



United States
General Accounting Office

National Security and
International Affairs Division

B-247984

December 3, 1992



148096

The Honorable Sam Nunn
Chairman
The Honorable John W. Warner
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Les Aspin
Chairman
The Honorable William L. Dickinson
Ranking Minority Member
Committee on Armed Services
House of Representatives

Enclosed are comments by the Department of Defense on our report entitled AV-8B Program: Aircraft Sales to Foreign Government to Fund Radar Procurement (GAO/NSIAD-93-24), which was issued on October 23, 1992. These comments were received after the 30 calendar days specified by law and were too late to be printed in our report. Thus, we are enclosing the comments for your consideration along with our responses to the comments.

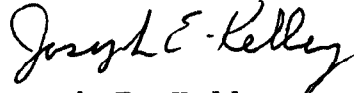
The Department continues to maintain that the sale of two TAV-8Bs to Italy and the Navy's use of the sale proceeds was a replacement-in-kind transaction based on applicable laws and regulations. It does not acknowledge that the two aircraft were not replaced. However, as we reported, the sale proceeds were not used to purchase replacement aircraft as required by federal law. As a result of the TAV-8B sale, the Marine Corps will have two fewer aircraft. The two aircraft that the Navy states are the replacement aircraft were already fully funded with appropriations and under contract before the initiation of the TAV-8B sale. For these reasons we recommended that the Secretary of Defense direct that an amount equal to the proceeds from the sale of two TAV-8Bs to Italy, \$44.4 million, be deposited in the Special Defense Acquisition Fund or if the fund is at its statutory ceiling, in the Treasury as miscellaneous receipts. Nothing in the Department's comments causes us to change this recommendation.

GAO/NSIAD-93-91R AV-8B Program

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Following the text of the Defense Department's comments is our response to specific points raised by the Department. We will be sending copies of this letter to the Department of Defense and to other interested parties. We will also send copies of the letter to others upon request. Please contact me at (202) 275-4128 if you or your staff have any questions concerning the Department's comments or our responses to the comments.



Joseph E. Kelley,
Director, Security and International
Relations Issues

COMMENTS FROM THE DEPARTMENT OF DEFENSE

Note: GAO comments on the matters raised in this letter appear at the end of this enclosure.



ACQUISITION

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

19 OCT 1992

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "AV-8B PROGRAMS: Aircraft Sales to Foreign Government to Fund Radar Procurement," dated July 13, 1992 (GAO Code 463817), OSD Case 9008-A. The DoD concurs or partially concurs with the GAO findings. However, the DoD disagrees with the GAO recommendation that the proceeds from the sale of two TAV-8B aircraft to Italy be returned to the Treasury.

The DoD also does not concur with the two suggestions to the Congress that reprogramming procedures need to be amended. The existing procedures are adequate, and additional oversight is not required. The DoD Budget Guidance Manual will, however, be modified to provide more explicit guidance to the Military Departments on the use of below threshold reprogramming actions.

As a result of congressional direction to study the feasibility of a radar capability for the AV-8B, an operational requirement for a multi-mode radar was established. That capability became the subject of discussions between the Spanish, Italian and United States Governments. A cooperative research and development program was instituted with potential follow-on production. To finance the United States obligations, it was determined that up to six aircraft could be deleted from the FY 1989-FY 1991 multi-year contract and the proceeds from the sale of inventory aircraft applied to the acquisition of radar equipped AV-8B aircraft. Funds available within the Navy aircraft procurement appropriation were legally available for the radar effort.

The Congress was notified, as required by law, of the intent to enter into a memorandum of understanding with Spain and Italy for acquisition of radar equipped AV-8B aircraft. To help finance the U.S. part of the consortium, the Italians purchased two AV-8B trainers to train its pilots and technicians for participation in the cooperative program. The Italian requirement was satisfied by a sale from existing U.S. aircraft stock, which enabled two radar equipped AV-8Bs to be procured by

ENCLOSURE

ENCLOSURE

See p. 19 of
our report
and comment 1.

a replacement-in-kind transaction. That sale, plus the sale of three additional U.S. aircraft not required by the Marine Corps, provided funds that allowed the DoD to complete the acquisition of the aircraft under the multi-year contract without loss of the economic quantity pricing in the contract, and avoided the termination of the multi-year contract for the FY 1991 aircraft that might otherwise have been necessary to meet the United States funding requirement for the radar production phase. The Department acknowledges that it did not properly execute the accounting entries associated with the sale of the two TAV-8B aircraft to Italy and the sale and subsequent reprocurement of three other AV-8B aircraft.

Detailed DoD comments on each finding and recommendation are provided in the enclosure. The DoD appreciates the opportunity to comment on the draft report.

Sincerely,



Frank Kendall
Director
(Tactical Systems)

Enclosure

GAO DRAFT REPORT - DATED JULY 13, 1992
(GAO CODE 463817) OSD CASE 9008-A

"AV-8B PROGRAMS: AIRCRAFT SALES TO FOREIGN GOVERNMENT TO
FUND RADAR PROCUREMENT"

DEPARTMENT OF DEFENSE COMMENTS

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FINDINGS

- o **FINDING A: Radar to Improve AV-8B Capabilities.** The GAO reported that the Navy is currently procuring a mixture of 72 AV-8Bs and TAV-8Bs from McDonnell Douglas Corporation, under a multi-year contract. The GAO observed that 24 aircraft a year were funded for FY 1989, FY 1990 and FY 1991 by a contract modification on September 27, 1989. The GAO pointed out that the fielded AV-8Bs do not carry a radar system. The GAO explained that the 1988 examination of expanded roles for the AV-8B led to an approved operational requirement for a multimode radar system. The GAO found that the Navy decided to add the APG-65 radar through an engineering change proposal to the 24 AV-8Bs purchased in FY 1991. The GAO noted that, since Italy and Spain were interested in procuring radar-equipped AV-8Bs, they signed a memorandum of understanding with the United States to jointly fund and share the benefits of the integration (codevelopment) portion of the radar program. The GAO reported that the Navy estimated the total radar program will cost \$401 million. The GAO explained that Navy officials indicated the radar program must be a "zero-sum game," that is, the program had to be funded from existing resources--additional appropriations could not be requested. (pp. 10-13/GAO Draft Report)

Now on
pp. 8-10.

DOD RESPONSE: Concur.

- o **FINDING B: Aircraft Sales as Funding Source.** The GAO reported that two different types of aircraft sales to Italy were used to help fund the AV-8B radar program: three AV-8Bs were sold through a "dependable undertaking," and the Navy characterized the sale of two TAV-8Bs and the use of sale proceeds as a "replacement-in-kind" transaction.

The GAO observed that Section 22 of the Arms Export Control Act authorizes the President to enter into contracts for the procurement of defense articles for sale to foreign governments, if the foreign government provides the United States with a dependable undertaking to pay the full cost of the item being produced and to

make funds available to meet payments required by the contract as they become due. The GAO noted that, in this instance, the Navy allowed Italy to buy three radar-equipped AV-8Bs by assuming the Navy contract responsibilities for three AV-8Bs the Navy was acquiring in the FY 1991 portion of the multi-year contract. The GAO explained that Italy was required to pay the full cost for the three aircraft increments as necessary to meet the contract requirements. The GAO found that Italy paid the full cost of the aircraft. The GAO also found that the Navy then used the appropriations intended for those three aircraft to fund the radar effort. The GAO concluded that the Aircraft Procurement, Navy, funds were legally available for the radar program.

The GAO also reported that Section 21 of the Act authorizes the President to sell defense articles to foreign countries from the stocks of the Department of Defense. The GAO explained that, if the sold items are to be replaced, the transaction is characterized by DoD instructions as either a replacement-in-kind or a "replacement" transaction. The GAO observed that, in a replacement-in-kind transaction, the proceeds of the sale are used to procure an "identical" replacement item. The GAO noted that, in a replacement transaction, the replacement item is an improved model that accomplishes the same basic purpose as the item sold. (pp. 14-16/GAO Draft Report)

Now on
pp. 11, 12.

DoD RESPONSE: Concur.

- o FINDING C: Navy Characterized TAV-8B Sale as Replacement-in-Kind Transaction. The GAO reported that, on September 12, 1990, the Navy sold two TAV-8B aircraft to Italy from DoD stocks. The GAO noted that the Navy characterized the sale and the intended use of the sale proceeds as a replacement-in-kind transaction, with the replacement aircraft to be two radar-equipped AV-8Bs from the FY 1991 portion of the multi-year AV-8B contract. The GAO explained that the expressed Navy intent was to procure the two radar-equipped AV-8Bs with the sale proceeds, and use the freed-up appropriated funds to finance the radar program.

The GAO found that the Navy did not enter into new contracts to procure any replacement aircraft, nor were additional quantities of AV-8Bs added to the existing multi-year contract. The GAO observed that the AV-8Bs from the FY 1991 portion of the multi-year procurement were fully funded by appropriations and, almost a year before the sale of the two trainers to Italy, were already under contract for production. The GAO further noted that the aircraft would have been acquired by the Navy without the proceeds from the TAV-8B sale. The GAO

found that, as a result of the sale and the dependable undertaking sale to Italy, the Marine Corps will receive five fewer aircraft than originally appropriated and contracted for.

The GAO asserted DoD instructions envision that replacement-in-kind transactions will result in the award of a contract to procure replacement items. The GAO noted that the DoD Foreign Military Sales Financial Management Manual states the following:

"Each sale of a principal or major item requires a test to determine if a requirement for inventory replacement is created as a result of the sale. The test is: Will the sale require award of a contract to replace the item...at the time the item shall be dropped from inventory?"

The GAO reported that, if the sale will not result in the award of a contract to replace the item sold, the sale is priced as a free asset transaction.
(pp. 18-24/GAO Draft Report)

Now on pp. 14,
15, 18, & 19.

DoD RESPONSE: Partially concur. The Marine Corps was willing to give up as many as six of the 24 aircraft to be procured in FY 1991 in order to procure radar equipped AV-8Bs. Concurrently, the Italians wanted to purchase two TAV-8B trainers from U.S. inventory to train both pilots and technicians to permit their further participation in the cooperative program. The U.S. determined it could spare two TAV-8Bs and sold Italy two aircraft from existing stock, and used the proceeds from the transaction to buy two replacement-in-kind radar equipped AV-8Bs. That sale, plus the sale of three additional aircraft, enabled the U.S. to complete the multi-year contract--albeit 21 radar equipped aircraft in FY 1991 vice 24 non-radar equipped aircraft--without loss of the economic quantity pricing in the contract and avoiding any termination costs if the FY 1989-FY 1991 multi-year contract had been broken by the U.S. The two TAV-8B aircraft sold to Italy were priced at the current multi-year contract price for a TAV-8B. If the aircraft were reprocured separately, apart from the multi-year contract, the Italians would have had to pay the actual cost of the acquisition. The sale of the aircraft was based on laws and regulations governing replacement-in-kind transactions, and the two TAV-8B aircraft sold from stock were replaced by AV-8B radar equipped aircraft. The TAV-8Bs were replaced with AV-8Bs because the Marine Corps has a shortage of AV-8Bs. It is the DoD position that a TAV-8B and an AV-8B are sufficiently common that one can constitute a replacement-in-kind for the other.

See p. 19 of
our report.

See pp. 4, 5
of our report.

- o **FINDING D: Proceeds From TAV-8B Sale Spent on Radar Procurement.** The GAO reported Navy accounting documents show that the proceeds from the sale to Italy of two TAV-8Bs were applied directly to the AV-8B radar program production costs. The GAO found that the sale proceeds were not used to procure replacement aircraft, as the Navy stated: those aircraft have actually been funded with the FY 1991 appropriations. The GAO reported that AV-8 program officials confirmed that the proceeds were spent on the radar program, but it was done for "administrative convenience." The GAO noted that the officials indicated that it would have required a large number of administrative accounting actions to use the proceeds of the sale to fund the AV-8Bs, and then transfer the appropriations to the radar program.

The GAO found that, even if the Navy had taken the administrative actions noted above, it did not charge Italy a high enough price for the two trainers to procure two replacement radar-equipped AV-8Bs. The GAO pointed out that, since two radar-equipped AV-8Bs would cost \$5,485,234 more than the amount the Navy charged Italy for the trainers, the proceeds from the sale could not have funded the stated replacements. The GAO observed that the DoD Foreign Military Sales Financial Management Manual states that the base cost to be used in the sale price calculation is the "estimated (or actual) cost of the replacement item. The GAO concluded, however, that the affordability of the AV-8Bs as replacement aircraft did not present a problem for the Navy, since it did not actually use the proceeds from the sale to fund the replacement of the aircraft sold from stock. The GAO further concluded that the proceeds from the sale of aircraft to Italy should have been considered free assets. The GAO asserted the Navy used those free assets in a manner that is not authorized by section 114(C) of title 10, U.S. Code, and is contrary to DoD instructions. The GAO pointed out that, even if the Navy had applied the sale proceeds to two of the AV-8Bs already under contract, the Navy action would not have been a replacement-in-kind and would have been unauthorized, since no additional aircraft would have been procured. (pp. 24-27/GAO Draft Report)

Now on
pp. 19, 20.

DoD RESPONSE: Partially concur. The proceeds from the sale of the two TAV-8Bs made it possible to finance the cost of two radar equipped AV-8B aircraft as a replacement-in-kind. The accounting transactions to reflect this replacement were improperly executed. When additional reimbursable authority was requested, the Navy briefed the DoD Comptroller that it would be used to procure two radar equipped AV-8Bs as replacement-in-kind for the sale of two TAV-8B trainers. The DoD Comptroller concurred that the transaction constituted a replacement-

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See comments 1, 2, & 3.

See pp. 19, 20 of our report and comment 4.

in-kind if the accounting documents were modified to make it clear that the proceeds from the sale were being used to finance two additional AV-8B aircraft that would otherwise not be bought, and forwarded the request for reimbursable authority to the Office of Management and Budget. The price of the TAV-8Bs sold to Italy was formulated using two methods--(1) computing the replacement cost of a TAV-8B in the multi-year contract, and (2) computing the cost of a radar equipped AV-8B less the equipment not needed for a trainer. Both methods resulted in a similar price, although lower than the price of a fully radar equipped AV-8B aircraft.

- o **FINDING E: TAV-8B To Be Sold To Spain From Defense Department Stocks.** The GAO reported the Navy intends to sell a TAV-8B aircraft to Spain from DoD inventories. The GAO observed that, although the Congress was notified of this potential sale, the notification document did not specify the trainer was being sold from stock or state how the Navy plans to use the proceeds. The GAO noted that officials from the AV-8B program office and the DoD Office of General Counsel indicated that the Spanish TAV-8B sale will be handled in the same manner as the Italian TAV-8B sale. The GAO reported that the sale will be a replacement-in-kind transaction and the proceeds of the sale are to be applied to the procurement of one of the radar-equipped AV-8Bs from the FY 1991 procurement. The GAO noted that the appropriations for that aircraft are then to be used to fund the AV-8B radar program. (pp. 26-27/GAO Draft Report)

Now on p. 20.

DoD RESPONSE: Partially concur. The Memorandum of Understanding among Spain, Italy and the U.S. established provisions which allowed the collaborative partners to procure TAV-8B aircraft. Originally, it was anticipated that the sale of a TAV-8B to Spain would occur in the same time frame--and using the same methodology--as the sale of the two TAV-8Bs to Italy. However, subsequent budgetary difficulties in Spain precluded their purchase concurrent with the Italians. It now appears that Spain will buy the TAV-8B aircraft along with the purchase of radar equipped aircraft under the new contract recently established to replace aircraft lost in Desert Storm. If a TAV-8B is now sold to Spain from existing inventories, the proceeds from the sale would either be used to procure a replacement aircraft (in addition to those currently appropriated and under contract) or they would be deposited in either the Special Defense Acquisition Fund or Treasury miscellaneous receipts, depending on whether there was authority available to permit deposit of the proceeds in the Special Defense Acquisition Fund. They would not be used to finance any portion of the radar program.

See comment 5.

- o **FINDING F: Late Radar Contract Funding and the Anti-Deficiency Act.** The GAO reported that, while the Navy repeatedly has been late in obligating specific amounts on a contractually-provided schedule, the contract provisions essentially preclude an unfunded liability from arising that could violate the Anti-Deficiency Act. The GAO found that, in a number of instances, the Navy obligated funds after the scheduled date, but within the 30-day grace period specified in the contract. The GAO pointed out that, in three cases, the grace period had passed and McDonnell Douglas notified the Government that it had used all available funding. The GAO reported that McDonnell Douglas retracted or extended its official notifications in two of the cases because it subsequently discovered its subcontractors had sufficient funds remaining to continue work. The GAO noted that, in the third case, the Navy obligated funds the same day it was notified. The GAO reported that McDonnell Douglas officials indicated that the company did not incur expenses beyond the funding necessary to cover its termination liability in all of these cases. (pp. 28-29/GAO Draft Report)

Now on
pp. 22, 23.

DOD RESPONSE: Concur.

- o **FINDING G: Budget Documentation Was Misleading.** The GAO reported that documentation provided to the Congress was misleading because, long after the Navy determined that AV-8Bs would be sold abroad to fund the radar program, the documentation continued to indicate the Navy intended to purchase for its own use 24 AV-8B aircraft on the FY 1991 portion of the multi-year contract. The GAO reported that an April 1989 funding plan for the AV-8B radar program documented the Navy intent to use aircraft sales to finance partially the program. The GAO explained that the funding plan identified a potential of \$60 million from a sale of two TAV-8Bs and associated equipment to Italy. The GAO noted that the plan stated, "This sale is possible because current procurement on the TAV-8B trainer exceeds our near term requirements." The GAO observed that, by January 1990, the Marine Corps decided that six aircraft would be sold to Italy and Spain to fund the radar program.

The GAO pointed out that, had Congress been fully informed of the potential sale before the passage of the FY 1991 Defense Department appropriations act (November 1990), it could have decided whether it wanted to provide appropriations for 24 AV-8Bs in view of the plans that three of these aircraft were to be sold to Italy through a dependable undertaking. The GAO found that budget documentation as late as February 1991 (FY 1992 amended budget request) showed that 24 AV-8Bs were to be procured with the FY 1991 appropriation.

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The GAO reported that, according to Navy officials, the Navy is not allowed to show the effect of potential foreign military sales on procurement quantities or prices in budget request documentation. The GAO explained that such effects can only be reflected in budget request documentation after a Letter of Offer and Acceptance is signed by a foreign government. The GAO concluded, however, that the Navy could have informed Congress of its intent to sell three of the FY 1991 AV-8Bs in the narrative portions of its budget request documentation. (pp. 30-31/GAO Draft Report)

Now on
pp. 24, 25.

See comment 6.

DoD RESPONSE: Concur. Historically, the DoD reported the effects of Foreign Military Sales, co-production or collaborative sales after the event was officially documented with binding agreements between the parties. Notification of the sale of the two TAV-8B aircraft to Italy was sent to the Speaker of the House by the Defense Security Assistance Agency--transmittal No. 90-41, Case No. IT-P-SBH, dated June 12, 1990. The sale of the three AV-8B aircraft to Italy was identified in transmittal No. 91-39, Case No. IT-P-SBJ, dated July 31, 1991. Both of those transmittal notices were also submitted to the House and Senate Committees on Foreign Affairs, Armed Services and Appropriations. In addition, the transactions were reported in the Selected Acquisition Reports dated December 31, 1990, and December 31, 1991. The quantity reduction from 24 to 21 aircraft in the FY 1991 procurement and the TAV-8B sale to Italy was reflected in the amended FY 1992/FY 1993 Biennial Budget Estimates Staff Procurement Backup Book, dated January 1992--the first notification opportunity after the acceptance of the Letter of Offer and Acceptance. Nevertheless, in retrospect, the DoD agrees that mention of pending sales should have been made in the FY 1992 budget backup material, dated January 1991.

- o **FINDING H: Below Threshold Reprogramming Used to Fund AV-8B Radar.** The GAO reported that the DoD requested approval from the Congress to reprogram \$40 million of FY 1991 AV-8B Advanced Procurement funds into the AV-8B program to fund radar procurement. The GAO noted that, on July 22, 1991, the Senate Committee on Appropriations denied the request. The GAO found the Naval Air Systems Command subsequently executed three reprogramming actions that were below the congressional notification threshold amount and resulted in a net increase of \$25.2 million to the radar program.

The GAO explained that the notification threshold in procurement programs is an increase to a funding line item in excess of \$10 million, measured cumulatively within the fiscal year of the reprogramming actions.

The GAO found that the three actions were considered below threshold because they were:

- executed during two fiscal years (FY 1991 and FY 1992); and
- spread among three separate funding lines in the AV-8B program (FY 1990 advanced procurement and full funding, and FY 1991 full funding).

The GAO reported that, when Navy officials contacted a Senate Appropriations Committee staff member to inform him of the intent to use below threshold reprogramming to fund the radar program, the staff member indicated that he could not block below threshold reprogramming, but disliked the Navy action. The GAO pointed out that the practice of dividing a reprogramming action into multiple reprogrammings to avoid the notification threshold had been used before, and Congress expressed its disfavor. The GAO further observed the Senate Appropriations Committee report on the FY 1991 DoD appropriations bill indicated separate below threshold reprogramming actions that, in combination, would have exceeded the threshold for a single reprogramming action "violate either the letter or the spirit, or both, of the established reprogramming procedures." (pp. 32-33/GAO Draft Report)

Now on
pp. 25, 26.

See comment 7.

DoD RESPONSE: Partially concur. It is not DoD policy to permit a series of below threshold reprogramming actions to be used as a means of financing program increases that previously have been denied by the Congress when requested as above threshold reprogramming actions. The AV-8B reprogramming actions provided for various AV-8B support items, exchange rate adjustments, as well as the radar program itself. None of the reprogrammed funds came from the \$40 million FY 1991 AV-8B Advanced Procurement appropriation that had been cited as the source for the denied reprogramming. All three below threshold reprogrammings were performed in accordance with procedures outlined in DoD Budget Manual 7110-1-M, Chapter 431, Implementation of Reprogramming of DoD Appropriated Funds. There was no intent to circumvent any reprogramming restrictions or procedures. Nevertheless, the DoD agrees that, although technically correct, the Navy was injudicious in its use of the below threshold authority. The DoD Budget Guidance Manual will be modified to provide more explicit guidance to the Military Departments on the use of below threshold reprogramming actions. That modification will be made by the end of the third quarter of FY 1993.

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RECOMMENDATIONS

- o **RECOMMENDATION 1:** The GAO recommended that the Secretary of Defense direct that an amount equal to the proceeds from the sale of the two TAV-8Bs to Italy, \$44.4 million, be deposited in the Special Defense Acquisition Fund or, if the fund is at a statutory ceiling, in the Treasury as miscellaneous receipts. (p. 27/GAO Draft Report)

Now on pp. 20, 21.

See comment 1.

DOD RESPONSE: Nonconcur. The sale of the two TAV-8Bs to Italy was based on the laws and regulations governing replacement-in-kind transactions. The two TAV-8B aircraft sold from stock were replaced with the procurement of two AV-8B radar equipped aircraft in the FY 1989-FY 1991 multi-year contract. The failure of the Navy to properly execute the accounting transactions is not sufficient justification to redirect the proceeds of the sale to the Treasury.

- o **RECOMMENDATION 2:** The GAO recommended that the Secretary of Defense direct that, if the sale from stock of a TAV-8B to Spain occurs, and, if the Navy intends to replace the aircraft, an additional TAV-8B or AV-8B be either added to a current contract or included in a new procurement contract. The GAO further recommended that, if the Navy does not intend to replace the TAV-8B, the sale proceeds should be deposited in the Special Defense Acquisition Fund, or if that account is at the statutory ceiling, in the Treasury as miscellaneous receipts. (p. 27/GAO Draft Report)

Now on p. 21.

See comment 5.

DOD RESPONSE: Concur. If a TAV-8B is sold to Spain, the proceeds from the sale would either be used to procure a replacement aircraft (in addition to those currently appropriated and under contract) or they would be deposited in Treasury miscellaneous receipts, whichever is appropriate. They would not be used to finance any portion of the radar program. However, Spain no longer appears to be interested in purchasing a TAV-8B from inventory stock.

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MATTERS FOR CONGRESSIONAL CONSIDERATION

- o **SUGGESTION 1:** The GAO suggested that, to provide better oversight on program funding, Congress consider amending its agreements with the Department of Defense on reprogramming to add the requirement that any decrease in the procurement quantity of a weapon system, for which funds are authorized, receive prior Congressional approval if the quantity decrease is the result of a foreign military sale. (p. 33/GAO Draft Report)

Now on p. 26.

See comment 8.

DoD RESPONSE: Nonconcur. The DoD Budget Guidance Manual will be modified to provide more explicit guidance to the Military Departments on the sale of weapons systems, which have been placed under contract but not yet delivered. That modification will be made by the end of the third quarter of FY 1993. There is no need to amend the reprogramming agreements between the DoD and the congressional committees.

o SUGGESTION 2: The GAO suggested that, to provide better oversight on program funding, Congress consider amending its agreements with the Department of Defense on reprogramming to ensure that reprogramming thresholds apply to cumulative increases for specific programs during a fiscal year, as well as individual funding lines within the program. (pp. 33-34/GAO Draft Report)

Now on p. 26.

DoD RESPONSE: Nonconcur. In procurement budgets, all the costs to manufacture and deliver a useable end item are fully funded in a single program year. Each program year, therefore, has its unique budget execution problems and requires its own reprogramming threshold. To limit the increase to multiple program years during a single fiscal year time period would preclude the DoD from solving many execution problems in an efficient manner.

Similarly, major acquisition programs frequently have two budget line items, one for advance procurement (long lead items for the following program year) and one for full funding (relating to the current program year). Because the two line items relate to two program years (and usually to two contractual vehicles), each has its unique budget execution problems and requires its own reprogramming threshold. To treat them as a single entity for reprogramming purposes would preclude DoD from solving many of these execution problems in an efficient manner.

See comment 9.

To prevent abuses of the flexibility, the DoD Budget Guidance Manual will be modified to provide more explicit guidance to the Military Departments on the use of below threshold reprogramming actions. That modification will be made by the end of the third quarter of FY 1993. There is, however, no need to amend the reprogramming agreements between the DoD and the congressional committees.

GAO COMMENTS

1. The accounting entry reflecting the application of the proceeds from the sale of the two TAV-8Bs is not the determinant of whether this was a legitimate replacement-in-kind transaction. The determining factor was if two additional aircraft were procured as replacements with the sale proceeds. Even if the Navy had applied the sale proceeds to two of the AV-8Bs already under contract, the Navy's action would not have been a replacement-in-kind and would have been unauthorized since no additional aircraft were procured.
2. The Department states that the Comptroller's office forwarded the request for reimbursable authority to the Office of Management and Budget after directing that the accounting records be modified. However, according to an official of the Office of the DOD Comptroller, until informed by us, that office did not know that Navy accounting documents showed that the sale proceeds were applied directly to the AV-8B radar program instead of to the procurement of aircraft. We informed Department officials of the accounting entries in question about one year after the approval of the transaction by the Comptroller's office.
3. The official at the Office of Management and Budget who approved the reimbursable authority told us that, at the time of the request, he knew little of the transaction. The documentation provided to him by the Defense Department only stated that an increase of \$44,400,000 in reimbursable authority was requested for the Aircraft Procurement, Navy account as the result of foreign military sales orders. It did not mention the radar program or the intended use of the sale proceeds, nor did it mention that the reimbursements were the result of a sale of TAV-8Bs from stock. He said that the Office of the Navy Comptroller told him that two AV-8Bs had been sold and that two AV-8Bs were being bought as replacements with the sale proceeds. He was not told of the AV-8B radar program, nor was he told that the stated replacement aircraft were two AV-8Bs that were already fully funded by appropriations and under contract.
4. While two prices for the TAV-8Bs sold to Italy may have been computed and been "similar," the price offered to Italy was that of two TAV-8Bs at the current multiyear contract price, as confirmed by the Department in its comments on finding C. If the Navy intended to replace the aircraft, and even if the second price computed was used (that of "a radar equipped AV-8B less the equipment not needed for a trainer"), it would have been contrary to federal statute and Defense Department instructions since the sale is to be priced at "the estimated (or actual) cost of the

replacement item." In this case the Navy stated that the replacement aircraft were to be two radar-equipped AV-8Bs.

5. The Defense Department's decision to employ the proceeds from a potential sale of a TAV-8B to Spain in accordance with the applicable laws and regulations is appropriate. This approach should have been applied to the use of the proceeds from the sale of TAV-8Bs to Italy.

6. The foreign military sales notifications provided to Congress did not identify the source of the items being sold (such as a sale from stock or a sale from the production line of aircraft for which the Navy has received appropriations), nor did they report how the sale proceeds would be used (such as to "reprocure" aircraft already appropriated for and under contract).

7. Naval Air Systems Command executed a number of below threshold reprogramming actions within the AV-8B program during 1991 and 1992. Some of the funds were used for AV-8B support and exchange rate adjustments. However, the three actions we discuss, totaling \$25.6 million, supported the AV-8B radar program.

8. We believe that modifying the Budget Guidance Manual, if properly implemented, would be helpful, but also believe that amending the reprogramming agreements could better deter future similar use of dependable undertaking sales that reduce appropriated procurement quantities through foreign military sales without congressional approval.

9. We did not determine whether such reprogramming flexibility is necessary or desirable for the Department, because we believe this judgment rests with the authorization and appropriation committees. As stated in comment 8, modification of the Budget Guidance Manual, if properly implemented, could help prevent injudicious use of below threshold reprogramming authority in the future. However, we also believe that amending the agreements between the congressional committees and the Department could better assure Congress of proper use of these authorities.

(Code 463823)

(Code 463835)