actions that will reconcile offsetting collections transferred to the Treasury.

### *Our Response*

Section 2795 (b) of the Arms Export Control Act states that the SDAF shall consist of collections from the following sources.

- Asset use charges and rental payments. These are charges collected on an FMS case when a foreign customer or DoD contractor rents or leases defense articles, but the DoD retains ownership of those articles.
- Assets sold and not intended to be replace. These are defense articles that the DoD does not plan to replace.
- Research, development, and production recovery costs. These costs are added to FMS cases to recoup a portion of the DoD's cost for the research, development, and production of the equipment being sold.

According to the DoD FMR, collections authorized under the Arms Export Control Act are to be posted to the SDAF account.[22] Therefore, the DoD FMR requires that the SDAF consist of all collections authorized by the Arms Export Control Act, to include lease payments.

We acknowledge in Appendix A of the report that offsetting collections were recorded in the DoD Miscellaneous Receipt accounts, which may have reduced the $745.5 million in potential monetary benefit. We informed DSCA and DFAS-Indianapolis personnel that we would need to review each voucher for the offsetting collections to justify reducing the total potential monetary benefit. DFAS-Indianapolis personnel stated that collecting each voucher would be an intense manual effort. Therefore, we agreed to qualify the $745.5 million throughout the report and add an explanation in Appendix A.

The opinion provided by the DSCA Office of General Counsel stated that a definition for asset use charge does not exist in any legislation. We agree that that the Arms Export Control Act does not define asset use charge. However, the DoD FMR states that lease rental payments should be collected and posted to the SDAF account.

[22] DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 15, "Security Cooperation Policy," Chapter 1, Section 010201, "Treasury Accounts Applicable to FMS Trust Fund Operations," September 2017.

The opinion provided to the DSCA from the DoD Office of General Counsel, which was in the form of a draft e-mail, stated that the DoD OIG incorrectly assessed that lease charges are the same as asset use charges and that lease charges should be deposited in the SDAF without a sale being involved. We disagree with the DoD Office of General Counsel draft position. We identified DoD-owned assets, such as storage pods, that the DoD leased to a foreign partner through the FMS agreement process. The DoD incorrectly recorded the lease payments in DoD Miscellaneous Receipt accounts rather than in the SDAF account as required by the DoD FMR.

## Recommendations, Management Comments, and Our Response

### *Recommendation A.1*

**We recommend that the Defense Security Cooperation Agency Director:**

a. **Provide the implementing organizations with detailed accounting and reporting guidance for the Special Defense Acquisition Fund inventory that complies with Statement of Federal Financial Accounting Standards 3.**

b. **Update the Security Assistance Management Manual to require the implementing organizations to report the value and location of Special Defense Acquisition Fund inventory quarterly.**

c. **Work with the Directors of the implementing organizations to develop and implement a comprehensive end-to-end accounting and reporting process for Special Defense Acquisition Fund inventory. The Defense Security Cooperation Agency should require the implementing organizations to report the following attributes quarterly: item quantities, location, identification number, and value. The Defense Security Cooperation Agency should have this information readily available for management and stakeholders.**

d. **Perform annual inspections of DoD and contractor facilities to determine the location, identification numbers, quantities, and values of the inventory on hand.**

e. **Establish definitions for all Special Defense Acquisition Fund collection sources and issue detailed accounting and reporting guidance to the implementing organizations for the transactions.**

#### *Defense Security Cooperation Agency Comments*

The DSCA Director agreed with our recommendations, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller), DFAS, and the implementing organizations, has developed corrective action plans to address the recommendations. The corrective actions include performing quarterly inspections of DoD and contractor facilities to monitor SDAF inventory. The Director plans to implement the corrective actions by December 31, 2019.

### *Our Response*

Comments from the DSCA Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but will remain open. The Director's corrective action plans are adequate to address the recommendations. We will close the recommendations once we verify that the Director has implemented the corrective action plans, which includes developing a comprehensive accounting and reporting process for SDAF inventory.

- **f. Work with the Defense Finance and Accounting Service–Indianapolis Director to:**
    1. **Determine which accounting systems contain Special Defense Acquisition Fund accounting records.**
    2. **Test the completeness and accuracy of the Special Defense Acquisition Fund accounting records in the systems identified.**
    3. **Develop a corrective action plan to remedy any deficiencies identified during testing.**
    4. **Correct the Defense Departmental Reporting System to accept, consolidate, reconcile, and report Special Defense Acquisition Fund accounting records.**
    5. **Analyze all Foreign Military Sales cases dating back to FY 2012 to identify the correct number of lease cases.**
    6. **Analyze all open and closed Foreign Military Sales cases to determine whether the cases were properly coded in accordance with the Security Assistance Management Manual.**

### *Defense Security Cooperation Agency Comments*

The DSCA Director agreed with our recommendations, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller), DFAS, and the implementing organizations, has developed corrective action plans to address the recommendations. For Recommendation A.1.f.6, the Director recommended limiting the review for proper coding to FMS cases implemented since FY 2017. Analyzing cases implemented since 2012, approximately 143,000, would require extensive manpower with minimal benefit. In the event that the DSCA identifies a significant number of FMS cases coded incorrectly during the review, DSCA would be open to expanding the scope of the review. The Director plans to implement the corrective actions by September 30, 2020.

### *Our Response*

Comments from the DSCA Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but will remain open. The Director's corrective action plans are adequate to address the recommendations. Additionally, we agree with the Director's approach to limiting the review for proper coding to FMS cases implemented since FY 2017. We will close the recommendations once we verify that the Director has implemented the corrective action plans.

**7. Recover and transfer into the Special Defense Acquisition Fund all lease payments dating back to FY 2012 that the Defense Finance and Accounting Service did not transfer into the Special Defense Acquisition Fund account.**

### *Defense Security Cooperation Agency Comments*

The DSCA Director did not agree with our recommendation. The Director stated that the DoD and the DSCA Offices of General Counsel agree that the Arms Export Control Act does not authorize the SDAF account to collect offsetting collections for lease payments. The Director stated that Section 51(b) of the Arms Export Control Act specifies that asset use charges are one of several collections that fund the SDAF. Additionally, the Director stated that charges imposed on customers under Section 61 do not constitute asset use charges; therefore, proceeds from such leases may not be used to fund the SDAF.

### *Our Response*

Comments from the DSCA Director did not address the specifics of the recommendation; therefore, the recommendation is unresolved. Section 51(b) of the Arms Export Control Act states that the SDAF shall consist of collections from sales representing the value of asset use charges. An asset use charge is a charge collected on an FMS case when a foreign customer or DoD contractor rents or leases defense articles, but the DoD retains ownership of those articles. The DSCA Office of General Counsel acknowledged that the Arms Export Control Act does not define an asset use charge and did not provide any documentation or reference to documentation that expressly prohibits lease payments from funding the SDAF account. Section 61 of the Arms Export Control Act only provides the authority to lease defense articles. The section does not specify in which account the lease payments are to be recorded.

While we agree that the Arms Export Control Act does not define asset use charge, the DoD FMR, which implements the Arms Export Control Act, states that lease rental payments should be collected and posted to the SDAF account. The DSCA Office of General Counsel did not consider the DoD FMR requirements in its analysis. We request that the Director review the DoD FMR requirements and provide additional comments in response to the final report. The Director should explain how the DSCA will comply with the DoD FMR requirement to collect and post all lease rental payments to the SDAF.

8. **Recover and transfer into the Special Defense Acquisition Fund account all authorized collections dating back to FY 2012 that the Defense Finance and Account Service did not transfer into the Special Defense Acquisition Fund account.**
9. **Develop and implement internal controls to prevent the implementing organizations from improperly coding Foreign Military Sales cases.**

### *Defense Security Cooperation Agency Comments*

The DSCA Director agreed with our recommendations, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller), DFAS, and the implementing organizations, has developed corrective action plans to address the recommendations. The Director's corrective actions include developing and implementing a process to reconcile offsetting collections transferred to the Treasury. The Director plans to implement the corrective actions by September 30, 2020.

### *Our Response*

Comments from the DSCA Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but will remain open. The Director's corrective action plans are adequate to address the recommendations. We will close the recommendations once we verify that the Director has implemented the corrective action plans.

10. **Obtain transaction-level detail for the Accrued Unfunded Annual Leave liability balance for all DoD employees who support the Security Assistance Accounts.**
11. **Develop and implement standard operating procedures, process narratives, and process maps to instruct Defense Finance and Accounting Service personnel on how to record the Accrued Unfunded Annual Leave balance correctly.**
12. **Develop and implement internal controls to ensure that all Accrued Unfunded Annual Leave transactions are recorded completely and accurately.**

### *Defense Security Cooperation Agency Comments*

The DSCA Director agreed with our recommendations, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller), DFAS, and the implementing organizations, has developed corrective action plans to address the recommendations. The Director plans to implement the corrective actions by January 31, 2020.

### *Our Response*

Comments from the DSCA Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but will remain open. The Director's corrective action plans are adequate to address the recommendations. We will close the recommendations once we verify that the Director has implemented the corrective action plans.

# Finding B

## The DSCA and DFAS-Indianapolis Lacked Effective Controls Over Financial Reporting for the SAAs

We determined that DSCA and DFAS-Indianapolis personnel did not have effective controls over financial reporting for the SAAs.[23] Specifically, DSCA and DFAS-Indianapolis personnel did not:

- perform FBWT reconciliations of the SAA accounting records with the SAA balances reported in the Central Accounting and Reporting System;[24]
- document the complete consolidation, reconciliation, and reporting processes for all SAA financial activity in standard operating procedures, process narratives, or process maps as required by the DoD FMR; or
- comply with the mission work agreement established between them.

These conditions occurred because DSCA personnel did not exercise prudent financial management over the SAAs in accordance with DoD Directive 5105.65.[25] Specifically, the DSCA delegated financial management tasks required by the DoD FMR to DFAS-Indianapolis, such as documenting financial processes and performing reconciliations.[26] However, the DSCA did not establish a process for monitoring DFAS-Indianapolis personnel who performed the financial management tasks. Additionally, DSCA and DFAS-Indianapolis personnel did not perform FBWT reconciliations because DFAS-Indianapolis personnel did not design the Defense Departmental Reporting System to collect, reconcile, and report the SAA accounting records.

DSCA and DFAS-Indianapolis need effective controls over financial reporting for the SAAs in order to produce accurate accounting records. The DoD relies on accurate accounting records to prepare budget requests and calculate overhead fees to recover the DoD's operating costs associated with executing the SAAs. Without effective internal controls, the DoD will be unable to determine whether

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23 Effective controls ensure that data recorded in an accounting system and used in a financial report is accurate, complete, and supportable.

24 The Treasury's Bureau of the Fiscal Service uses the Central Accounting and Reporting System to capture and record summary-level information, such as collections and disbursements, and provides agencies with an account statement of their FBWT accounts.

25 DoD Directive 5105.65, "Defense Security Cooperation Agency," October 26, 2012. The Directive delegated financial management responsibility of the SAAs to the DSCA.

26 DoD Regulation 7000.14-R, "DoD Financial Management Regulation." The DoD FMR directs statutory and regulatory financial management requirements, and functions for all appropriated and non-appropriated, working capital, revolving, and trust fund activities.

it is incurring a gain or loss on individual cases on its business transactions with its foreign customers, which may result in DoD appropriations being spent on SAA operations.[27]

## Internal Controls Over Financial Reporting for the SAAs Need Improvement

### *The DSCA and DFAS-Indianapolis Did Not Perform FBWT Reconciliations*

Reconciling the FBWT accounts is a key internal control for maintaining the accuracy and reliability of the FBWT accounts.[28] DSCA and DFAS-Indianapolis personnel did not perform FBWT reconciliations of the SAA accounting records with the SAA balances reported in the Central Accounting and Reporting System.

According to the Treasury Financial Manual, the first step in performing mandatory FBWT reconciliations is to compare balances reported in the Central Accounting and Reporting System with the organizations' general ledger totals.[29] DSCA and DFAS-Indianapolis personnel did not compare balances reported in the Central Accounting and Reporting System with the general ledger totals in accordance with Treasury guidance. According to the DoD FMR, the DSCA and DFAS are jointly responsible for effective FBWT reconciliations.[30] However, DSCA personnel could not provide any documentation indicating that they had performed FBWT reconciliations of the SAAs for September 2017. DSCA personnel stated that they delegated the reconciliation responsibility to DFAS-Indianapolis personnel.

DFAS-Indianapolis personnel did not perform FBWT reconciliations of the DSCA-SAA FBWT accounts. DFAS-Indianapolis personnel copied FBWT balances for the FMS Trust Fund and the SDAF from the Central Accounting and Reporting System and manually entered the balances into the Defense Departmental Reporting System to prepare the DSCA-SAA balance sheet. The FMS and SDAF FBWT balances accounted for $33.8 billion of the $40.2 billion, or 84 percent, of the FBWT balance reported on the DSCA-SAA balance sheet as of September 30, 2017.[31]

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[27] Generally, the foreign customer is responsible for paying for all costs incurred by the DoD to execute the security assistance programs.

[28] The FBWT is an asset account that reflects available funds in the entity's accounts with the Treasury that the entity uses to pay liabilities.

[29] "Treasury Financial Manual," Part 2, Chapter 5100 "Reconciling Fund Balance With Treasury Accounts," March 2012.

[30] DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 4, "Accounting Policy," Chapter 2, "Accounting for Cash and Fund Balances with Treasury," January 2016.

[31] FMS Trust Fund accounted for $33.1 billion and the SDAF accounted for $739.8 million.

According to DFAS-Indianapolis personnel, the SAA balances are not included in the DoD's primary FBWT reconciliation tools for Other Defense Organizations, the Cash Management Report and Department 97 Reconciliation and Reporting Tool.[32]

Without performing reconciliations, DSCA and DFAS-Indianapolis personnel will not be able to identify and resolve differences between accounting records and SAA FBWT balances in the Central Accounting and Reporting System. According to the DoD FMR, all differences identified in the FBWT reconciliation process must be cleared within 60 days. However, DSCA and DFAS-Indianapolis personnel did not resolve all differences within 60 days.

For example, DFAS-Indianapolis personnel reported 14,550 transactions with an absolute value of $474.2 million in the SAAs that had not been reconciled in over 60 days as of September 30, 2017. This means that DoD personnel disbursed or collected funds from or to the SAAs but DSCA and DFAS-Indianapolis personnel were not able to match the transactions to obligating documents (such as a contract) or did not receive the accounting documentation (such as a voucher) for over 2 months. In August 2018, we selected 92 of the 14,550 transactions with an absolute value of $54.3 million that were aged at least 360 days as of September 30, 2017, and requested DSCA and DFAS-Indianapolis personnel to provide evidence that the transactions were resolved. DSCA and DFAS-Indianapolis personnel could not provide evidence that any of the transactions had been resolved. Therefore, the 92 transactions have been unresolved for at least 2 years. This is not the first time the DoD Office of Inspector General has identified this problem for the DSCA. In 2016, the DoD Office of Inspector General reported that the DSCA was not resolving FBWT transactions in a timely manner.[33]

In another example, DFAS personnel made $5.3 billion in adjustments to collection and disbursement balances in the FMS Trust Fund during FY 2017. The Treasury reported the adjustments on the September 30, 2017, FMS Trust Fund Central Accounting and Reporting System account statement. DSCA and DFAS-Indianapolis personnel were unable to provide evidence of review or supporting documentation for any of the $5.3 billion in adjustments. According to the DoD FMR, reconciliation documentation, including support for any adjustments, must be prepared and retained. Additionally, evidence of review and approval for the reconciliation and any adjustment must be contained in the documentation.[34]

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[32] Other Defense Organizations include Defense agencies, Defense-wide appropriations and programs, and trust funds.

[33] Report No. DODIG-2016-064, "Other Defense Organizations and Defense Finance and Accounting Service Controls Over High-Risk Transactions Were Not Effective," March 28, 2016.

[34] DoD Regulation 7000.14-R, "DoD Financial Management Regulation," Volume 4, "Accounting Policy," Chapter 2, "Accounting for Cash and Fund Balances with Treasury," January 2016.

Until these differences are researched and resolved, DSCA and DFAS-Indianapolis personnel cannot be sure that the FBWT universe of transactions is complete and transactions included in the FBWT accounts are valid. Unresolved differences compromise the reliability of FBWT balances and the Treasury's published financial statements. This, in turn, compromises the overall integrity and status of the financial position of the DoD and the U.S. Government. Without an accurate and reliable FBWT balance, the DSCA's spending decisions could result in an over or underutilization of the SAA funds.

DSCA and DFAS-Indianapolis personnel did not perform FBWT reconciliations because DSCA personnel did not exercise prudent financial management over the SAAs in accordance with DoD Directive 5105.65.[35] Specifically, the DSCA delegated the responsibility for performing FBWT reconciliations to DFAS-Indianapolis personnel. However, the DSCA did not establish and implement a process for reviewing the FBWT reconciliations performed by DFAS-Indianapolis personnel. While the DSCA may rely on DFAS to provide assistance, the DSCA is still responsible for monitoring and approving the reconciliations performed by DFAS. Therefore, we recommend that the DSCA Director work with the DFAS-Indianapolis Director to:

- research and resolve at the transaction level each of the transactions aged over 60 days;
- research and resolve each of the adjustments on the FY 2017 SAA Central Accounting and Reporting System statements; and
- develop and implement a FBWT reconciliation process for all of the SAAs. The process should be documented in standard operating procedures, process narratives, and process maps.

We recommend that the DSCA Director review and provide written approval for each:

- reconciliation performed by DFAS-Indianapolis of the SAAs, and
- adjustment made by DFAS-Indianapolis to the SAAs.

Additionally, DSCA and DFAS-Indianapolis personnel did not perform FBWT reconciliations because DFAS-Indianapolis personnel did not design the Defense Departmental Reporting System to collect, reconcile, and report SAA financial activity. DFAS-Indianapolis personnel stated that they did not have access to the SAA accounting records because the accounting records were excluded from the Defense Departmental Reporting System. DFAS-Indianapolis personnel could not explain why the accounting records were excluded from the system.

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[35] DoD Directive 5105.65, "Defense Security Cooperation Agency," October 26, 2012.

Additionally, DFAS-Indianapolis personnel stated that they were unable to collect the accounting records because they did not know which organizations or accounting systems executed and recorded SAA financial activity. However, the DoD FMR identifies each of the implementing organizations; therefore, DFAS-Indianapolis personnel could have coordinated with the implementing organizations to consolidate the accounting records. Therefore, we recommend that the DSCA Director work with the DFAS-Indianapolis Director to make the necessary corrections to the Defense Departmental Reporting System to collect and reconcile data so that the DoD can report all SAA balances in the DoD Agency Financial Report.

## *Lack of Documentation for Financial Reporting Process*

DSCA personnel did not document the complete consolidation, reconciliation, and reporting processes for all SAA financial activity in standard operating procedures, process narratives, or process maps, as required by the DoD FMR. Additionally, the operating procedures must include evidence of dated supervisory review and approval certifying that the documentation is current and accurate.[36]

The DSCA did not have up-to-date process documentation to direct the complete financial reporting process of the SAAs. For example, we requested that DSCA personnel provide all standard operating procedures, process narratives, and maps related to the SAAs. DSCA personnel provided standard operating procedures for six of the nine SAAs—the International Military Education and Training, FMS, and four Foreign Military Financing loan accounts, but none of the procedures showed evidence that DSCA management had reviewed or approved them.

- The International Military Education and Training standard operating procedure provided an overview of the account, roles and responsibilities, and financial systems used for processing transactions. However, the standard operating procedure did not provide any guidance on the consolidation, reconciliation, or reporting of the International Military Education and Training financial activity. Additionally, the standard operating procedure was prepared 7 days after we requested the documentation. The DSCA did not provide any process maps or narratives related to the International Military Education and Training account.
- The FMS standard operating procedure and process map contained instructions for the budget formulation and review process for the administrative fund, but did not contain any details for the consolidation, reconciliation, or financial reporting of the FMS financial activity.

[36] DoD Regulation 7000.14-R, “DoD Financial Management Regulation,” Volume 4, “Accounting Policy,” Chapter 2, “Accounting for Cash and Fund Balance With Treasury,” January 2016.

- The Foreign Military Financing standard operating procedure provided for the four loan accounts included only general background information and instructions for preparing loan packages. The standard operating procedure did not include any information related to the consolidation and reporting of the financial activity.

Without complete process documentation, DSCA personnel may not be able to evaluate weaknesses in their internal controls so DSCA personnel can prevent or detect future errors or misstatements in financial reports. Additionally, this will increase the risk of inconsistencies in the execution of processes and internal controls by DSCA personnel.

The DSCA did not have financial reporting processes documented because DSCA personnel did not exercise prudent financial management over the SAAs in accordance with DoD Directive 5105.65.[37] The DSCA is responsible for the financial management of the SAAs, including complying with the process documentation requirements in the DoD FMR. DSCA personnel delegated responsibility for preparing and maintaining process documentation to DFAS-Indianapolis. However, we determined that DFAS-Indianapolis personnel did not prepare or maintain complete process documentation. Furthermore, DSCA personnel did not establish and implement a process for reviewing or approving the documentation prepared or maintained by DFAS-Indianapolis. While the DSCA may rely on DFAS-Indianapolis to perform accounting and finance functions, it is the DSCA's responsibility to ensure that the process for collecting, reconciling, and reporting financial activity for their SAAs is documented and understandable. Therefore, we recommend that the DSCA Director develop and implement detailed standard operating procedures, process narratives, and process maps for each of the SAAs. The documentation should include the entire life cycle of each transaction within the SAAs, roles and responsibilities, internal controls, and a listing and description of the interfaces with other accounting cycles and systems. DSCA management should review the documentation annually.

### *DSCA and DFAS-Indianapolis Did Not Comply With the Mission Work Agreement*

The DSCA and DFAS-Indianapolis did not comply with the mission work agreement established between them. The DoD FMR requires that the DSCA and DFAS have a written agreement that defines the roles and responsibilities between the DSCA and DFAS. The purpose of the mission work agreement is to describe the work

[37] DoD Directive 5105.65, "Defense Security Cooperation Agency," October 26, 2012.

DFAS performs for the DSCA. The mission work agreement describes performance management and quality assurance metrics, and roles and responsibilities for both the DSCA and DFAS.

According to the mission work agreement, DFAS-Indianapolis personnel are responsible for establishing and documenting procedures to support end-to-end walkthroughs of key processes.[38] The documentation is required to contain process maps, internal controls, and financial reporting objectives for each of the processes. However, DFAS-Indianapolis personnel did not have this documentation available. For example, DFAS-Indianapolis personnel provided standard operating procedures and process narratives related to various SAA tasks, such as billing customers, reconciling FMS transactions in Air Force accounting and finance systems, preparing vendor payments, and preparing the DSCA-SAA financial statements. However, the standard operating procedures and narratives did not completely describe how DFAS-Indianapolis personnel:

- collect all SAA financial activity from the implementing organizations accounting systems, and
- reconcile all SAA financial activity to Treasury records.

DFAS-Indianapolis personnel provided process maps that showed the manual consolidation process of the SAAs, but the maps did not identify whether any internal controls exist throughout the consolidation process, such as controls to verify that DFAS consolidated all SAA balances or whether DFAS management reviewed the consolidation. Additionally, DFAS-Indianapolis personnel did not provide a narrative that explained the consolidation process depicted in the process map. This documentation is important so that management and other stakeholders can ensure a standardized process exists and can be re-performed. Additionally, well-documented processes will assist DSCA and DFAS management in evaluating weaknesses in internal controls so DSCA and DFAS personnel can prevent or detect future errors or misstatements in financial reports.

According to the mission work agreement, DFAS-Indianapolis personnel are responsible for collecting, recording, reconciling, and reporting of all financial transactions related to the SAAs. However, DFAS-Indianapolis personnel did not perform these tasks. For example, DFAS-Indianapolis personnel did not collect accounting records from the implementing organizations accounting systems or attempt to perform FBWT reconciliations of SAA accounting records for the two largest accounts, the FMS Trust Fund and the SDAF.

[38] KDD-DA-17031, "Mission Work Agreement between DFAS and the DSCA," March 13, 2017.

Additionally, DFAS-Indianapolis personnel did not report all financial transactions related to the SAAs, such as inventory and Accrued Unfunded Annual Leave balances as explained in Finding A of this report.

According to the mission work agreement, DFAS-Indianapolis personnel are responsible for managing all transactions that have not been resolved in over 60 days. DFAS-Indianapolis personnel did not manage all of these transactions. DFAS-Indianapolis personnel were unable to provide accounting-level transactions or documentation that the transactions were resolved due to complicated and labor-intensive manual efforts to gather the data. DFAS's decentralized management of these transactions needs to be improved.

According to the mission work agreement, the DSCA is responsible for advising DFAS when the quality, timeliness, extent, nature, or cost of services does not meet the DSCA's expectations. DFAS-Indianapolis did not meet the requirements in the mission work agreement, and the DSCA did not hold DFAS-Indianapolis personnel accountable. We requested that DSCA personnel provide examples of reviews that the DSCA performed of DFAS-Indianapolis work products discussed in the mission work agreement. The DSCA could not provide any examples.

The DSCA and DFAS-Indianapolis did not comply with the mission work agreement because DSCA personnel did not exercise prudent financial management over the SAAs in accordance with DoD Directive 5105.65.[39] Specifically, the DSCA did not establish and implement a process for reviewing the work that DFAS-Indianapolis personnel performed. The DSCA is responsible for the financial management of the SAAs, which includes holding its service provider accountable. If DFAS-Indianapolis cannot perform the tasks required by the DSCA to execute the SAA mission, the DSCA may need to reconsider using DFAS as its service provider. DSCA and DFAS personnel are required to review and update the mission work agreement annually. Therefore, we recommend that the DSCA Director work with the DFAS-Indianapolis Director to:

- review and update the mission work agreement to include detailed performance metrics, roles, and responsibilities; and
- improve the management of overaged transactions so that the data and supporting documentation is available in a single location.

[39] DoD Directive 5105.65, "Defense Security Cooperation Agency," October 26, 2012.

## Conclusion

DSCA and DFAS-Indianapolis need effective controls over financial reporting for the SAAs in order to produce accurate accounting records. The DoD relies on accurate accounting records to prepare budget requests and calculate overhead fees to recover the DoD's operating costs associated with executing the SAAs. Without effective internal controls, the DoD will be unable to determine whether it is incurring a gain or loss on individual cases on its business transactions with its foreign customers, which may result in DoD appropriations being spent on SAA operations.

## Recommendations, Management Comments, and Our Response

### *Revised Recommendation*

As a result of management comments, we revised Recommendation B.1.d.4 to clarify that the Defense Department Reporting System needs to be corrected so that DSCA-SAA balances can be reported in the DoD Agency Financial Report.

### *Recommendation B.1*

**We recommend that the Defense Security Cooperation Agency Director:**

a. **Review and provide written approval for each reconciliation performed by the Defense Finance and Accounting Service–Indianapolis of the Security Assistance Accounts.**

b. **Review and provide written approval for each adjustment made by the Defense Finance and Accounting Service–Indianapolis to the Security Assistance Accounts.**

### *Defense Security Cooperation Agency Comments*

The DSCA Director agreed with our recommendations, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller), DFAS, and the implementing organizations, has developed corrective action plans to address the recommendations. The Director plans to implement the corrective actions by October 1, 2019.

### Our Response

Comments from the DSCA Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but will remain open. The Director's corrective actions plans are adequate to address the recommendations. We will close the recommendations once we verify that the Director has implemented the corrective action plans.

c. **Develop and implement detailed standard operating procedures, process narratives, and process maps for each of the Security Assistance Accounts. The documentation should include the entire life cycle of each transaction within the Security Assistance Accounts, roles and responsibilities, internal controls, and a listing and description of interfaces with other accounting cycles and systems. Defense Security Cooperation Agency management should review the documentation annually.**

d. **Work with the Defense Finance and Accounting Service–Indianapolis Director to:**

   1. **Research and resolve at the transaction level each of the transactions aged over 60 days.**
   2. **Research and resolve each of the adjustments on the FY 2017 Security Assistance Account Central Accounting and Reporting Systems statements.**
   3. **Develop and implement a Fund Balance With Treasury reconciliation process for all of the Security Assistance Accounts. The process should be documented in standard operating procedures, process narratives, and process maps.**
   4. **Make the necessary corrections to the Defense Department Reporting System to collect and reconcile data so that the DoD can report all Security Assistance Account balances in the DoD Agency Financial Report.**

### Defense Security Cooperation Agency Comments

The DSCA Director agreed with our recommendations, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller), DFAS, and the implementing organizations, has developed corrective action plans to address the recommendations. The Director plans to implement the corrective actions by September 30, 2020.

### Our Response

Comments from the DSCA Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but will remain open. The Director's corrective actions are adequate to address the recommendations. We will close the recommendations once we verify that the Director has implemented the corrective action plans.

### Office of the Under Secretary of Defense (Comptroller) Comments

Although not required to comment, the Assistant Deputy Chief Financial Officer for the Office of the Under Secretary of Defense (Comptroller) provided the following comments on Recommendation B.1.d.4. Please see the Management Comments section of the report for the full text of the Assistant Deputy Chief Financial Officer's comments.

The Assistant Deputy Chief Financial Officer for the Office of the Under Secretary of Defense (Comptroller) disagreed with the recommendation for the DSCA and DFAS-Indianapolis to report all SAA balances in the DoD Agency Financial Report. The Assistant Deputy Chief Financial Officer agreed that the SAA balances should be properly reported in the Defense Department Reporting System. However, based on an analysis of Federal Accounting Standards by his office, the DSCA-SAA should be a stand-alone entity and not included in the DoD Agency Financial Report. This will remain the DoD's position unless officially redirected by the Office of Management and Budget and the U.S. Government Accountability Office.

Additionally, in response to Notice of Findings and Recommendation AWC-N0005 described in Appendix C, the Assistant Deputy Chief Financial Officer stated that consolidating the SAA in the DoD Agency Financial Report would not comply with Generally Acceptable Accounting Principles. While the DoD provides support to the Department of State for the execution of the SAAs, it would be misleading to consolidate SAA funding (Title 22) with DoD funding (Title 10) for the benefit of U.S Forces.

### Our Response

We disagree with the Assistant Deputy Chief Financial Officer's statements that the DSCA-SAAs should be a standalone entity and excluded from the DoD Agency Financial Report. Statement of Federal Financial Accounting Standards 47 requires the DoD to consolidate and report on all entities for which they are administratively accountable in the DoD Agency Financial Report.[40] The DoD was assigned administrative responsibilities for the SAAs in the Foreign

[40] Statement of Federal Financial Accounting Standards 47, "Reporting Entity," December 23, 2014.

Assistance Act, Arms Export Control Act, and Executive Orders 12163 and 13637. DoD Directives 5105.65 and 5132.03 established the DSCA as the DoD agency responsible for the execution of all security assistance programs and activities of the DoD. By not consolidating and reporting the financial activity of all of DSCA's security assistance programs, the DoD is not complying with Standard 47 requirements.

The DoD has received guidance from the Office of Management and Budget in Circular A-136, "Financial Reporting Requirements," but the DoD has not complied with the guidance. SAA funds are transferred from the Executive Office of the President to the DoD for execution of the security assistance programs. Once the SAA funds are transferred to the DoD accounts, the DoD disburses the funds to execute SAA related payments, such as contract payments to vendors. The transfer from the Executive Office of the President accounts to DoD accounts is referred to as a parent-child relationship and has been acknowledged by the DoD in the DoD FMR. The Executive Office of the President accounts are considered the parent accounts and the receiving DoD accounts are referred to as the children accounts. According to Office of Management and Budget Circular A-136, the DoD must report all financial activity executed in the children accounts on their financial statements. However, we determined that the DoD does not report any of the activity in the SAA children accounts on their financial statements. Therefore, the DoD is not complying with Office of Management and Budget Guidance Circular A-136.

We disagree that it is misleading to include SAA balances with DoD balances in the DoD Agency Financial report. The Department of State reports SAAs in its Agency Financial Report in accordance with financial reporting requirements, including portions of the Foreign Military Financing and International Military Education and Training balances. It is unclear why the DoD would report the SAA balances differently than the Department of State when the reporting requirements for the SAA accounts are the same. In addition, the DoD reported $5.9 billion in non-entity assets as of September 30, 2018, such as cash and foreign currency.[41] Furthermore, the SAA financial activity is executed in DoD accounting systems and the security assistance programs rely heavily on the DoD to provide acquisition support. According to the FY 2018 DoD Agency Financial Report, the DSCA has improved the management of the FMS program in cooperation with the Office of the Under Secretary of Defense for Acquisition and Sustainment. With statutory responsibility for the FMS program, the DSCA has developed several new performance measures, including FMS milestones and performance targets, which

[41] Non-entity assets are funds for which the DoD is accountable but cannot use for their operations.

are coordinated with the various implementing agencies and geographic combatant commands. It is unclear why the Assistant Deputy Chief Financial Officer would include this information on program improvements in the Management Discussion and Analysis section of the DoD Agency Financial Report if it were misleading to include SAA balances impacted by the program improvements in the DoD Agency Financial Report.

While the U.S Forces do not use the SAA funds, the DoD is responsible for their management, such as ensuring sufficient cash is available to cover the customer's expenses. We are recommending that the Assistant Deputy Chief Financial Officer comply with Standard 47 and Office of Management and Budget Circular A-136 by consolidating the SAA balances with the DoD balances as non-entity assets. We also revised Recommendation B.1.d.4 to clarify that the Defense Department Reporting System needs to be corrected so that DSCA-SAA balances can be reported in the DoD Agency Financial Report.

5. **Review and update the mission work agreement to include detailed performance metrics, roles, and responsibilities.**

### *Defense Security Cooperation Agency Comments*

The DSCA Director agreed with our recommendation. The Director provided the updated mission work agreement, which the DSCA signed on April 1, 2019, in response to our report.

### *Our Response*

Comments from the DSCA Director addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. The Director provided an updated mission work agreement that discusses the intent for the DSCA and DFAS to establish and implement performance measures and targets that DSCA and DFAS will updated annually. The updated mission work agreement included roles and responsibilities; however, it did not include the performance measures. We will close the recommendation once we verify that the Director has established, included, and implemented the performance measures in the mission work agreement.

6. **Improve the management of overaged transactions so that the data and supporting documentation is readily available in a single location.**

### *Defense Security Cooperation Agency Comments*

The DSCA Director agreed with our recommendation, stating that the DSCA, in coordination with the Office of the Under Secretary of Defense (Comptroller), DFAS, and the implementing organizations, has developed a corrective action plan to address the recommendation. The Director plans to implement the corrective action by September 30, 2020.

### *Our Response*

Comments from the DSCA Director addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. The Director's corrective action plan is adequate to address the recommendation. We will close the recommendation once we verify that the Director has consolidated the overaged transactions and supporting documentation in a single location.

# Appendix A

## Scope and Methodology

We conducted this performance audit from March 2018 through May 2019 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.

Our announced objective was to determine whether the DSCA and DFAS implemented effective controls over financial reporting for the FMS Trust Fund. In addition, we were going to determine whether the DSCA and DFAS performed effective reconciliations of the FMS Trust Fund account balances as of September 30, 2017. However, based on observations during the planning phase of the audit, we revised the objectives to determine whether the September 30, 2017, balance sheet for the DSCA-SAAs was accurate. Additionally, we determined whether the DSCA and DFAS implemented effective controls over financial reporting for the SAAs. We notified DSCA and DFAS personnel of the change in the announced objective in July 2018.

To achieve our objective, we observed operations at the DSCA in Arlington, Virginia, and at DFAS in Indianapolis, Indiana, to understand the financial reporting of the SAAs. We reviewed the mission work agreement between the DSCA and DFAS to understand the role and responsibilities in the management and financial reporting of the SAAs. In addition, we received briefings from the DSCA and DFAS-Indianapolis personnel on the description and purpose of the SAAs. We observed operations at Navy facilities in Washington, D.C., Philadelphia, Pennsylvania, and Patuxent River, Maryland, to understand FMS case documentation and closure procedures. We also visited the Letterkenny Munitions Center in Chambersburg, Pennsylvania, to review SDAF inventory procedures. We interviewed key personnel at the Office of the Under Secretary of Defense (Comptroller), the Treasury, the Office of Management and Budget, and the Government Accountability Office to understand the presentation of the SAAs in the DoD Agency Financial Report.

We reviewed the standard operating procedures, process documentation, briefing charts and other documentation related to the consolidation, reconciliation, and financial reporting of the SAAs. We also reviewed applicable public laws, the Federal Financial Accounting Standards, the Treasury Financial Manual, DoD directives and policies, the DoD FMR, and the SAMM. We nonstatistically selected the Inventory, FBWT, and Accrued Unfunded Leave balances to review.

We nonstatistically selected inventory from the September 30, 2017, DSCA-SAA balance sheet because DSCA personnel did not report any inventory on the balance sheet even though the DSCA manages the SDAF inventory. We calculated the unreported inventory amount of $410.7 million by subtracting SDAF sales ($235.6 million) from SDAF procurements ($646.3 million) between FYs 2012 and 2017 for a total of $736 million.[42] DSCA personnel should have reported this amount on the September 30, 2017, DSCA-SAA balance sheet. DSCA personnel provided the data used in our calculation.

We also nonstatistically selected the FBWT balance ($40.2 billion) because it was the largest asset on the balance sheet, representing 39.2 percent of the total assets ($102.5 billion). To determine the $745.5 million FBWT understatement, we deducted the total of collections the DoD recorded in the SDAF account ($506.8 million) from the total of collections recorded in Army, Navy, Air Force, and Other Defense Organizations miscellaneous receipt accounts ($1,242.8 million) between FYs 2012 and 2017 for a total of $736 million.[43] Next, we summed the total of lease payments ($9.5 million) that the DoD received between FYs 2012 and 2017 and added that to the collection total. DFAS-Indianapolis personnel provided the data used in the calculations. According to DFAS-Indianapolis, offsetting adjustments to the miscellaneous receipt accounts could have reduced the $745.5 million understatement. However, DFAS-Indianapolis personnel were unable to provide any supporting documentation for the adjustments. The $745.5 million in available collections that the DSCA and DFAS-Indianapolis did not transfer from DoD Miscellaneous Receipt accounts to the SDAF are funds that could be put to better use, which represent a potential monetary benefit to the DoD.[44]

The Accrued Unfunded Leave balance is part of Note 11, "Other Liabilities," in Appendix A of the FY 2017 DoD Agency Financial Report. DSCA personnel stated that over 1,400 personnel support security assistance programs. We reviewed the Accrued Unfunded Leave balance because the balance ($2.7 million) seemed too small of a balance considering the volume of DoD personnel supporting the SAAs. In response to our data request, DFAS-Indianapolis personnel provided civilian payroll data from a Navy accounting system, which included

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[42] The SDAF was established in 1981 but was inactive between 1993 and 2012. Congress authorized the SDAF to be recapitalized in 2012.

[43] The total understatement is up to $745.5 million. This difference is due to rounding.

[44] DoD Manual 7600.07, "DoD Audit Manual", August 3, 2015, defines funds put to better use as funds that could be used more efficiently when management takes action to implement and complete the recommendation made by the audit organization.

the duplicated accounting entry of $1.3 million.[45] DSCA and DFAS-Indianapolis personnel were unable to provide balances for the Army, Air Force, and Other Defense Organizations.

DFAS-Indianapolis provided the 14,550 transactions used in our calculation of transactions aged over 60 days. Additionally, we calculated the $5.3 billion in adjustments to the FMS Trust Fund from the Treasury's Central Accounting and Reporting System report for FY 2017. We reviewed the FMS Trust Fund adjustments because the FMS Trust Fund is the largest of the SAAs.

## Use of Computer-Processed Data

We used computer-processed data provided by the DSCA and DFAS-Indianapolis. The information provided on the SAAs was submitted by DoD personnel and was processed through various systems, including the Defense Departmental Reporting System and the Defense Integrated Financial System. We validated the reliability of the data by comparing reported SAA balances to the Treasury's Central Accounting and Reporting System balances and to supporting documentation, when available. Additionally, we used data that DFAS-Indianapolis provided, including aged transactions and Accrued Unfunded Annual Leave balances. However, based on our analysis, we determined that the data that the DSCA and DFAS-Indianapolis provided were unreliable as discussed in the report Findings.

## Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) issued five reports discussing the SAAs. During the last 5 years, the DoD Office of Inspector General (DoD OIG) issued two reports discussing the SAAs. Unrestricted GAO reports can be accessed at http://www.gao.gov. Unrestricted DoD OIG reports can be accessed at http://www.dodig.mil/reports.html/.

### *GAO*

Report No. GAO-18-553, "Foreign Military Sales – Financial Oversight of the Use of Overhead Funds Needs Strengthening," July 2018

> The DSCA lacked key information needed to fulfill its financial management responsibility, such as having reliable spending data that could help the DSCA identify trends in the use of funds and inform its budget decisions. The DSCA also was unable to provide reasonable assurance that DoD Components' use of administrative and contract administration services funds is allowable and approved, increasing the risk of the potential fraud, waste, or abuse of these funds.

[45] This amount is $2.7 million due to rounding.

Report No. GAO-18-401, "Foreign Military Sales – Controls Should be Strengthened to Address Substantial Growth in Overhead Account Balances," May 2018

From FYs 2007 to 2017, the balance of the FMS administrative account grew dramatically to $4.1 billion. The DSCA had not performed comprehensive reviews of the administrative fee rate at least every 5 years, consistent with DSCA policy, and had not set an upper bound that would provide a target range for the account. These conditions limited the DSCA's ability to appropriately target the fee rate and to protect against excessive growth in the account balance.

Report No. GAO-18-242, "Foreign Military Sales – DoD Should Take Additional Steps to Streamline Process for Assessing Potential Recovery of Certain Acquisition Costs," January 2018

Within the DoD, there were opportunities to consider streamlining the waiver review process to eliminate efforts that are potentially repetitive or inefficient. The review process for waiver requests requires that multiple offices review all waiver requests, regardless of the amount of nonrecurring costs to be waived or the complexity of the specific circumstances. The FMS program has been criticized for being slow and burdensome. To create efficiencies in the overall FMS program, the DoD could take additional steps to streamline the FMS waivers review process.

Report No. GAO-17-703, "Foreign Military Sales – DoD Needs to Improve Its Use of Performance Information to Manage the Program," August 2017

The DoD implemented reforms designed to improve its capacity to deliver FMS assistance in a timely manner. The DoD needs to improve its performance of the program. Without a comprehensive analysis of the entire FMS process facilitated by the collection of data, the DoD is unable to identify and achieve performance goals and improvement areas.

Report No. GAO-17-682, "Foreign Military Sales – Expanding Use of Tools to Sufficiently Define Requirements Could Enable More Timely Acquisitions," August 2017

The FMS acquisition process continued to be hindered by insufficiently defined requirements that did not fully articulate the desired equipment, training, and other services and can, from the outset, impede timely delivery to FMS customers.

## *DoD OIG*

Report No. DODIG-2018-120, “The Treasury Index 97 Cash Management Report,” May 23, 2018

The DoD OIG determined that the September 2016 Cash Management Report was not complete, accurate, or supported by the details necessary for the Other Defense Organizations to perform FBWT reconciliations. DFAS-Indianapolis personnel excluded 69 appropriations from the Cash Management Report that were reported in the Central Accounting and Reporting System. Additionally, DFAS-Indianapolis personnel did not report $3.6 billion in financial activity for the Defense Working Capital Fund. DFAS-Indianapolis personnel made unsupported adjustments of $322.6 million to FBWT accounts to resolve differences identified while reconciling the Cash Management Report. DFAS-Indianapolis reported an absolute amount of $11 billion in unidentified limits on the Cash Management Report; therefore, the Other Defense Organizations did not have the details needed to perform FBWT reconciliations.

Report No. DODIG-2016-064, “Other Defense Organizations and Defense Finance and Accounting Service Controls Over High-Risk Transactions Were Not Effective,” March 28, 2016

The DoD OIG determined that controls were not effective to ensure the accurate and timely update of Other Defense Organization expenditures that DFAS identified as problem disbursements. Other Defense Organizations and DFAS personnel did not have a universe of detail-level transactions for problem disbursements that were accurate and complete. Additionally, Other Defense Organization personnel did not always meet established metrics related to the timely correction and posting or reduction of high-risk transactions to the FBWT.

# Appendix B

## Foreign Military Sales Process

The FMS process begins when a foreign customer submits a letter of request to the U.S. Government. The Department of State and DoD personnel, including personnel from the DSCA and the implementing organization, will evaluate and respond to the customer's request, and will begin to coordinate with the customer to create a letter of offer and acceptance.

An FMS case begins when the customer signs the letter of offer and acceptance and provides the initial deposit of funds to DFAS. The U.S. Treasury holds these funds at the Federal Reserve and commercial bank accounts. DFAS releases obligation authority to the implementing organization responsible for the FMS case so that the implementing organization may begin to incur legally binding financial obligations against the case.

Foreign customers make payments into the FMS Trust Fund based on quarterly billing statements that DFAS-Indianapolis provides. Under the DSCA's oversight, DFAS ensures that sufficient cash is available from the foreign customer to cover accrued expenditures, costs to be incurred during the remainder of the quarter, and costs to be incurred during the next quarter.

During the execution phase, the DoD pays contractors using one of two methods.

- Direct Cite: The contractors are paid directly from the FMS Trust Fund.
- Reimbursement: The implementing organization pays the contractor using its own appropriated funds, and then submits a request to DFAS for reimbursement of those funds from the FMS Trust Fund.

The implementing organization personnel begin case closure procedures once they have determined that all articles and services have been delivered to the foreign customer. During this phase, the implementing organization, DFAS, and the foreign customer reconcile the accounting records. The implementing organization fulfills its case requirements when it sends the case closure certificate to DFAS. DFAS then issues the final bill to the customer.

# Appendix C

## DSCA-SAA Financial Reporting Entity

The Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards 47, "Reporting Entity," became effective on October 1, 2017. This standard requires Component reporting entities, such as the DoD, to consolidate and report on all entities for which they are accountable. Statement of Federal Financial Accounting Standards represent generally accepted accounting principles for federal reporting entities of the U.S. Government, and financial statement audits assess whether financial statements are presented in accordance with generally accepted accounting principles.

The Under Secretary of Defense (Comptroller)/Chief Financial Officer did not consolidate the DSCA-SAA reporting entity into the FY 2017 DoD Agency-Wide Basic Financial Statements. Instead, the Under Secretary of Defense (Comptroller)/Chief Financial Officer reported the financial activity for the DSCA-SAA reporting entity in an Appendix to the FY 2017 DoD Agency Financial Report. Since 2008, the DSCA-SAA financial statements have not been audited and have been presented in an Appendix to the DoD Agency Financial Report, rather than consolidated with the DoD Agency-Wide Basic Financial Statements. However, in FY 2018 the Under Secretary of Defense (Comptroller)/Chief Financial Officer did not include the DSCA-SAA reporting entity in the FY 2018 DoD Agency-Wide Basic Financial Statements or Appendixes. Instead, the DSCA-SAA reporting entity was consolidated directly into the FY 2018 Financial Report of the U.S. Government.

By not consolidating the DSCA-SAA reporting entity, the Under Secretary of Defense (Comptroller)/Chief Financial Officer is not presenting the DoD Agency Financial Report in accordance with the generally accepted accounting principles contained in Statement of Federal Financial Accounting Standards 47. Furthermore, by excluding the DSCA-SAA reporting entity, the DoD is not accepting financial accountability for its assigned security assistance programs. We issued Notice of Finding and Recommendation AWC-N0005 to address this material weakness with management.

# Management Comments

## Defense Security Cooperation Agency Comments

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

MAR 2 8 2019

MEMORANDUM FOR INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE

SUBJECT: Response to Audit of the Defense Security Cooperation Agency-Security Assistance Accounts (Project No. D2018-D000FP-0115.000)

Thank you for the opportunity to respond to the March 13, 2019, "Audit of the Defense Security Cooperation Agency Security Assistance Accounts, Draft Report." As you know, in the 47 years since the Defense Security Cooperation Agency (DSCA) was founded, our Security Assistance Accounts' (SAA) financial statements have never been audited. As an organization, we value transparency and integrity, and as such, we appreciate any opportunity to learn how we can improve our financial and accounting practices across the entire security cooperation community.

I concur with the two identified findings and 25 of the 26 associated recommendations. DSCA and the Defense Finance and Accounting Service developed seven Corrective Action Plans (CAPs) to fully remediate the deficiencies by September 30, 2020. The details of the CAPs and the nature of my non-concurrence on one of the recommendations are included in Attachment A. I am pleased to see that many of your findings are consistent with those DSCA self-identified through discovery efforts and self-reported to the Inspector General of the Department of Defense at the onset of the audit.

The Department of Treasury identified the SAA as material to the United States Government Financial Statements in Fiscal Year (FY) 2015, requiring the SAA to undergo a financial statement audit. Prior to this determination, DoD considered the SAA out-of-scope for Title 10 audit efforts, which resulted in the SAA not benefitting from the significant advancements, best practices, and improvements DoD achieved during the 13-year preparation for the Title 10 audit. However, I have mandated that the security cooperation community leverage the work accomplished in preparing for the Title 10 audit to ready the SAA for audit in FY 2022, a deadline the Office of the Under Secretary of Defense Comptroller, the Department of Treasury, and the Office of Management and Budget have approved.

As you have pointed out, accurate financial management and reporting underpin effective execution of the security cooperation mission. I agree, and have made remediating all identified findings a top priority for not only DSCA, but the entire community. DSCA developed a master audit schedule for audit preparation activities, which includes remediation activities across six lines of effort to ready the entire community for audit. We have also implemented additional measures including, but not limited to, conducting periodic limited-scope examinations, establishing an audit infrastructure, and assessing information technology system controls. I

## Defense Security Cooperation Agency Comments (cont'd)

have also established a three-tiered Audit Governance Structure to provide oversight of these efforts at the strategic, operational, and administrative levels.

Thank you again for providing valuable feedback over the course of this audit. Your report both validated our ongoing approach and provided recommendations that will continue to advance the auditability of the SAA. We will continue to embrace the findings and we will fix the problems.

Charles W. Hooper
Lieutenant General, USA
Director

Attachment: As stated

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# Defense Security Cooperation Agency Comments (cont'd)

## Attachment A. DSCA Response to Department of Defense Inspector General (DoDIG) Issued Recommendations

The DoDIG audit of the Defense Security Cooperation Agency's (DSCA's) Fiscal Year 2017 Security Assistance Account (SAA) Financial Statement (Project No. D2018-D000FP-0115.000) resulted in two findings and 26 recommendations. DSCA concurs with both findings and 25 of 26 recommendations.

DSCA, in coordination with the Defense Finance and Accounting Service (DFAS), Office of Under Secretary of Defense (Comptroller) (OUSD(C)), and the Implementing Agencies (IAs), has developed seven (7) Corrective Actions Plans (CAPs) to remediate the two identified findings. The following matrix represents the corresponding CAP for each recommendation.

| Recommendation | Recommendation Summary | CAP Number | OPR | Implementation Date |
|---|---|---|---|---|
| A.1.a | Provide the Implementing Agencies (IAs) with detailed accounting and reporting guidance for the SDAF inventory that complies with Statement of Federal Financial Accounting Standards (SFFAS) 3. | 1 | DSCA | 12/31/2019 |
| A.1.b | Update the Security Assistance Management Manual (SAMM) to require the IAs to report the value and location of Special Defense Acquisition Fund (SDAF) inventory quarterly. | 1 | DSCA | 12/31/2019 |
| A.1.c | Work with the IAs to develop and implement a comprehensive end-to-end accounting and reporting process for SDAF inventory. The DSCA should require the IAs to report the following attributes quarterly: item quantities, location, identification number, and value. | 1 | DSCA | 12/31/2019 |
| A.1.d | Perform annual inspections of DoD and contractor facilities to determine the location, identification numbers, quantities, and values of the inventory on hand. | 1 | DSCA | 12/31/2019 |
| A.1.e | Establish definitions for all SDAF Fund collection sources and issue detailed accounting and reporting guidance to the IAs. | 1 | DSCA | 12/31/2019 |
| A.1.f.1 | Determine which accounting systems contain SDAF accounting records. | 2 | DFAS/DSCA | 9/30/2020 |
| A.1.f.2 | Test the completeness and accuracy of the SDAF accounting records in systems identified. | 2 | DFAS/DSCA | 9/30/2020 |
| A.1.f.3 | Develop a corrective action plan to remedy any deficiencies identified during testing. | 2 | DFAS/DSCA | 9/30/2020 |
| A.1.f.4 | Correct the Defense Departmental Reporting System (DDRS) to accept, consolidate, reconcile, and report SDAF accounting records. | 2 | DFAS/DSCA | 9/30/2020 |
| A.1.f.5 | Analyze all Foreign Military Sales (FMS) cases dating back to FY 2012 to identify the correct number of lease cases. | 2 | DSCA | 4/01/2019 **CLOSED** |
| A.1.f.6 | Analyze all open and closed FMS cases to determine whether the cases were properly coded in accordance with the SAMM. | 2 | DSCA | 9/30/2020 |
| A.1.f.6 **(Revised)** | Work with the Implementing Agencies to analyze all open and closed Foreign Military Sales cases, to include lease cases, implemented | 2 | DSCA | 9/30/2020 |

# Defense Security Cooperation Agency Comments (cont'd)

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|---|---|---|---|---|
| | since FY 2017 to determine whether the cases were properly coded in accordance with the Security Assistance Management Manual (SAMM). | | | |
| A.1.f.7 | Recover and transfer into the SDAF account all lease payments dating back to FY 2012 that the DFAS did not transfer into the SDAF. | **NON-CONCUR** | | |
| A.1.f.8 | Recover and transfer into the SDAF account all authorized collections dating back to FY 2012 that DFAS did not transfer into the SDAF account. | 2 | DFAS/DSCA | 9/30/2020 |
| A.1.f.9 | Develop and implement internal controls to prevent the IAs from improperly coding FMS cases. | 2 | DFAS/DSCA | 9/30/2020 |
| A.1.f.10 | Obtain transaction-level detail for Accrued Unfunded Annual Leave liability balance for all DoD employees who support the SAAs. | 3 | DFAS | 1/31/2020 |
| A.1.f.11 | Develop and implement standard operating procedures (SOP), process narratives, and process maps to instruct DFAS personnel on how to record the Accrued Unfunded Annual Leave balance correctly. | 3 | DFAS | 1/31/2020 |
| A.1.f.12 | Develop and implement internal controls to ensure that all Accrued Unfunded Annual Leave transactions are recorded completely and accurately. | 3 | DFAS | 1/31/2020 |
| B.1.a | Review and provide written approval for each reconciliation performed by DFAS of the SAA. | 4 | DSCA | 10/1/2019 |
| B.1.b | Review and provide written approval for each adjustment made by DFAS to the SAA | 4 | DSCA | 10/1/2019 |
| B.1.c | Develop and implement detailed SOPs, process narratives, and process maps for each of the SAA Treasury Accounts. The documentation should include the entire life cycle of each transaction within the SAA roles and responsibilities, internal controls, and a listing and description of interfaces with other accounting cycles and systems. DSCA management should review the documentation annually. | 5 | DSCA | 9/30/2020 |
| B.1.d.1 | Research and resolve at the transaction level each of the FBwT transactions aged over 60 days. | 6 | DFAS | 9/30/2020 |
| B.1.d.2 | Research and resolve each of the adjustments on the FY 2017 SAA Treasury Central Accounting and Reporting Systems statements. | 6 | DFAS | 9/30/2020 |
| B.1.d.3 | Develop and implement a Fund Balance with Treasury reconciliation process for all of the SAA. The process should be documented in SOPs, process narratives, and process maps. | 6 | DFAS | 9/30/2020 |
| B.1.d.4 | Make the necessary corrections to DDRS to collect, reconcile, and report all SAA balances. | 6 | DFAS | 9/30/2020 |
| B.1.d.5 | Review and update the mission work agreement to include detailed performance metrics, roles, and responsibilities. | 7 | DSCA/DFAS | 4/01/2019 **CLOSED** |
| B.1.d.6 | Improve the management of overaged transactions so that the data and supporting documentation is readily available in a single location. | 6 | DFAS | 9/30/2020 |

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# Defense Security Cooperation Agency Comments (cont'd)

## Finding A. The September 2017 DSCA-SAA Balance Sheet Misstated Assets and Liabilities.

**Recommendations A.1.f.7**

- A.1.f.7: "Recover and transfer into the Special Defense Acquisition Fund account all lease payments dating back to FY 2012 that the Defense Finance and Accounting Service did not transfer into the Special Defense Acquisition Fund account.

**DSCA Response: Non-concur.** On March 26, 2019, the DoD Office of General Counsel concurred with the legal determination of the DSCA Office of General Counsel that the Arms Export Control Act (AECA) of 1976 (Title II of Public Law 94–329, 90 Stat. 729, enacted June 30, 1976, codified at 22 U.S.C. Chapter 39) does not authorize the Special Defense Acquisition Fund (SDAF) account to collect offsetting collections for lease payments. Specifically, Section 51(b) of the AECA specifies that asset use charges are one of several collections that make up the SDAF. However, charges imposed on Foreign Military Sales (FMS) customers under Section 61 do not constitute asset use charges and therefore, proceeds from such leases may not be used to capitalize the SDAF.

## Finding A. Recommendations

**DSCA Response**: Concur. DSCA, DFAS, and IAs have developed the below three (3) CAPs to remediate and implement recommendations. Additionally, based on the further discussion with the DoDIG regarding Recommendation A.1.5.f, DSCA has closed this recommendation and consolidated remediation efforts in the below revised language for Recommendation A.1.f.6. After initial analysis, DSCA recommends limiting a review for proper coding to FMS Cases implemented since FY 2017. FMS Cases implemented since FY 2017 account for over 44 percent of all Undelivered Value. Assuming a two-hour review per LOA, a review of all open and closed FMS Cases (~143,000) as proposed by the DoDIG would require extensive manpower with minimal benefit expected. In the event that DSCA identifies a significant number of FMS Cases coded incorrectly during our proposed limited review in which we will report to the DoDIG, we would be open to expanding the scope of the review. Remediation efforts are included in Corrective Action Plan (CAP) #2.

**Revised Recommendation for A.1.f.6:**

- Work with the Implementing Agencies to analyze all open and closed Foreign Military Sales cases, to include lease cases, implemented since FY 2017 to determine whether the cases were properly coded in accordance with the Security Assistance Management Manual (SAMM).

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## Defense Security Cooperation Agency Comments (cont'd)

**CAP #1**
**Planned Implementation Date: 12/31/2019**

**To implement this CAP, DSCA will:**

- Release formal signed guidance to require Implementing Agencies to report inventory quarterly that include National Stock Number (NSN), location of physical inventory, and value in accordance with Statements of Federal Financial Accounting Standards (SFFAS-3);
- Develop process for quarterly inspection of DoD and contractor facilities to determine the location, identification number, quantities, and values of the inventory on hand;
- Perform first quarterly inspection of DoD and contractor facilities;
- Review and update the Security Assistance Management Manual (SAMM), and other applicable financial management regulations, to clarify/update SDAF inventory guidance. Updated guidance should include requirement for applicable IAs to report the value and location of SDAF inventory quarterly;
- Review and update the SAMM, and DoD Financial Management Regulation (FMR), to clarify/update SDAF for all sources of funding collections; and
- Issue detailed accounting and reporting guidance to the IAs for these collections. Guidance should also clarify if authorized collection sources are required/not required to be collected and deposited into SDAF.

**CAP #2**
**Planned Implementation Date: 09/30/2020**

**To implement this CAP, DFAS/DSCA will:**

- (DFAS) Determine which accounting systems contain SDAF accounting records;
- (DFAS) Test the completeness and accuracy of the SDAF accounting records in the systems identified;
- (DFAS) Develop a corrective action plan to remedy any deficiencies identified during testing;
- (DFAS) Correct the Defense Departmental Reporting System (DDRS) to accept, consolidate, reconcile, and report SDAF accounting records;
- (DSCA) Work with the Implementing Agencies to analyze all open and closed Foreign Military Sales cases, to include lease cases, implemented since FY 2017 to determine whether the cases were properly coded in accordance with the Security Assistance Management Manual (SAMM);
- (DFAS) Recover and transfer into the SDAF account all authorized collections dating back to FY 2012 that DFAS did not transfer into the SDAF account;
- (DFAS) Develop and implement a process to reconcile offsetting collections transferred to the Treasury; and
- (DSCA) Develop and implement clarifying guidance and internal controls to prevent the implementing organizations from improperly coding FMS cases.

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# Defense Security Cooperation Agency Comments (cont'd)

**CAP #3**
**Planned Implementation Date: 01/31/2020**

**To implement this CAP, DFAS will:**

- Obtain transaction-level detail for the Accrued Unfunded Annual Leave liability balance for all DoD employees supporting SAA;
- Develop and implement standard operating procedures (SOP), process narratives, and process maps to correctly record the Accrued Unfunded Annual Leave balance; and
- Develop and implement internal controls to ensure all Accrued Unfunded Annual Leave transactions are recorded completely and accurately.

## Finding B. The DSCA and DFAS-Indianapolis Lacked Effective Controls Over Financial Reporting for SAAs.

## Finding B. Recommendations

**DSCA Response**: Concur. DSCA, DFAS, and IAs have developed the below four (4) CAPs to remediate and implement recommendations. Many of these milestones were underway prior to the DoDIG's report, and DSCA, DFAS, and the IAs have already made significant progress on remediating Finding B.

**CAP #4**
**Planned Implementation Date: 10/01/2019**

**To implement this CAP, DSCA will:**

- Review and provide written approval for each reconciliation performed by the DFAS-Indianapolis of the SAA; and
- Review and provide written approval for each adjustment performed by the DFAS-Indianapolis of the SAA.

**CAP #5**
**Planned Implementation Date: 09/30/2020**

**To implement this CAP, DSCA will:**

- Develop and implement detailed SOPs, process narratives, and process maps for each of the SAA. The documentation should include the entire life cycle of each transaction within the SAA, roles and responsibilities, internal controls, and a listing and description of interfaces with other accounting cycles and systems. DSCA management should review the documentation annually.

**CAP #6**
**Planned Implementation Date: 09/30/2020**

**To implement this CAP, DFAS will:**

- Research and resolve at the transaction level each of the Fund Balance with Treasury (FBwT) transactions aged over 60 days;

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# Defense Security Cooperation Agency Comments (cont'd)

- Research and resolve each of the adjustments on the FY 2017 SAA Treasury Central Accounting Reporting System (CARS) statements;
- Develop and implement a FBwT reconciliation process for all of the SAA. The process should be documented in SOPs, process narratives, and process maps;
- Develop and implement a FBwT beginning balance reconciliation;
- Make the necessary corrections to DDRS to collect, reconcile, and report all SAA balances in the SAA Agency Financial Report (AFR); and
- Improve the management of overaged transactions so that the data and supporting documentation is readily available in a single location.

**CAP #7**
**Closed Date: 4/01/2019**

- On April 1, 2019, DSCA and DFAS signed the updated the Mission Work Agreement (MWA) to include detailed performance metrics, roles, and responsibilities.

## OUSD(C) Response to DoDIG Notice of Findings and Recommendations (NFR) AWC-N005

On January 18, 2019, the Office of Defense Chief Financial Officer (ODCFO) non-concurred with the DoDIG NFR AWC-N005, "Incorrect Interpretation and Application of SFFAS 47, "Reporting Entity", and provided its position in the following paragraph:

"OUSD(C) non-concurs with the recommendation. Consolidating the SAA reporting entity in the DoD Agency-Wide Basic Financial Statements would not comply with Generally Accepted Accounting Principles (GAAP) and would materially overstate assets and liabilities. While DoD provides support to the Department of State (DOS) for the execution of the SAA, it would be misleading to consolidate Title 22 Foreign Relations and Intercourse funding with Title 10 U.S. Armed Forces funding made available by the Arms Services Committee for the benefit of U.S. Forces."

## DSCA Response to DoDIG Comment: "Additionally, we identified $745.5 million in potential monetary benefit."

DSCA does not agree with the DoDIG's methodology and calculation that determined a $745.5 million potential monetary benefit to the DoD. While the SDAF is legally authorized to collect funds into the parent account (11X 4116), known as offsetting collections pursuant to criteria identified in Section 51(b) of the AECA, it is not a requirement to move all collections into SDAF.

- The DoDIG's methodology only accounted for funds that were deposited into the U.S. Treasury miscellaneous receipts account and did not account for the offsetting reductions to the account, resulting in an unsubstantiated position. Additionally, the $745.5 million

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## Defense Security Cooperation Agency Comments (cont'd)

calculation incorrectly included lease payments that are not authorized for collection into SDAF, as referenced in the legal opinions received from both the DSCA and DoD Offices of General Counsel on March 26, 2019 (see response to non-concur recommendation A.1.f.7). DSCA and DFAS are working to implement CAP #2 that will reconcile offsetting collections transferred to the Treasury.

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## Office of the Under Secretary of Defense (Comptroller)

**Final Report Reference**

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

APR 0 2 2019

MEMORANDUM FOR INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE

SUBJECT: Response to Audit of the Defense Security Cooperation Agency-Security Assistance Accounts (Project No. D2018-D000FP-0115.000)

Thank you for providing the draft report for review and official comments. The Department appreciates the opportunity to clarify our position.

The Office of Under Secretary of Defense (Comptroller) (OUSD(C)) response to Notice of Finding and Recommendation AWC-N0005, referenced in Appendix C, is the official position of the Department. Recommendation B.1.d.4 requests the Defense Department Reporting System (DDRS) to collect, reconcile, and report all Defense Security Cooperation Agency-Security Assistance Account (DSCA-SAA) balances in the Department of Defense (DoD) Agency Financial Report (AFR).

**Revised Recommendation B.1.d.4**

OUSD(C) agrees DSCA-SAA balances should be properly reported in DDRS. However, based on an analysis of Federal Accounting Standards, we have concluded DSCA-SAA should be designated a stand-alone entity and not included in the DoD AFR. This will remain the Department's position unless officially redirected by the Office of Management and Budget and the U.S. Government Accountability Office. As such, OUSD(C) does not concur with recommendation B.1.d.4.

My action officer for this matter is [redacted] who can be reached at: [redacted]

D. A. Glenn
Douglas A. Glenn
Assistant Deputy Chief Financial Officer

cc:
Director, Defense Security Cooperation Agency
Director, Defense Finance and Accounting Service

# Acronyms and Abbreviations

| | |
|---|---|
| **DFAS** | Defense Finance and Accounting Service |
| **DSCA** | Defense Security Cooperation Agency |
| **FBWT** | Fund Balance With Treasury |
| **FMR** | Financial Management Regulation |
| **FMS** | Foreign Military Sales |
| **SAA** | Security Assistance Account |
| **SAMM** | Security Assistance Management Manual |
| **SDAF** | Special Defense Acquisition Fund |

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