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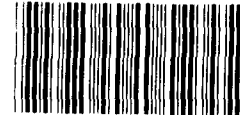
GAO

Report to the Chairman, Subcommittee on
Europe and the Middle East, Committee
on Foreign Affairs, House of
Representatives

April 1988

NATO

U.S. Contributions to
the Airborne Early
Warning and Control
Program



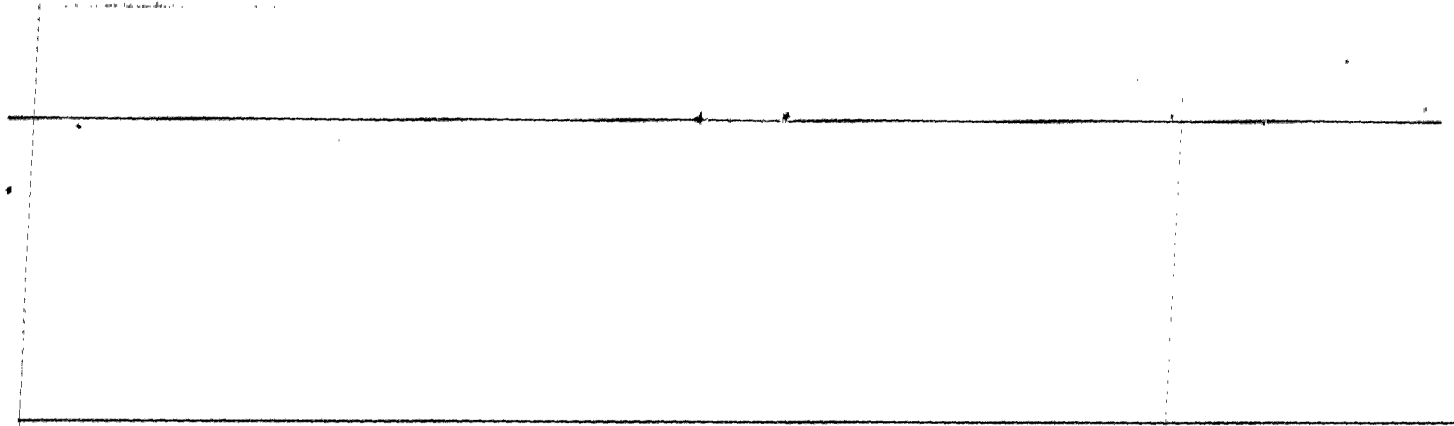
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**National Security and
International Affairs Division**

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April 14, 1988

The Honorable Lee H. Hamilton
Chairman, Subcommittee on Europe
and the Middle East
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

In response to your request, we are providing you our report on the financial controls over U.S. contributions to the North Atlantic Treaty Organization (NATO) Airborne Early Warning and Control Program. The objective of our review, was to determine whether U.S. performance in this program was consistent with the Multilateral Memorandum of Understanding establishing the program and with U.S. laws and regulations covering contributions to such multilateral efforts.

We found that the United States and other participating countries provided contributions to the NATO Program Management Agency (NAPMA) in advance of specific funding requirements. NAPMA deposited these contributions in commercial, interest-bearing accounts. As a result, the program earned approximately \$250 million on participating nations' contributions. We estimate that as much as \$80 million in interest earnings could be attributed to U.S. contributions which were made until 1985. According to Department of Defense (DOD) and NATO officials, all interest earnings have been committed for original program requirements or for payment of outstanding claims.

Funds contributed to an international organization lose their character as federal funds once they are contributed; therefore, they are not subject to the usual statutory requirements and restrictions imposed on the U.S. government for federal funds. We found no other statutory requirements or restrictions dealing with the use or disposition of U.S. funds contributed to NAPMA. While we found that no U.S. laws were violated, the Treasury Department's policies and procedures for providing funds to international organizations were not adhered to. The U.S. government's policy is not to provide funds to any international organization until required for specific, immediate funding requirements. Treasury guidelines state that all U.S. funding should be obtained by appropriation and that interest on U.S. contributions cannot be used to augment international programs but must be returned to the Treasury.

Air Force (the program's executive agent for DOD) and Treasury officials were aware of the interest accumulation on U.S. contributions early in the program. However, U.S. representatives did not request that NAPMA adjust or delay its requests for contributions from the United States or support efforts to identify interest attributable to U.S. contributions so that it could be returned.

U.S. representatives to the Board of Directors of the NATO Programs Management Organization stated that retaining and using the interest for program purposes were necessary to ensure the program's success. Summary financial information on the program provided to Congress did not contain information concerning the accumulation and use of interest.

Background

In the early 1970s, NATO decided to procure an early-warning system to counter the increasing low-level threat from aircraft over both land and sea. The United States and 12 other participating NATO countries signed a 1978 Multilateral Memorandum of Understanding establishing the Airborne Early Warning and Control Program. The memorandum recorded the basic national understandings on such items as aircraft numbers, facilities, aircraft configuration, acquisition costs, operation and support costs, cost sharing, procurement schedule, financial management, and other government services. The primary goals of the program were to procure 18 E-3A Boeing 707 surveillance aircraft, modify 40 ground radar sites in Europe, and activate main and forward operating bases and locations.

The 18 aircraft were delivered to NATO by 1985. The program should be completed by the early 1990s. Total program costs are about \$3 billion; U.S. contributions, which ended in 1985, totaled approximately \$1.3 billion.

Program Management

Concurrent with signing the Memorandum of Understanding, the participating governments established the NATO Program Management Organization to plan, control, supervise, and implement the program. The organization is comprised of a Board of Directors and NAPMA. Each participating government has representatives on the Board with adequate status and authority to make decisions. Unanimity is required of the Board for all general policy decisions and for decisions involving financial commitments on the part of the participating governments. The

Board is also supported by several committees. NAPMA, under the direction of a general manager, is responsible for the day-to-day operations of the program, including the acquisition and support effort.

U.S. management of the program is carried out by the Air Force, which provided the executive agent for DOD and representatives to the NATO Program Management Organization Board. The U.S. Treasury Department, which acts as the cash management advisor to the Air Force, established financial accounts and guidelines to disperse funds from the United States to NAPMA.

Financial Arrangements Governing Participating Nations' Contributions

Under the Memorandum of Understanding, participating nations were to provide timely contributions based on an estimated schedule of funding requirements as adjusted for inflation and updated NAPMA financial plans. The schedule shows the funds each country was to provide for aircraft, the ground environment component, facilities, administration, and operations and support. The U.S. share of costs ranged from about 27 percent for the ground environment component to 44 percent for aircraft acquisition. The NATO Program Management Organization financial plans were to identify all anticipated quarterly expenditures, which were to be updated at least annually. The memorandum, as supplemented by NAPMA's Financial Procedures, required the NAPMA financial officer to maintain minimum cash balances and to adjust requests for national contributions in line with actual cash requirements.

Prior to the signing of the memorandum, a Treasury official sent a letter to the Air Force stating that the U.S. share of funding for the NATO Airborne Early Warning and Control Program should remain in the Treasury until payments were needed to meet program expenditures and that the U.S. government's share of the funding should be provided by direct appropriations rather than by interest earnings on prior U.S. contributions. In 1979, the Treasury incorporated these requirements for government agencies in its "Principles and Guidelines for Financial Transactions with Foreign Nations and International Organization."¹ These principles were based on the premises that U.S. dollars should be retained in the Treasury as long as possible to minimize interest costs on the public debt, interest on U.S. government contributions should not be used to subsidize international program activities, and arrangements

¹The principles were formally promulgated in the Treasury Fiscal Requirements Manual for the Guidance of Departments and Agencies (now called the Treasury Financial Manual) in 1980. See volume 1, part 6, section 8065, of the Manual, entitled "Restrictions on Financial Transactions With Foreign Countries and International Organizations."

with international organizations should accommodate the financial policies and procedures of each participating nation to the maximum extent feasible.

These principles formed the basis of a December 1979 Memorandum of Agreement between the Air Force, the Treasury, and NAPMA for providing U.S. contributions to the Airborne Early Warning and Control Program. According to the memorandum, U.S. contributions would go to a non-interest bearing Treasury account before disbursement to NAPMA and funds would not be provided until needed by NAPMA. The memorandum further stipulated that the NATO Program Management Organization Board would determine if interest had been earned on national contributions. If there was any interest on the contributions of the participating governments, interest earned on U.S. contributions would be returned to the U.S. government on a semiannual basis.

In the following month, January 1980, these principles were further emphasized by Treasury in a letter to the Air Force. The letter also stated that the U.S. position in a forthcoming meeting of the NATO Program Management Organization committee should be that, since all funds required to support the program must be appropriated, any interest amounts should be identified and the U.S. government's share should be returned to the Treasury.

Contributions Provided to NAPMA Exceeded Immediate Needs

In the early years of the program, cash requirements were substantially less than originally estimated due in part to inaccurate forecasts and a lag in contract execution. Nevertheless, NAPMA's calls for funds from the United States and other participating nations were based on the original estimated schedule adjusted only for inflation. Updated NAPMA financial plans were not used as a basis to adjust the national call for funds as required by the Memorandum of Understanding. DOD officials stated that the contribution schedule was fixed in accordance with projected expenditure profiles. The Chairman of the NATO Program Management Organization's Board of Directors said the contribution schedule was not revised in line with forecasted requirements because it would not have been possible to reach agreement among all members. He also said most of the decisions concerning program contributions required a unanimous agreement and many times a less than optimal solution was agreed on to obtain the consensus of all nations. The Chairman added that major financial problems often threatened the program's existence and continuation.

We do not know if agreement could have been reached to revise the contribution schedule, but we found no evidence of efforts to do so. As a result, from the end of 1979 to the end of 1981, NAPMA's cash balances increased from about \$110 million to about \$321 million. During these years, U.S. contributions (in accordance with the Memorandum of Understanding) were about 61 percent of the total funds contributed. In subsequent years the U.S. percentage of contributions decreased, and that of the other major contributor (Germany) increased.

As early as 1979 and in subsequent reports, the NATO Board of Auditors called attention to NAPMA's large cash balances and interest earnings and the need to adjust future requests for funds. The auditors also stated that NAPMA, by requesting funds in advance of needs was not adhering to the Memorandum of Agreement with the United States. The Board did not act on the auditors' recommendations to adjust contributions. NAPMA continued to withdraw funds from the Treasury account for U.S. contractor payments and for deposits to commercial interest-bearing accounts. As a result, NAPMA accumulated large cash balances, and significant interest was being earned on U.S. as well as other participating nations' contributions.

In their official oral comments on our report, DOD officials stated that U.S. contributions were not excessive and that the release of funds from the Treasury account to NAPMA complied with the Memorandum of Agreement, U.S. fiscal policies, and NAPMA financial procedures. These DOD officials also said it was understood by DOD, the Treasury, and NAPMA that funds would be transferred each month to the NAPMA commercial account or for payments to prime contractors and other program requirements.

The Board of Auditors stated in one of its reports that such an understanding is illogical in view of the explicit Memorandum of Agreement. We also believe such an understanding is contrary to the memorandum and the records of discussions that took place at the time. Further, NAPMA's financial procedures state that cash balances should be held to the minimum practical.

Interest Earned on Contributions Provided to NAPMA

According to DOD and NAPMA, as of mid-1987, the equivalent of about \$250 million in interest was earned from participating nations' contributions. NAPMA also estimated that the total interest earnings would reach the equivalent of \$280 million by the end of 1988. According to the Memorandum of Agreement, the NATO Program Management Organization Board is responsible for determining if interest is being accumulated on a nation's contribution. If there was any interest on the contributions of the participating governments, interest earned on U.S. contributions would be returned to the U.S. government on a semiannual basis. However, the Board has not calculated the interest earned by individual nations and has approved retention of the total accumulated interest to be used in accordance with its direction.

According to records of discussions, the U.S. representative was a leading proponent for retaining and using interest for program purposes to ensure the program's success. If the U.S. representative had voted against the use of the interest, it could not be used by NAPMA for program requirements since unanimity was required among all Board members.

While the Board did not calculate the interest earned on a nation-by-nation basis, the NATO Board of Auditors and a NAPMA committee believed that this was possible to do. In 1982, NAPMA reported that approximately 32 percent² of the interest earned could be attributed to U.S. contributions. By using NAPMA's percentage and applying it to the total interest accumulated through mid-1987 (\$250 million), the accumulated interest on U.S. contributions could be as much as \$80 million.

According to DOD officials, all of the interest has been committed by the NATO Program Management Organization Board either for program requirements that existed at the time the Memorandum of Understanding was signed in 1978 or is being held in reserve to pay outstanding claims. Our concern, however, is that the United States is financing the program, in part, with interest accumulated from U.S. contributions rather than with funds obtained through the appropriations process. This method of financing circumvents oversight by the Congress and is contrary to the principles and guidelines established by the Treasury for providing funds to international organizations.

²U.S. contributions to the program were approximately 42 percent. However, in arriving at 32 percent, the Committee considered only those U.S. funds deposited in the commercial interest-bearing account.

In testimony before the Senate Committee on Armed Services in 1979 concerning the program, the Chief of Staff, U.S. Air Force, stated that the Congress would be provided periodic reports detailing fiscal and other program information. However, summary financial information of the program provided to Congress did not contain information concerning the accumulation and use of interest earnings.

In response to our draft report, Treasury Department officials did not comment on the calculation of interest attributable to U.S. contributions. However, they had stated in a June 1987 response to our letter of inquiry that in 1979 they were aware that funds were being provided in advance of needs and were earning significant interest. Treasury noted that when the opportunity arose to comment on the interest issue, it repeated Treasury's policy that program balances should be kept to a minimum and that interest earned, when possible, should be returned to the United States. Treasury stated that its advisory role ceased in 1983 or 1984 and that the Air Force had primary responsibility for ensuring compliance with these fiscal principles, including the timing of payments. The Treasury, therefore, relied on the Air Force to take any necessary corrective actions. Treasury officials assumed that funding was provided according to their recommendations or that other acceptable arrangements had been made.

Conclusions

The U.S. Air Force, as executive agent for DOD, did not ensure that U.S. fiscal policies were properly carried out concerning contributions to the NATO Airborne Early Warning and Control Program. The U.S. representative did not seek to have NAPMA's requests for contributions adjusted to reflect actual requirements. This allowed the program to earn significant amounts of interest. The NATO Program Management Organization Board, supported by the U.S. representative, decided to retain and use the accumulated interest for program requirements. As a result, as much as \$80 million in interest earnings could be attributed to U.S. contributions. DOD did not inform the Congress that interest earnings from U.S. contributions were being used for this purpose.

Using interest earnings to support the NAPMA program circumvented oversight by the Congress as well as the fiscal controls contained in Treasury guidance that state such funds must be obtained by appropriations. In addition, the premature release of funds to NAPMA most likely resulted in increased borrowing and interest costs for the Treasury.

Recommendations

The Secretaries of Defense and the Treasury should ensure that U.S. contributions to NATO programs are provided by appropriations and that appropriate U.S. Treasury fiscal policies are adhered to. Therefore, we recommend that the Secretary of Defense direct his representatives to NATO organizations to support U.S. fiscal policies regarding contributions to international organizations and the return of interest, as contained in the Treasury's principles and guidelines for transactions with countries and international organizations.

We also recommend that the Secretary of the Treasury continue to stress to other U.S. departments and agencies the need to ensure that they comply with Treasury's fiscal principles and guidelines when providing funds to international organizations.

Agency Comments and Our Evaluation

Comments on our report were requested from the Departments of Defense, State, and the Treasury. The Department of State reviewed our report and had no comments (see app. I). The Department of the Treasury provided comments (see app. II) that basically clarified Treasury's authority to enforce its fiscal principles. Our draft report recommended that the Secretary of Treasury establish procedures to ensure compliance with department policies concerning the release of U.S. funds to international organizations. Treasury stated that the Secretary does not have the statutory or regulatory authority to compel other departments to comply with Treasury's fiscal principles. We revised our recommendation to reflect Treasury's comments.

DOD did not provide written comments. However, we discussed this report with DOD officials and their official oral comments have been considered throughout the report. DOD officials stated that releasing U.S. contributions to the NAPMA interest-bearing account complied with the Memorandum of Agreement and that using the interest earned for program expenditures was necessary to ensure its success. While additional funds may have been needed to support the program, U.S. contributions were made in advance of program requirements and large cash balances were accumulated. This was counter to the Memorandum of Agreement and to Treasury's fiscal policies that appropriated funds should be used to finance programs.

DOD officials stated that the U.S. government does not have sufficient information to calculate the amount of interest earned on U.S. contributions. These officials also stated there would have been several complications had the United States sought to identify and obtain interest

refunds. For instance, the participating nations' contributions varied in percentage and amounts over time and not all the U.S. funds were deposited to the interest-bearing accounts. Further complicating the problem, a majority of the nations had budgetary rules that allow interest earned to be used for program expenditures. Had the interest associated with country contributions been refunded, additional funds would have been required from participating governments. According to DOD officials, the additional funding might not have been approved. Because of these factors, DOD officials emphasized that the identification of interest by nation could not have been accomplished because the participating nations could not have reached a consensus on the method to be used to calculate each nation's share of the interest.

We recognize that the identification and return of interest could not have been a unilateral action on the part of the United States but must be done in conjunction with other nations' representatives. However, as noted in the report, NAPMA and the NATO Board of Auditors believe, as we still do, that the interest attributable to each nation's contributions could have been calculated. In view of the difficulties surrounding the calculation of the interest earned on U.S. contributions and since DOD officials have informed us that the interest has been expended or committed for program purposes, we have deleted our recommendation that the Secretary of Defense obtain a full accounting of the estimated interest earned on U.S. contributions and its disposition.

Regarding our recommendation to support U.S. fiscal policies on the return of interest, DOD officials stated that they concur in its intent and that it has been their long-standing position that when interest is earned and identified, it should be returned to the Treasury.

Objectives, Scope, and Methodology

The primary objective of our review was to examine financial controls over U.S. contributions to the NATO Airborne Early Warning and Control Program from inception of the program until the present. In conducting our review, we examined the financial arrangements in the Multilateral Memorandum of Understanding, the Memorandum of Agreement between the U.S. government and NAPMA, Treasury's fiscal policies and procedures regarding contributions to international organizations, and other pertinent documents and records.

Our review was conducted at the Department of Defense, U.S. Air Force Headquarters, and the Department of the Treasury in Washington, D.C., and at the U.S. Mission to NATO in Brussels, Belgium. We held discussions

with DOD and Air Force officials responsible for monitoring the program; Treasury Department and NATO fiscal officials; a director of the U.S. Mission to NATO; U.S. representatives to the NATO Program Management Organization, including the Chairman of the Board; and NATO's Board of Auditors.

We also sent letters of inquiry to the Secretaries of Defense and the Treasury in April 1987 to obtain clarification of certain matters. Treasury's response has been considered in preparing this report. DOD did not respond. We conducted our review from August 1986 to November 1987 in accordance with generally accepted government auditing standards.

As arranged with your Office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from the date of the report. At that time, we will send copies of this report to the Secretaries of Defense, the Treasury, and State; the Director, Office of Management and Budget; the cognizant congressional appropriation and authorization committees; and other interested parties.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

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