



July 2018

# FOREIGN MILITARY SALES

## Financial Oversight of the Use of Overhead Funds Needs Strengthening

Accessible Version

# GAO Highlights

Highlights of [GAO-18-553](#), a report to congressional committees

## Why GAO Did This Study

The U.S. government sells defense equipment and services worth billions of dollars to foreign partners through the FMS program. DSCA has overall management responsibility for the program, and various other DOD components are responsible for implementing and supporting it. DSCA charges purchasers certain overhead fees for FMS operating costs, including the administrative fee and the CAS fee. Overall administrative expenditures were \$879 million in fiscal year 2017. Overall CAS expenditures were \$182 million in fiscal year 2015—the most recent year available with reliable total balance data. In past audits, GAO and the DOD Office of Inspector General raised questions about DOD's financial oversight of these funds.

House Report 114-537 and Senate Report 114-255 included provisions that GAO review DSCA's use of these funds. This report examines DSCA's financial oversight of DOD components' use of (1) administrative and (2) CAS funds. GAO assessed the reliability of DSCA data for fiscal years 2012 through 2016 (the most recent available) on DOD components' use of these funds. GAO reviewed documentation and conducted interviews with agency officials.

## What GAO Recommends

GAO is making 11 recommendations for DSCA to improve its financial oversight of administrative and CAS funds, such as by collecting reliable data on DOD components' use of these funds, and conducting periodic, targeted financial reviews. DOD concurred with GAO's 11 recommendations.

View [GAO-18-553](#). For more information, contact Thomas Melito at (202) 512-9601 or [MelitoT@gao.gov](mailto:MelitoT@gao.gov).

July 2018

## FOREIGN MILITARY SALES

### Financial Oversight of the Use of Overhead Funds Needs Strengthening

## What GAO Found

The Defense Security Cooperation Agency (DSCA) has established some policies and procedures for financial oversight of Department of Defense (DOD) components' use of Foreign Military Sales (FMS) administrative funds for costs related to processing FMS cases, but GAO found certain deficiencies in its oversight. As part of its oversight, DSCA has taken steps such as clarifying guidance on how administrative funds may be used, and developing procedures for reviewing business processes for the use of these funds. DSCA, however, lacks the reliable funding data it needs to ensure proper spending and to inform its budget decisions. DSCA has not conducted regular reconciliations of the data, with its financial service provider, to identify and correct data reliability issues, including gaps and inconsistencies in reported spending for the Army, the Navy, and the Air Force—the primary recipients of this funding. While DSCA conducts reviews of DOD components' business processes, providing an opportunity for sharing information about positive practices and identifying potential problems, it has not followed its annual minimum requirement for the number of reviews to conduct, or its requirement for tracking corrective action items. For example, DSCA was unable to provide an update on the status of action items from most of its reviews conducted since 2012. Moreover, DSCA does not conduct periodic, targeted financial reviews to verify components' obligations and disbursements of administrative funds, raising the risk of misuse of funds.

#### The Defense Security Cooperation Agency Has Overall Responsibility for Financial Oversight of Foreign Military Sales Overhead Funds



Source: GAO. | GAO-18-553

DSCA also has not developed adequate processes for financial oversight of the use of contract administration services (CAS) funds for costs such as contract management, in accordance with internal control standards. Specifically, DSCA lacks reliable data on DOD components' use of CAS funds. GAO identified inconsistencies in DSCA's data, including no, or low, reported disbursements in some years for three of the four DOD components that received CAS funds in fiscal years 2012 through 2016, which did not align with data that GAO obtained from the components. DSCA has not conducted regular reconciliations of the data, with its financial service provider, to identify and correct data reliability issues. In addition, DSCA does not conduct periodic, targeted financial reviews to verify components' CAS spending. For example, GAO found that at least \$89 million in fiscal year 2016 CAS disbursements were incorrectly processed for the Defense Contract Management Agency—the primary recipient of these funds. DSCA periodically communicates with DOD components about problematic issues, but generally does not take steps to verify spending, including reviewing supporting documentation and any actions taken by components to address such issues. As a result, DSCA raises the risk of unallowable or unapproved payments that could lead to fraud, waste, or abuse of funds.

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# Contents

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Letter		1
	Background	4
	DSCA Established Certain Policies and Procedures for Financial Oversight of FMS Administrative Funds, but Its Oversight Has Certain Deficiencies	13
	DSCA Has Inadequate Policies and Procedures to Provide Reliable Data and Ensure CAS Funds Are Used for Allowable and Approved Purposes	31
	Conclusions	39
	Recommendations for Executive Action	40
	Agency Comments	42
<hr/>		
Appendix I: Objectives, Scope, and Methodology		45
Appendix II: Comments from the Department of Defense		49
Appendix III: GAO Contact and Staff Acknowledgments		53
	GAO Contact	53
	Staff Acknowledgments	53
<hr/>		
Appendix IV: Accessible Data		54
	Agency Comment Letter	54
<hr/>		
Tables		
	Table 1: Examples of Activities Listed in the Defense Security Cooperation Agency's (DSCA) "Foreign Military Sales (FMS) Activity Matrix" for Administrative Funds	14
	Table 2: Defense Security Cooperation Agency's (DSCA) Business Process Reviews for Department of Defense (DOD) Components' Use of Foreign Military Sales (FMS) Administrative Funds in 2012-2017	24

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## Figures

Figure 1: Overview of the Department of Defense's (DOD) Process for Collecting and Using Foreign Military Sales (FMS) Administrative and Contract Administration Services (CAS) Funds	6
Figure 2: Five General Phases of the Foreign Military Sales (FMS) Process	7
Figure 3: Various Department of Defense (DOD) Components Use Foreign Military Sales (FMS) Administrative Funds	8
Figure 4: Several Department of Defense (DOD) Components Use Foreign Military Sales (FMS) Contract Administration Services (CAS) Funds	9
Figure 5: Components of Internal Control Framework Prescribed for Federal Agencies	10
Figure 6: Timeline of Prior GAO and Department of Defense (DOD) Office of Inspector General (OIG) Audits with Findings Related to Financial Oversight of Foreign Military Sales (FMS) Trust Fund	12

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### Abbreviations

BeSMART	Budgeting, Programming, and Execution Submission Management and Reporting Tool
CAS	contract administration services
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFAS	Defense Finance and Accounting Service
DIFS	Defense Integrated Financial System
DISA	Defense Information Systems Agency
DOD	Department of Defense
DSCA	Defense Security Cooperation Agency
FAR	Federal Acquisition Regulation
FIAR	Financial Improvement and Audit Readiness
FMS	Foreign Military Sales
LOA	Letter of Offer and Acceptance
OIG	Office of Inspector General
OMB	Office of Management and Budget
SAMM	Security Assistance Management Manual
SCES	Security Cooperation Enterprise Solution
State	Department of State

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July 30, 2018

Congressional Committees

The Foreign Military Sales (FMS) program provides security assistance, such as equipment and training, to over 150 foreign partners, with average annual sales of approximately \$38 billion in fiscal years 2007 through 2017.<sup>1</sup> The U.S. Department of State (State) reviews and approves FMS purchases, and several Department of Defense (DOD) components, led by the Defense Security Cooperation Agency (DSCA), are responsible for implementing and supporting the FMS program.

DSCA charges purchasers certain overhead fees to cover the U.S. government's costs for operating the FMS program. These fees include the administrative fee, which DOD components use to cover costs such as civilian employee salaries, facilities, and information systems, and the contract administration services (CAS) fee, which components use to cover the costs of quality assurance and inspection, contract management, and contract audits.<sup>2</sup> Administrative and CAS fee collections are held in separate accounts within the FMS trust fund.<sup>3</sup> For

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<sup>1</sup>We previously reported that annual sales were over \$30 billion in each of these years except two, and grew 80 percent over the period, from \$23 billion in fiscal year 2007 to \$42 billion in fiscal year 2017. See GAO, *Foreign Military Sales: Controls Should Be Strengthened to Address Substantial Growth in Overhead Account Balances*, [GAO-18-401](#) (Washington, D.C.: May 10, 2018).

<sup>2</sup>According to DSCA, the authority to collect these fees originates in the International Security Assistance and Arms Export Control Act of 1976. DSCA specifically cites sections 2761(e)(1)(a) and (h) codified in title 22 of the United States Code. Section 2761(e)(1)(a) of the act states, in part, that the charge for administrative services should be calculated on an average percentage basis to recover the full estimated costs of the administration of sales. Pub. L. No. 94-329, § 205, 90 Stat. 729, 737 (codified as amended at 22 U.S.C. § 2761). DSCA officials also noted that DSCA collects the administrative and CAS fees based on a percentage, in accordance with this provision of the act.

<sup>3</sup>Administrative and CAS fee collections are held in the FMS trust fund, which comprises separate accounts for each partner country and several distinct accounts for fees. Expenses related to administrative and CAS services are paid from the respective related fee account. The administrative and CAS accounts are the two main overhead accounts, which as of the beginning of fiscal year 2016 contained about 93 percent of the overall FMS trust fund overhead account balances. The third largest account, for transportation-related costs, contained an additional 6 percent of the overall FMS trust fund overhead account balances. We plan to review the transportation account in a subsequent report.

fiscal year 2017, overall expenditures paid from administrative funds totaled \$879 million. In addition, overall expenditures paid from CAS funds totaled \$182 million in fiscal year 2015, the most recent year for which reliable total account balance data are available.<sup>4</sup>

We, as well as the DOD Office of Inspector General, conducted a series of audits over the past 30 years that found deficiencies in internal controls related to DOD's financial oversight of the FMS trust fund, including administrative and CAS funds.<sup>5</sup> Although DOD has undertaken steps to improve controls, questions remain about whether they are adequate to ensure that administrative and CAS funds are used for allowable and approved purposes.

House Report 114-537 and Senate Report 114-255 included provisions for GAO to review DSCA's management and use of these funds.<sup>6</sup> This

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<sup>4</sup>Overall expenditures equal the amount of funds transferred from the administrative and CAS accounts to DOD components. DOD components are responsible for obligating and disbursing administrative and CAS funds. In May 2018, we reported on DSCA's management of these fees and the overall administrative and CAS account balances. We determined that the overall administrative account balance data for fiscal years 2007 to 2017, as well as the overall CAS account balance data for fiscal years 2007 to 2015, were sufficiently reliable for assessing the account balances and related trends. However, we identified issues related to the reliability of DSCA's overall CAS account balance data for fiscal years 2016 and 2017. We included a recommendation for DOD to correct an issue that led to the incorrect processing of CAS funds out of a different FMS account. See [GAO-18-401](#).

<sup>5</sup>For example, see GAO, *Defense Exports: Foreign Military Sales Program Needs Better Controls for Exported Items and Information for Oversight*, [GAO-09-454](#) (Washington, D.C.: May 20, 2009). Other prior GAO reports identified a lack of actual cost information for the FMS program as a critical DOD deficiency. See GAO, *Foreign Military Sales: Redirection of Accounting Improvement Efforts is Appropriate*, [GAO/AFMD-88-75](#) (Washington, D.C.: Sept. 15, 1988), and GAO, *Centralization: Best Long-Range Solution to Financial Management Problems of the Foreign Military Sales Program*, [GAO/FGMSD-79-33](#) (Washington, D.C.: May 17, 1979). In addition, prior relevant DOD Office of Inspector General reports include, for example, *Foreign Military Sales Administrative Surcharge Fund*, Report No. 97-227 (Arlington, VA: September 30, 1997), and *Contract Administration Services for Foreign Military Sales*, Report No. 96-049 (Arlington, VA: December 20, 1995). See figure 6 in this report for more information about prior GAO and DOD Office of Inspector General audits.

<sup>6</sup>H. Rept. No. 114-537 at 240. This House Armed Services Committee report accompanied H.R. 4909, a bill to authorize appropriations for fiscal year 2017 for military activities of the Department of Defense and for other purposes. S. Rept. No. 114-255 at 228. This Senate Armed Services Committee report accompanied S. 2943, a bill to authorize appropriations for fiscal year 2017 for military activities of the Department of Defense and for other purposes. [GAO-18-401](#) also addressed provisions that were included in these House and Senate reports.

report examines (1) the extent to which DSCA has established and carried out financial oversight policies and procedures to ensure its data on DOD components' use of *administrative* funds are reliable, and that the use of these funds is allowable and approved; and (2) the extent to which DSCA has established and carried out financial oversight policies and procedures to ensure its data on DOD components' use of CAS funds are reliable, and that the use of these funds is allowable and approved.

To assess DSCA's financial oversight of administrative and CAS funds, we reviewed budget, obligations, and disbursements data that DSCA collected on DOD components' use of these funds in fiscal years 2012 through 2016, the most recent years available at the time of our review. We assessed the reliability of the data by reviewing it for potential gaps, inconsistencies, or obvious errors and by conducting interviews with DOD officials about the data. We found that the data on both the administrative and CAS funds were not reliable for our purposes due to gaps and inconsistencies that we identified in the data. We report on these data problems in the body of this report. We also reviewed DOD documents, including DOD and DSCA policies, procedures, and guidance related to the use of administrative and CAS funds, and conducted interviews with DOD officials, including from DSCA, the Defense Finance and Accounting Service (DFAS), the Defense Contract Management Agency (DCMA), the Defense Contract Audit Agency (DCAA), the Army, the Navy, and the Air Force. See appendix I for additional details on our scope and methodology.

We conducted this performance audit from February 2017 to July 2018 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.



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## Background

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### Roles and Responsibilities Related to the Use of Administrative and CAS Funds

DOD's Office of the Under Secretary of Defense (Comptroller) is responsible for setting DOD policies and procedures related to the financial management, accounting, and audit readiness of security cooperation activities, including the FMS program.<sup>7</sup> These policies and procedures are contained in DOD's Financial Management Regulation, which prescribes that DSCA administers the FMS program for DOD and has overall financial management responsibility for the FMS trust fund, including reviewing and approving the DOD components' administrative and CAS budgets, and monitoring the use of these funds.<sup>8</sup> DFAS provides DSCA's financial services for the FMS program and is responsible for accounting, billing, disbursing, and collecting funds for the FMS program. DOD components are responsible for annually submitting administrative and CAS budget requests along with supporting materials to DSCA, and for maintaining administrative and CAS obligations and disbursements within allotments.<sup>9</sup> The Financial Management Regulation also prescribes that DOD components are responsible for maintaining for

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<sup>7</sup>See DOD Directive 5132.03, *DOD Policy and Responsibilities Related to Security Cooperation* (December 29, 2016).

<sup>8</sup>DOD Financial Management Regulation, DOD 7000.14-R, vol. 15, ch. 3-4. DOD's Financial Management Regulation includes distinct policies and procedures for the financial management of administrative and CAS funds.

<sup>9</sup>For the purposes of this report, a budget is defined as a detailed statement of anticipated expenditures during an accounting period (e.g., fiscal year). An allotment is an authorization by an agency head or other authorized employee to incur obligations. An obligation is defined as a commitment that creates a legal liability of the government for the payment of goods and services ordered or received that can be paid immediately or in the future. Disbursements are defined as amounts paid by federal agencies during the fiscal year to liquidate government obligations.

audit purposes supporting documentation for obligations and disbursements against allotments.<sup>10</sup>

DOD's Financial Management Regulation refers to DSCA's Security Assistance Management Manual (SAMM) for additional information on DSCA's policies and procedures. DSCA'S SAMM provides guidance to DOD components managing or implementing FMS programs over which DSCA has responsibility, including on DSCA's financial policies and procedures for FMS. It also provides information to DOD components, including how they can use administrative and CAS funds for preparing and executing FMS cases.<sup>11</sup> In addition, DSCA officials noted that the Federal Acquisition Regulation provides guidance on a range of contract administration and quality assurance functions that applies to the use of CAS. For example, the Federal Acquisition Regulation list contract administration, quality assurance, and audit activities such as ensuring contractor compliance with contract quality assurance requirements, performing engineering surveillance to assess compliance with contractual terms, and submitting information and advice based on an auditor's analysis of the contractor's records or data as to the acceptability of the contractor's costs.<sup>12</sup>

Figure 1 provides an overview of DOD's process for collecting and using administrative and CAS funds for costs associated with implementing and supporting FMS agreements.

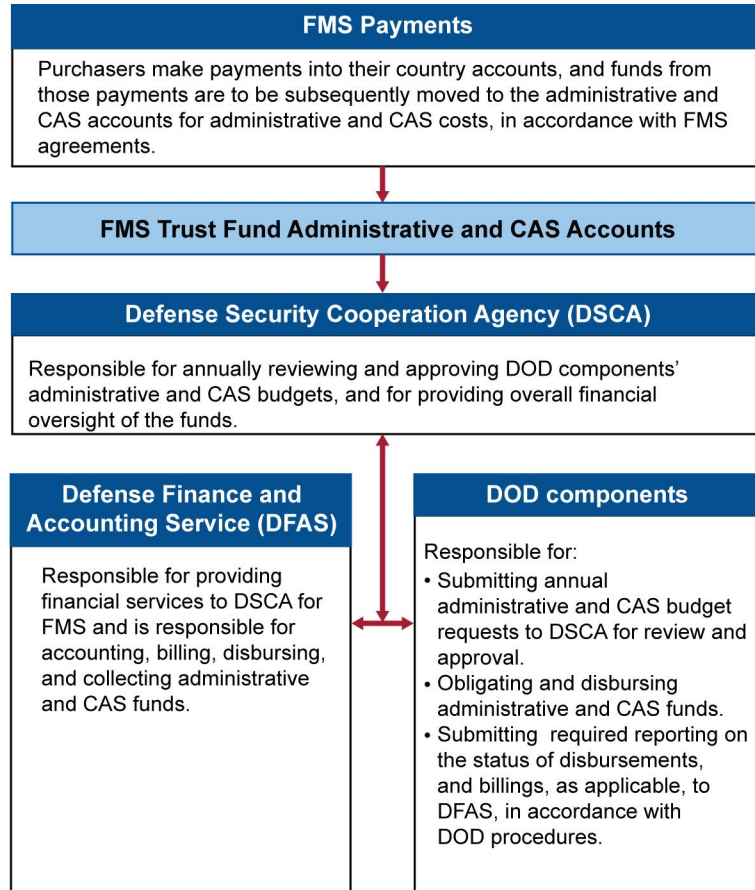
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<sup>10</sup>Standards for internal control in the federal government call for maintaining supporting documentation for financial transactions. Specifically, management should clearly document internal controls and all transactions in a manner that allows the documentation to be readily available for examination. Further, documentation and records are to be properly managed and maintained. See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

<sup>11</sup>An "FMS case" refers to a signed agreement between the United States and a foreign partner or ally, and to any subsequent amendments or modifications to that agreement, for the partner or ally to purchase equipment or services.

<sup>12</sup>See Federal Acquisition Regulation (FAR) Parts 42.1, 42.3, and 46.

**Figure 1: Overview of the Department of Defense’s (DOD) Process for Collecting and Using Foreign Military Sales (FMS) Administrative and Contract Administration Services (CAS) Funds**

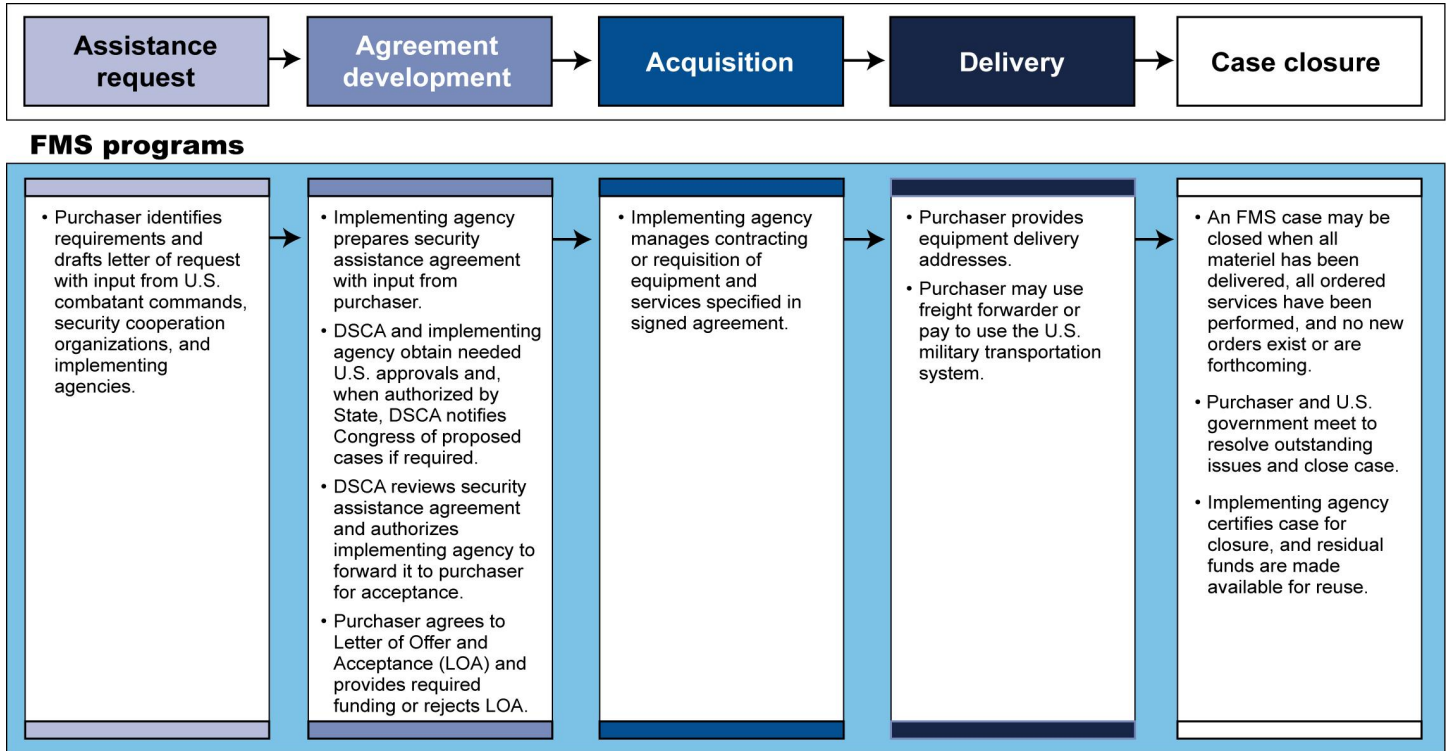


Source: GAO analysis of DOD documents. | GAO-18-553

## Recipients of FMS Administrative and CAS Funds

Multiple DOD components are involved in each FMS case and have a range of responsibilities related to implementing and supporting cases, throughout the five general phases of DOD’s FMS process. FMS cases include various types of equipment and services sold to foreign partners, ranging from fighter jets and integrated air and missile defense systems to combat helmets and training on the use of equipment. Each FMS case follows five general phases, as shown in figure 2.

**Figure 2: Five General Phases of the Foreign Military Sales (FMS) Process**



Legend: DSCA: Defense Security Cooperation Agency.

Source: GAO analysis of DSCA documents. | GAO-18-553

Fourteen different DOD components received administrative funds in fiscal years 2012 through 2016, including the military departments—the Army, the Navy, and the Air Force—as well as other DOD components, including DSCA, DFAS, and other implementing agencies (see fig. 3).<sup>13</sup> Military departments generally use administrative funds for administrative costs associated with implementing FMS agreements, such as for personnel and other costs associated with case development, execution, and closure.<sup>14</sup> In addition, for example, the Missile Defense Agency

<sup>13</sup>DOD components include DSCA, DFAS, the military departments and various other DOD implementing agencies that prepare and execute FMS cases.

<sup>14</sup>Various sub-components within each military department implement FMS cases, such as the U.S. Army Corps of Engineers and Army Tank-automotive and Armaments Command; the Naval Supply Systems Command and the Naval Sea Systems Command; and the Advanced—Medium-Range Air-to-Air Missile International Branch and the F-16 Program Office in the Air Force Life Cycle Management Center.

provides personnel and wireless services support for FMS cases, according to agency officials, and the National Geospatial-Intelligence Agency provides geospatial intelligence support for FMS cases.

**Figure 3: Various Department of Defense (DOD) Components Use Foreign Military Sales (FMS) Administrative Funds**



Source: GAO analysis of DOD information. | GAO-18-553

Note: Community Information Technology represents administrative funds that DSCA has provided for information technology initiatives—such as the Security Cooperation Enterprise Solution, a security assistance requisition system that DOD has been developing with administrative funds—for the benefit of the FMS community, across DOD. Community Information Technology funds are managed and spent by multiple DOD components. Overseas combatant commands that have received administrative funds include U.S. Africa Command, U.S. Central Command, U.S. Northern Command, U.S. European Command, U.S. Pacific Command, and U.S. Southern Command.

Six DOD components have received CAS funds since fiscal year 2012, including DCMA, DCAA, the Army, the Navy, the Air Force, and the Defense Information Systems Agency (DISA) (see fig. 4).<sup>15</sup> DSCA officials stated that the majority of CAS funds have been provided to DCMA, which provides contract management support to the military departments for FMS cases. According to DCAA officials, DCAA uses CAS funds to provide audit services and support for FMS contracts, on request by a military department.

**Figure 4: Several Department of Defense (DOD) Components Use Foreign Military Sales (FMS) Contract Administration Services (CAS) Funds**



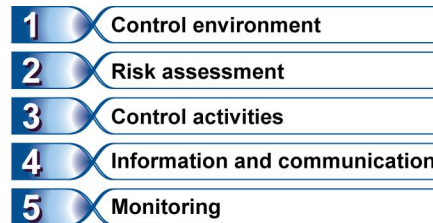
Source: GAO analysis of DOD information. | GAO-18-553

<sup>15</sup>DSCA approved CAS obligation authority for the Air Force and DISA for the first time in fiscal year 2017.

## Financial Risks, Internal Controls, and Prior Audits Related to Oversight of the FMS Trust Fund

To address financial risks, and to help ensure that administrative and CAS funds are spent for allowable and approved purposes and the appropriate funding source is used, both DSCA and the other DOD components that receive these funds have a role in tracking and monitoring their use. Financial risks for the use of administrative and CAS funds include the risk of fraud, waste, and abuse of funds.<sup>16</sup> The internal control framework prescribed for federal agencies includes five components (see fig. 5). These components apply to the use of administrative and CAS funds.

**Figure 5: Components of Internal Control Framework Prescribed for Federal Agencies**



Source: GAO. | GAO-18-553

The internal control framework prescribed for federal agencies calls for designing control activities at various levels, which commonly include top-level reviews by management and entity-level controls pertaining to multiple organizations.

Various audits that we and the DOD Office of Inspector General have conducted in recent decades have shown persistent weaknesses in DOD’s financial oversight of the FMS trust fund—including administrative and CAS funds (see fig. 6). Similarly, we have included DOD financial management as a high-risk area for the federal government since 1995, partly because of long-standing, uncorrected issues with related systems and business processes and material weaknesses in internal control and

<sup>16</sup>According to standards for internal control in the federal government, management should consider the potential for fraud when identifying, managing, and responding to risks; see [GAO-14-704G](#). GAO has also found that effective fraud risk management helps ensure that federal programs’ services fulfill their intended purpose, funds are spent effectively, and assets are safeguarded. See GAO, *A Framework for Managing Fraud Risks in Federal Programs*, [GAO-15-593SP](#) (Washington, D.C.: July 2015).

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financial reporting.<sup>17</sup> DOD's fiscal year 2017 financial report notes that DSCA's security assistance accounts, including the FMS trust fund, are unable to meet full accrual accounting requirements.<sup>18</sup>

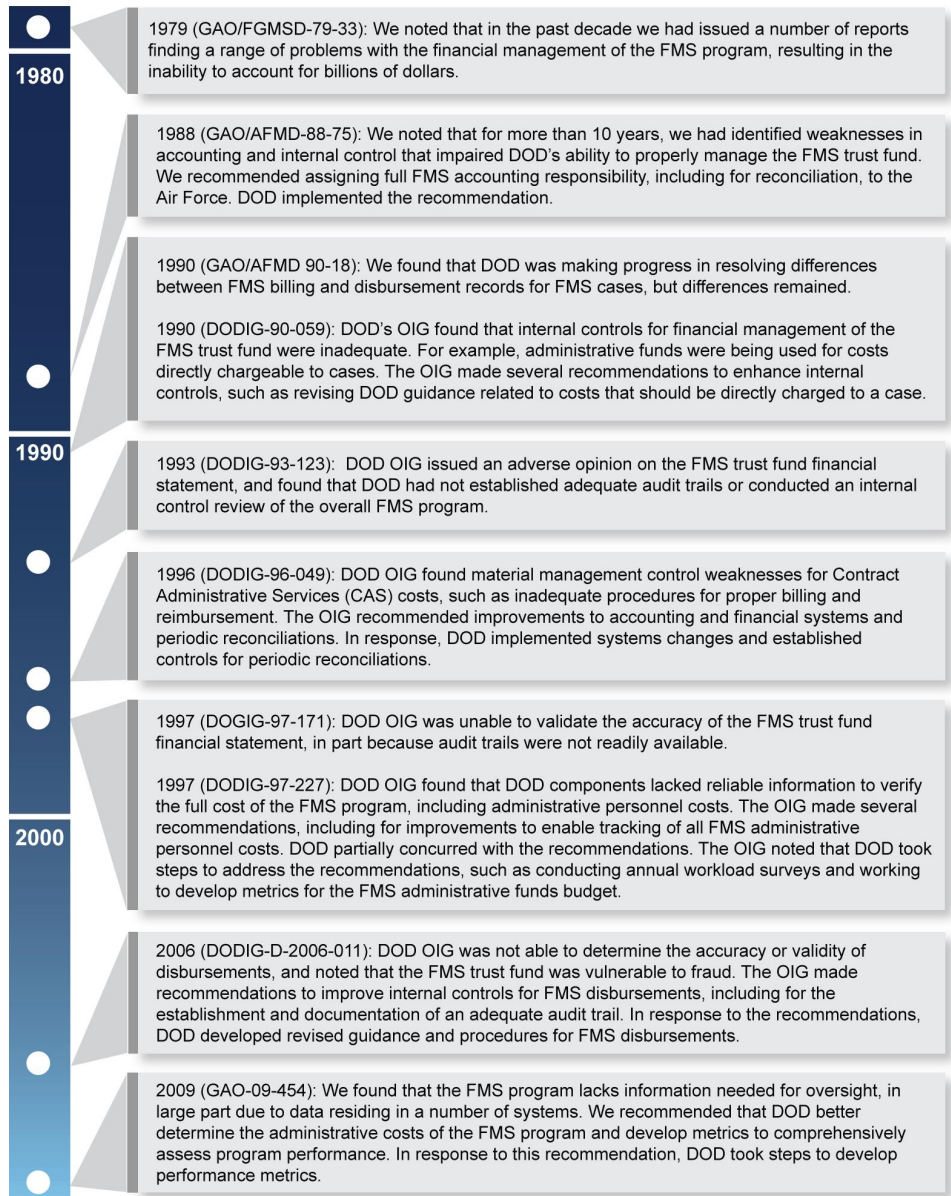
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<sup>17</sup>See GAO, *High-Risk Series: Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others*, [GAO-17-317](#) (Washington, D.C.: February 15, 2017).

<sup>18</sup>According to DOD's fiscal year 2017 financial report, DSCA and other DOD components are in the process of revising accounting systems to record transactions based on the U.S. Standard General Ledger. Until all DOD component systems and related processes are able to collect and report financial information as required by U.S. Generally Accepted Accounting Principles, reported financial data is based on budgetary transactions and data from nonfinancial feeder systems. The Federal Financial Management Improvement Act of 1996 emphasized the need for agencies to have systems that generate timely, accurate, and useful information with which to make informed decisions and to ensure accountability on an ongoing basis. In addition, the Federal Managers Financial Integrity Act of 1982 requires each executive agency to establish internal accounting and administrative controls in accordance with standards prescribed by the Comptroller General.



**Figure 6: Timeline of Prior GAO and Department of Defense (DOD) Office of Inspector General (OIG) Audits with Findings Related to Financial Oversight of Foreign Military Sales (FMS) Trust Fund**



Source: GAO summary of GAO and DOD OIG audit reports. | GAO-18-553

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## DSCA Established Certain Policies and Procedures for Financial Oversight of FMS Administrative Funds, but Its Oversight Has Certain Deficiencies

DSCA has established certain policies and procedures for financial oversight of administrative funds, but we found deficiencies in its oversight to ensure that DSCA has reliable funding data and that these funds are used as intended. First, related to monitoring, and to information and communication, DSCA lacks the reliable funding data it needs to ensure proper spending and to inform its budget decisions. Second, also related to monitoring, and to information and communication, DSCA has not followed its minimum requirements for the number of business process reviews to conduct annually or for tracking the status of action items, and has not selected components for review based on a risk-based approach. Third, related to control activities, DSCA has not conducted periodic, targeted financial reviews to verify components' obligations and disbursements of administrative funds. While DOD's Office of the Under Secretary of Defense (Comptroller) officials noted that, in accordance with DOD policy, DOD components are responsible for monitoring their own internal controls over the use of these funds, including potential deficiencies and corrective actions, they also noted that DSCA should provide direct oversight to ensure the components comply with their responsibilities.<sup>19</sup> The internal control framework prescribed for federal agencies calls for designing control activities at various levels, which commonly include top-level reviews by management and entity-level controls pertaining to multiple organizations.

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### DSCA Has Established Certain Policies and Procedures for Financial Oversight of FMS Administrative Funds

DSCA has established certain policies and procedures for financial oversight of the use of administrative funds. The internal control framework prescribed for federal agencies notes that the establishment of effective internal controls can help agencies achieve objectives related to efficient and effective operations, reliable reporting, and compliance with

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<sup>19</sup>DOD Financial Management Regulation, DOD 7000.14-R, vol. 15, ch. 3-4.

applicable laws and regulations.<sup>20</sup> Examples of DSCA’s internal controls for financial oversight of DOD components’ use of administrative funds include guidance that DSCA developed on how administrative funds may be used, an application for tracking DOD components’ budgeting and execution of funds, reviews of components’ business processes for the use of these funds, and ad hoc reviews of supporting documentation provided for components’ requests for additional funding.<sup>21</sup>

**Guidance on how funds may be used.** Specifically, in March 2017, DSCA released updated guidance for use by DOD components, titled “FMS Activity Matrix,” in its SAMM to clarify the types of activities that should be funded with administrative funds versus other sources, in all phases of the FMS case lifecycle (see table 1).<sup>22</sup> According to DSCA, it developed the revised guidance to help ensure the proper use of administrative funds across DOD components.

**Table 1: Examples of Activities Listed in the Defense Security Cooperation Agency’s (DSCA) “Foreign Military Sales (FMS) Activity Matrix” for Administrative Funds**

FMS phase	Examples of activities that may be funded with administrative funds
Pre-Letter of Request	Define requirements (logistics, maintenance, training) to help a partner nation write a Letter of Request Support foreign visits to the United States for potential FMS program or Letter of Request
Case Development (e.g., Agreement Development)	Enter FMS data and track DSCA metrics Take necessary actions to process a Letter of Request from receipt through completion Develop and prepare Letters of Offer and Acceptance, amendments, and modifications Conduct quality control to ensure legal, financial, and policy compliance Participate in case development meetings
Case Execution (e.g., Acquisition and Delivery)	Establish cost, schedule, and performance goals and objectives for case execution Process logistics acquisitions and track defense articles from ordering through delivery Develop integrated master schedule for items on a Letter of Offer and Acceptance

<sup>20</sup>See [GAO-14-704G](#).

<sup>21</sup>DSCA also manages and oversees the annual Security Assistance Program and Budget Review process, through which DSCA reviews and approves implementing agencies’ administrative budget requests.

<sup>22</sup>This guidance defines the list of activities in all phases of the FMS Letter of Offer and Acceptance Lifecycle and their appropriate funding source. FMS case-related activities funded by the administrative fund are considered standard, indirect charges. Direct charges are considered non-standard and are included as line items on an FMS case. Other funding sources include, for example, funds appropriated for DOD operation and maintenance.

FMS phase	Examples of activities that may be funded with administrative funds
	Conduct financial management and case reconciliation of financial and logistical management systems until case is complete
	Monitor and manage case performance, including scope, schedule of work, cost, problem resolution, and financial management services
	Maintain case files
Case Closure	Perform case closure activities
Case Review	Conduct day-to-day case analysis, including review of financial status and related meetings or correspondence
	Analyze space rental or refurbishment charges, and information technology services or equipment, specifically incurred to support the FMS “community” mission

Source: GAO analysis of DSCA information. | GAO-18-553

**An application for tracking funds.** In addition, DSCA developed an application, called the Budgeting, Programming, and Execution Submission Management and Reporting Tool (BeSMART), as the authoritative database for budgeting and tracking execution of administrative funds by all DOD components at both the component and the object class<sup>23</sup> level.<sup>24</sup> According to the application’s user guide, DSCA developed BeSMART to improve efficiency and accountability, as an integrated application that would allow DSCA to analyze budget estimates and actual execution and to review manpower levels and average work-year costs.<sup>25</sup> According to DSCA officials, DSCA requires DOD components to submit funding data, including obligations and

<sup>23</sup>Office of Management and Budget (OMB) Circular No. A-11 provides guidance to federal agencies on classifying obligations by object class, or items or services provided. Major object classes include personnel compensation and benefits, contractual services and supplies, acquisition of assets, and grants and fixed charges.

<sup>24</sup>DOD Financial Management Regulation, vol. 4, ch. 19, notes that the *Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards 4 – Managerial Cost Accounting Concepts and Standards for the Federal Government* (July 31, 1995) provides cost management guidance and direction to be used to support management decision-making across DOD, as well as to provide accurate and timely reporting of cost information. DOD’s Financial Management Regulation also notes that, according to managerial cost accounting standards, costs reflect resources used or consumed to accomplish a given objective, and cost information is an essential component of any well-managed, cost-effective organization. DOD’s Financial Management Regulation adds that budgetary accounting should be provided along with cost information, for use in determining resource needs and future budgets, and that cost information should be reconcilable to the original source. Further, it notes that costs should be recorded at a level that is discrete enough to establish cost centers and define outputs.

<sup>25</sup>According to a DSCA official, DSCA began developing the BeSMART application in 2010.

disbursements, monthly.<sup>26</sup> DSCA officials also told us that DSCA has performed monthly reviews of overall status of funds reports from BeSMART for certain components. These reports are provided to DSCA by DFAS and show data on the status of obligations and disbursements for the military departments and overseas combatant commands.

**Reviews of business processes.** DSCA has conducted periodic reviews of DOD components' business processes related to the use of administrative funds, called business process reviews. DSCA developed procedures for these reviews, which typically involve 2 to 3 days of meetings between DSCA and recipient organizations focused on how the components determine resource requirements and apply administrative funds to the appropriate types of expenses, in accordance with the "FMS Activity Matrix."<sup>27</sup> According to DSCA's SAMM, DSCA began conducting business process reviews to carry out its responsibility to ensure funds are used correctly and in compliance with security assistance policies, and the purpose of these reviews is to evaluate an organization's practices related to the use of administrative funds, to identify any best practices and needed improvements.<sup>28</sup>

**Resource management reviews.** DSCA has also carried out ad hoc resource management reviews, which involve the review of documentation provided by components in support of requests for additional funding, such as information on an organization's administrative workload and resource management. Specifically, according to DSCA officials, DSCA conducted three resource management reviews in fiscal years 2012 through 2016: one in fiscal year 2016 for the Air Force's civilian pay funded by administrative funds,

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<sup>26</sup>DOD's Financial Management Regulation, vol. 15, ch.3, requires DOD components to submit monthly status of allotments reports for administrative funds to DFAS showing current allocations, obligations, and disbursements for the end of that reporting month.

<sup>27</sup>DSCA officials noted that DSCA's standard operating procedures for these reviews call for DSCA to review case lines for selected FMS cases as part of the reviews.

<sup>28</sup>The SAMM adds that the business process review is neither an audit nor an inspection, but a joint effort, with the applicable implementing agency, to assess and better understand the existing processes, and assist with any issues.

another for the Army Contracting Command in fiscal year 2015, and another for the Navy's Naval Air Systems Command in fiscal year 2013.<sup>29</sup>

## DSCA Lacks Reliable Data on DOD Components' Use of FMS Administrative Funds

### Internal Control Components: Information and Communication, and Monitoring

- 1 Control environment
- 2 Risk assessment
- 3 Control activities
- 4 Information and communication
- 5 Monitoring

According to internal control standards prescribed for federal agencies, management should use, and externally communicate, quality information to achieve an entity's objectives, and management should perform monitoring activities.

Key attributes that contribute to the operating effectiveness of the Information and Communication principle include identifying

<sup>29</sup>According to DSCA officials, the purpose and results of these reviews have varied. For example, according to Air Force officials, as a result of DSCA's Resource Management Review of the Air Force's civilian pay in fiscal year 2016, DSCA issued a memorandum to the Under Secretary of the Air Force for International Affairs in June 2017 that included a requirement for the Air Force to provide evidence to DSCA that it had implemented management reforms to prevent sub-organizations from changing the size and shape of their administrative workforce without prior DSCA approval.

information requirements; obtaining relevant and reliable data in a timely manner; and processing, using, and externally communicating data into quality information to make informed decisions and address risks. For Monitoring, key attributes include establishing a baseline and internal control system monitoring. Common management activities include ongoing monitoring, including regular management and supervisory activities, as well as reconciliations, to identify internal control issues.

Source: GAO. | GAO-18-553

Although DSCA developed an application for tracking DOD components' budgeting and execution of administrative funds, we determined that DSCA lacks reliable data on components' use of administrative funds, because it has not conducted regular reconciliations of the data to the components' source data. We identified gaps and inconsistencies in DSCA's data from the BeSMART application, discussed below. DSCA has not conducted regular reconciliations of the data, with the support of its financial service provider and other DOD components, to identify and correct data reliability concerns, including gaps and inconsistencies in reported spending in BeSMART for the Army, the Navy, and the Air Force—the primary recipients of administrative funds. DSCA officials stated that, in accordance with DOD policy, DFAS, as DSCA's financial service provider, has a responsibility to provide reliable financial reporting for administrative funds to DSCA.<sup>30</sup> However, DFAS officials noted that they have not conducted any reconciliation of the data to ensure that it is reliable. As a result, DSCA lacks the information and data that it needs to fulfill its financial management responsibility to monitor DOD components' use of administrative funds, including trends in the use of funds, as well as adherence to requirements.<sup>31</sup> Without actual spending data, DSCA is also hampered in its ability to make informed budget decisions and to assess the validity of its approved budgets for components' use of these funds. The internal control framework prescribed for federal agencies calls for management to perform monitoring activities, and also for management to use quality information to achieve an entity's objectives.<sup>32</sup>

We found that DSCA lacks reliable data on DOD components' use of administrative budget, obligations, and disbursements data, by component and by object class, in its BeSMART application. DSCA provided administrative funding data from BeSMART to us that showed, for example, approximately \$469 million in reported disbursements by the Army, the Navy, and the Air Force in fiscal year 2016. However, DSCA cannot be assured that its data are accurate, because it has not taken

<sup>30</sup>According to DSCA officials, DOD Financial Management Regulation, DOD 7000.14-R, vol. 6A, ch.2 applies to administrative and CAS funds. This section of the Financial Management Regulation notes that the reconciliation of source data is a joint responsibility of DFAS and the DOD components.

<sup>31</sup>For example, DSCA requires DOD components to expend no more than 8 percent of administrative funds on pre-Letter of Request activities. DSCA has delegated responsibility to the components for ensuring that they meet the requirement to expend no more than 8 percent of administrative funds on pre-Letter of Request activities.

<sup>32</sup>See [GAO-14-704G](#).

adequate steps to monitor the data or to ensure that DFAS—its financial service provider—has conducted reconciliations of the data.<sup>33</sup> We identified gaps and inconsistencies at both the DOD component and object class level in our review of budget, obligations, and disbursements data that DSCA has collected in its BeSMART application on DOD components' use of administrative funds in fiscal years 2012 through 2016.<sup>34</sup> For example,

- DSCA's BeSMART obligations and disbursements data for the Army's civilian full-time permanent pay object class in fiscal years 2012 through 2016 were not in line with approved budgets for those years. DSCA's budget data for the Army showed at least \$100 million under the civilian full-time permanent pay object class in each fiscal year from 2012 through 2016. However, we found that reported obligations and disbursements—which were generally equivalent—for the Army's civilian full-time permanent pay decreased from approximately \$24 million in fiscal year 2012 to approximately \$4 million in fiscal years 2013 through 2015, and further decreased to approximately \$33,000 in fiscal year 2016, raising questions about the accuracy of the data the Army reported for this object class.<sup>35</sup>
- DSCA's BeSMART data showed no administrative obligations or disbursements for certain DOD components in some fiscal years, although DSCA had approved administrative budget requests for those entities. For example, DSCA's data showed no administrative obligations or disbursements in fiscal years 2012 through 2013 and in fiscal years 2015 through 2016 for DFAS—which had total approved

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<sup>33</sup>Specifically, such reconciliation should include monitoring the data to identify any gaps or inconsistencies, and working with the DOD components to identify the cause and correct any data reliability issues.

<sup>34</sup>DSCA officials noted that OMB Circular No. A-11 does not require them to collect administrative funds data at the object class level; however, DSCA established a requirement for DOD components to provide the object class data to better inform DSCA's resource decisions.

<sup>35</sup>According to DSCA officials, DOD components are required to obligate administrative funds within the fiscal year in which funds are approved, and a majority of funds are also disbursed within the fiscal year in which they are approved. Army officials indicated that the BeSMART data for the Army's civilian full-time permanent pay object class do not represent actual under-execution of administrative funds, but that the data were inaccurate due to a systems issue; however, our audit procedures did not include testing to verify these costs. Army officials added that, although the BeSMART data was inaccurate for this object class, they submitted correct data on their actual spending annually to DSCA through BeSMART in a budgetary worksheet as part of the Army's annual budget request for administrative funds.



budgets of approximately \$86 million for those fiscal years, or for the National Security Agency—which had an approved budget of approximately \$764,000.<sup>36</sup> Additionally, DSCA’s data showed no administrative obligations or disbursements in fiscal year 2015 for the National Geospatial-Intelligence Agency—which had an approved budget of approximately \$1.1 million; and in fiscal years 2015 and 2016 for DCMA—which had an approved budget of approximately \$1.3 million, or for DISA—which had an approved budget of approximately \$551,000.

- DSCA also was not able to provide actual administrative obligations or disbursements data for Community Information Technology Funds. According to DSCA officials, in fiscal years 2012 through 2016 these funds were provided for the Security Cooperation Enterprise Solution (SCES)—a security assistance requisition system that DOD has been developing with administrative funds—which had a budget in BeSMART of a total of about \$205 million in those fiscal years.<sup>37</sup> We found that DSCA’s budget data for SCES by object class showed a total of about \$510,000 for military personnel in fiscal years 2013 and 2015, which is not an allowable use of administrative funds under the Arms Export Control Act.<sup>38</sup> DSCA officials indicated that the funding

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<sup>36</sup>According to DSCA officials, they also received annual data on DFAS’s administrative obligations and disbursements from fiscal years 2012 through 2016 outside of BeSMART, in end-of-year status of funds reports. However, a DSCA official expressed concerns about the reliability of the execution data in the end-of-year status of funds reports, because any updates to obligations and disbursements after the end of the fiscal year would not be included in the data. In addition, the data in those reports are not provided by object class.

<sup>37</sup>According to DSCA officials, SCES is a system that DSCA has been working to develop since 2008 as a replacement for various legacy military department data systems, to serve as the primary requisition system for security cooperation programs, including FMS. DSCA officials indicated that SCES will not serve as a financial management system for FMS administrative or CAS funds.

<sup>38</sup>Congress amended the Arms Export Control Act in 1989 to exclude from the administrative fee certain expenses associated with military personnel who work on the FMS program as well as unfunded civilian retirement and other benefits. Pub. L. No. 101-165, § 9104(b)(1) (amending section 43(b) of the Arms Export Control Act). According to DSCA officials, this section of the Arms Export Control Act does not apply to U.S. Coast Guard military personnel; however, U.S. Coast Guard military personnel do not have a role in SCES.

for military personnel likely represented a budgeting error.<sup>39</sup> However, DSCA was not able to provide obligations and disbursements data for SCES, by object class, to show whether actual spending was reported for military personnel.<sup>40</sup> DSCA officials noted that actual spending data for SCES were not readily available, because DSCA does not track the actual spending once the funding is approved by DSCA and provided to DOD components (e.g., the Defense Logistics Agency and the Navy).

DSCA officials indicated that these data gaps and inconsistencies may be due in part to a lack of a direct systems interface between BeSMART and other components' systems and to incomplete submissions by some components. According to DSCA officials, although DFAS is not responsible for BeSMART system maintenance or modifications, DFAS, as DSCA's financial service provider, nevertheless has a responsibility to provide reliable financial reporting for administrative funds to DSCA.<sup>41</sup> However, DFAS officials noted that DFAS has not conducted any reconciliation of the data from the BeSMART application to components' source data. Instead, DFAS has relied on the components to provide complete and accurate data. As a result, DFAS has not reviewed the data to identify any actions needed to correct any data reliability issues. Officials whom we interviewed at each of the military departments also raised questions about the reliability of their BeSMART data, particularly for actual obligations and disbursements of administrative funds, and

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<sup>39</sup>DSCA officials noted that budget data are not approved by object class and that an implementing agency is able to execute funds for an object class even if it did not include funds for that object class in its budget. However, DSCA's annual budget guidance for administrative fund states that components should be prepared to explain and defend any yearly increases or decreases in requested funding by object class equal to or greater than 5 percent above or below inflation.

<sup>40</sup>In addition, we found that DSCA's budget data for SCES did not match data provided to us by the DOD component that is responsible for SCES program management—the Defense Logistics Agency. The Defense Logistic Agency's data showed that about \$199 million was provided for SCES for those years; these data were not reported by object class. DSCA officials indicated that DSCA's data likely reflected an initial budget, whereas the Defense Logistic Agency's data should accurately reflect the final approved budget or obligation authority.

<sup>41</sup>DSCA officials referred to DOD's Financial Management Regulation, DOD 7000.14-R, vol. 6A, ch. 2.

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noted that the manual data entry could lead to problems with the data.<sup>42</sup> DSCA officials noted that, as of January 2018, they were considering other options for collecting reliable data, including an application that could compile data from direct interfaces with other entities' systems. However, without adequate procedures for monitoring the reliability of the data that it receives, DSCA is unable to fully perform its overall financial management responsibility.

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### DSCA Did Not Fully Comply with its Requirements for Reviews of DOD Components' Processes for Using FMS Administrative Funds

DSCA has not fully complied with its requirements for conducting reviews of DOD components' business processes related to the use of administrative funds. In addition, its policy for selecting military department organizations for review does not adequately reflect internal control standards, which call for a risk-based approach. DSCA established requirements and procedures in its SAMM for reviewing DOD components' business processes related to the use of administrative funds. Our review of DSCA's standard operating procedures and other documentation for these reviews conducted since 2012 found that these reviews have provided an opportunity to share information between both parties about positive practices for identifying resource requirements and to identify potential problems such as overlap or inefficiencies in staffing.<sup>43</sup> However, DSCA has not complied with its SAMM requirement to conduct

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<sup>42</sup>For example, officials from the Office of the Deputy Assistant Secretary of the Army for Defense Exports and Cooperation noted that they were concerned about the lack of an audit trail in BeSMART, since it is not possible to see who has made a change in their data in BeSMART or when a change was made. They indicated that because there is not a direct interface between BeSMART and the Army's source systems, changes made in source systems would not necessarily be reflected in their BeSMART data. In addition, Navy International Program Office officials stated that the Navy's administrative allocations data are reliable, but they cannot attest to the reliability of the Navy's administrative obligations and disbursements data in BeSMART, because the data are manually entered and the Navy International Programs Office lacks access to verify administrative funds data from Navy sub-component systems. Officials from the Office of the Secretary of the Air Force for International Affairs also noted that their BeSMART data are manually entered and not linked to the Air Force's official accounting system and this has created limitations in the Air Force's administrative execution data in BeSMART.

<sup>43</sup>For example, as a result of the business process reviews that DSCA conducted, DSCA updated its SAMM guidance on how funds may be used, to address a discrepancy that it identified in implementing agencies' interpretations of whether activities should be funded with administrative funds or other sources.

at least two business process reviews with selected military department organizations each year. Also, according to DSCA officials, DSCA does not maintain a list of organizations and offices within the military departments that receive administrative funds. As a result, it is not clear that DSCA is able to select organizations for review based on a risk-based approach. Further, DSCA has not conducted reviews with DOD components other than the military departments, and it has not tracked and followed-up on action items from the reviews that it has conducted with military departments. The internal control framework prescribed for federal agencies calls for management to perform monitoring activities and to use, and externally communicate, quality information to achieve an entity's objectives, to make informed decisions, and address risks.<sup>44</sup>

DSCA's SAMM requires DSCA to conduct at least two business process reviews with selected military department organizations each year. In addition, the SAMM states that DSCA's goal is to conduct three reviews with military department organizations annually, with one review for an organization or office within each of the three military departments. From 2012 through 2017, we found that DSCA met its goal in 3 years and its requirement in an additional year, but DSCA did not conduct any business process reviews with military department organizations in 2015 or 2017. Specifically:

- In 2015, DSCA issued a memo to the military departments noting that it was temporarily suspending the reviews, due to ongoing efforts to revise the SAMM guidance on the use of administrative funds and to implement other initiatives related to DSCA's 2020 strategic plan.
- In 2016, DSCA resumed the reviews and met its requirement by conducting two reviews—one for an Air Force organization in July 2016, and another for a Navy organization in October 2016.
- In 2017, according to DSCA officials, DSCA did not conduct any reviews, due to its ongoing focus on initiatives related to the implementation of its 2020 strategic plan, and also to allow time for the military departments to implement DSCA's revised SAMM guidance.

Further, the SAMM states that DSCA may also conduct reviews of DOD components other than the military departments that receive administrative funds, to help ensure that the other components also use

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<sup>44</sup>See [GAO-14-704G](#).

administrative funds correctly and in compliance with security assistance policies, as well as to identify any needed improvements in their use of these funds. However, DSCA did not conduct any reviews with components other than the military departments in 2012 through 2017.

Table 2 provides a summary of the business process reviews that DSCA conducted in 2012 through 2017.

**Table 2: Defense Security Cooperation Agency’s (DSCA) Business Process Reviews for Department of Defense (DOD) Components’ Use of Foreign Military Sales (FMS) Administrative Funds in 2012-2017**

Year	Annual requirement for at least two reviews with military departments <sup>a</sup> met	Annual goal for one review per military department met	Reviews conducted with other DOD components <sup>b</sup>
2012	Yes	Yes	No
2013	Yes	Yes	No
2014	Yes	Yes	No
2015	No	No	No
2016	Yes	No	No
2017	No	No	No

Source: GAO analysis of DSCA information. | GAO-18-553

<sup>a</sup>The military departments are the Army, the Navy, and the Air Force.

<sup>b</sup>Other DOD components that receive administrative funding include, for example, the Defense Contract Management Agency, the Defense Information Systems Agency, the Defense Logistics Agency, the Missile Defense Agency, the National Geospatial-Intelligence Agency, and the National Security Agency.

<sup>c</sup>In June 2015, DSCA issued a memo to the military departments noting that it was temporarily suspending its business process reviews due to ongoing efforts to revise its guidance on the use of administrative funds and to develop DSCA’s 2020 strategic plan.

<sup>d</sup>According to DSCA officials, DSCA did not conduct any business process reviews in 2017 to allow time for the military departments to implement its revised guidance on the use of administrative funds, which was released in March 2017.

DSCA officials indicated that DSCA has focused its reviews to date on the military departments, since they receive the majority of administrative funds. DSCA officials noted that they learned of potential concerns related to one DOD component’s use of administrative funds in the summer of 2017. Nevertheless, as of February 2018, DSCA officials stated that they had not yet scheduled a review for that component. The officials added that they would not begin developing a schedule for any business process reviews to be conducted in 2018 for military department organizations or any other components until after March 2018—the 1-

year anniversary of the release of the revised SAMM guidance.<sup>45</sup> As a result, DSCA has not carried out a key mechanism for providing guidance and oversight to military department organizations and other DOD components on their use of administrative funds, including implementation of the revised SAMM guidance. DSCA may also lack timely awareness of any positive practices or internal control deficiencies, such as potential inefficiencies or wasteful use of funds.

Further, DSCA has not developed a risk-based approach for selecting military department organizations or offices for business process reviews, in accordance with internal control standards.<sup>46</sup> Specifically, the SAMM notes that to identify organizations for review, DSCA is to issue an annual request to DSCA and military department officials for nominations of organizations or offices that would benefit from a business process review. According to DSCA officials, DSCA does not maintain a list of organizations and offices within the military departments that receive administrative funds and therefore could be the subject of a business process review, because DSCA's selections for these reviews are based on nominations by the military departments.<sup>47</sup> We requested such a list from DSCA, but DSCA was not able to provide it as of April 30, 2018. As a result, it is not clear that DSCA has sufficient information needed to conduct a risk based approach to selecting the organizations most in need of review. Such an approach could include representative sampling over time, as well as considering whether an entity has received a prior review, the amount of funding received, prior audit findings, or other identified risks. However, without a complete list of military department organizations and offices that receive administrative funds, DSCA risks not having full information to be able to adequately perform monitoring activities for all uses of administrative funds.

Additionally, DSCA's SAMM states that DSCA will prepare minutes from these reviews, including any action items, and track and follow up on any action items until they have been completed. DSCA was able to provide us with a list of action items from 10 of the 11 business process reviews that it has conducted with the military departments since 2012. For

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<sup>45</sup>On March 28, 2018, DSCA officials informed us that they had not yet scheduled any business process reviews for 2018.

<sup>46</sup>See [GAO-14-704G](#).

<sup>47</sup>DSCA approves administrative budgets at the DOD component level, and the components are responsible for allocating funds across sub-organizations and offices.

example, prior action items have called for an organization to provide DSCA with additional information on FMS personnel and funding sources for sub-organizations, as well as for DSCA to determine whether certain costs should be paid for by administrative funds. However, DSCA does not have a systematic process to track the status of the action items. DSCA officials noted that tracking has varied depending on the official who carried out the review and on the level of involvement on the part of the reviewed organization. As a result, DSCA was unable to provide an update on the status of action items from most of these reviews.<sup>48</sup>

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### DSCA Has Not Developed a Process for Targeted Financial Reviews of Use of FMS Administrative Funds

DSCA has not developed a process for conducting targeted financial reviews to verify DOD components' obligations and disbursements of administrative funds, including any review of supporting documentation.<sup>49</sup> Such documentation could include timesheets and personnel reports; travel orders; documentation from components' quality assurance reviews or studies related to their execution of administrative funds; as well as invoices or receipts related to components' use of administrative funds for supplies, equipment, or contractual costs. As a result, DSCA cannot provide reasonable assurance that DOD components' actual spending of administrative funds is allowable and approved, and reflects the appropriate funding source. DOD's Financial Management Regulation and DSCA's SAMM require DSCA to periodically monitor the use of funds, as part of its financial management responsibility for the FMS trust fund. Although DOD components are responsible for their own internal control programs, including investigating any potential internal control deficiencies and identifying any necessary corrective action, DSCA has an overall oversight responsibility to ensure that administrative funds are

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<sup>48</sup>DSCA provided an update on the status of action items for 2 of 11 reviews that it conducted since 2012. Specifically, as of August 2017, DSCA had documented updates on the status of some action items from two reviews that it conducted in October 2016 and August 2014.

<sup>49</sup>We have previously defined a targeted financial review as a review by management that verifies actual incurred costs compared to planned budgets; appropriately documented transactions and internal controls; and provides reasonable assurance that financial transactions were properly executed, valid, accurate, and timely. (See [GAO-17-224](#) and [GAO-14-704G](#).) Such targeted reviews may vary in scope and frequency, depending on factors such as prior audits or risks identified.

used correctly by DOD components, including DSCA, DFAS, the military departments, and other DOD components. The internal control framework

**Internal Control Component: Control Activities**

1	Control environment
2	Risk assessment
3	<b>Control activities</b>
4	Information and communication
5	Monitoring

According to internal control standards prescribed for federal agencies, management should design control activities to achieve objectives and respond to risks. Control activities are the actions management established through policies and procedures to achieve objectives. For financial management, common control activity categories include:

- Top-level reviews by management
- Proper execution of transactions
- Accurate and timely recording of transactions
- Appropriate documentation of transactions and internal control
- Reviews by management at the activity level
- Entity-level controls pertaining to multiple components



Source: GAO. | GAO-18-553

prescribed for federal agencies calls for management to design control activities, which commonly include entity-level controls pertaining to multiple components and top-level reviews by management, to achieve objectives and respond to risks.<sup>50</sup> Targeted financial reviews can also help identify potential gaps and areas for improvement in internal controls, and provide a reliable picture of liabilities and spending.

In its October 2017 report to Congress on the management and use of administrative funds, DSCA reported that it conducts regular and multiple levels of oversight to ensure sound management and use of these funds. However, we found that DSCA's oversight mechanisms do not include any verification of DOD components' actual obligations and disbursements of these funds. For example, DSCA reported that it has conducted reviews of the overall administrative account balance and fee rate, developed SAMM guidance on how funds may be used, and conducted business process reviews.<sup>51</sup> While DSCA's reviews of the overall administrative account balance address funds flowing into and out of the account, they do not include any verification of DOD components' actual spending of these funds.<sup>52</sup> In addition, DSCA's business process reviews also do not include any cost verification or financial transactions testing. Such testing can be used to verify the proper approval, accuracy, validity, and completeness of supporting documentation and ensure that the dollar amount of a transaction was properly supported. According to DOD's Office of the Under Secretary of Defense (Comptroller), DSCA's oversight responsibilities include monitoring components' actual administrative spending and internal controls over the use of these funds, in accordance with DOD's Financial Management Regulation.

<sup>50</sup>See [GAO-14-704G](#).

<sup>51</sup>See Defense Security Cooperation Agency, *Foreign Military Sales Administrative Surcharge Fund Management* (October 23, 2017.) DSCA provided this report to congress in response to a requirement in section 1297(a) of the National Defense Authorization Act for Fiscal Year 2017, for the Secretary of Defense to provide a plan to improve the management and use of fees collected on transfer of defense articles and services via sale, lease, or grant to international customers under programs over which DSCA has administration responsibilities. Pub. L. No. 114-328, § 1297(a), 130 Stat. 2000, 2563 (2016).

<sup>52</sup>We previously reviewed data reliability for DSCA's overall administrative and CAS account balances (e.g., DSCA's collections into the accounts and overall disbursements out of the accounts) for fiscal years 2007 to 2017, and found the data to generally be reliable for our purposes, except for gaps in the fiscal years 2016 to 2017 CAS data. See [GAO-18-401](#) for more information.

Monthly status of administrative funds reports for the military departments and the overseas combatant commands that DSCA received from DFAS showed instances of over or under-obligations and disbursements of funds, raising questions about potential internal control deficiencies. DSCA's data also showed that DOD components have obligated and disbursed administrative funds for personnel as well other costs, including services, equipment, and contractual costs. However, DSCA and DFAS officials noted that they do not take any steps to verify components' reported costs, including review of supporting documentation to verify costs and any actions taken by the components to identify and correct any internal control deficiencies. As a result, DSCA lacks reasonable assurance that any internal control deficiencies that may have led to these reporting issues have been identified and addressed. DFAS officials noted that they—not DSCA—would generally follow up with components to provide information and training, as necessary, on any potential issues identified in the monthly status of administrative funds reports. However, the DFAS officials added that they do not follow up with the components to verify the cause and corrective actions taken to address any internal control issues.<sup>53</sup> For example, the June 2017 status report showed about \$4.5 million in over-disbursements for the Navy in fiscal years 2012 and 2013.<sup>54</sup> DFAS provided supporting documents to us that indicated that the Navy had increased obligations to match disbursements, but DFAS officials were unable to provide additional details on the cause of the issue or steps taken by the Navy to address it.

Further, in fiscal year 2017, DSCA found that the Air Force and DISA had been incorrectly using administrative or FMS case funds for contract administration services costs that should have been covered by CAS

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<sup>53</sup>According to DFAS officials, they have followed up with DOD components on potential issues identified in these reports to request that the components research the issues and take necessary corrective action, but DFAS does not take any additional steps to verify the cause and any corrective actions taken by the components to address any internal control issues.

<sup>54</sup>Our review of monthly administrative status of funds reports from January 2015 to June 2017 found that the reports showed ongoing potential issues for several organizations within the Navy, such as unobligated balances, unliquidated obligations, and over-disbursements of funds going back to fiscal year 2012. According to GAO's budget glossary, an obligated balance, or unliquidated obligation, is the amount of obligations incurred for which payment has not been made. For budget authority that is available for a fixed period, the obligated balance remains available to liquidate obligations for five fiscal years. At the end of the fifth fiscal year, the account is closed and any remaining balance is cancelled. See GAO, *A Glossary of Terms Used in the Federal Budget Process*, [GAO-05-734SP](#) (Washington, D.C.: September 2005).

funds. According to DSCA officials, as a result, DSCA began providing CAS funds to cover these costs for the Air Force and DISA in fiscal year 2017.<sup>55</sup> DSCA officials told us that they became aware of the issue following inquiries from the DOD components. The officials added that DSCA relies on DOD components to request appropriate funding types and levels. In January 2018, DSCA officials indicated that later in fiscal year 2018 they planned to begin issuing additional annual guidance to DOD in an effort to raise awareness about administrative and CAS account funding types and requirements. According to military department officials, each of the military departments conducts some reviews related to their execution of administrative funds, such as personnel time and attendance reviews, to verify that the proper funding source was used.<sup>56</sup> However, DSCA officials noted that they do not conduct any reviews of military departments' internal controls related to their execution of administrative funds, because, in their view, the DOD components are responsible for ensuring spending is allowable and appropriate in accordance with approved budgets.

DSCA officials noted that DSCA's oversight of the use of administrative funds has focused on approving budgets, rather than oversight of actual spending, because these funds are collected based on a percentage charge, and also due to the challenges of tracking actual costs in DOD components' financial systems.<sup>57</sup> However, DSCA officials added that DSCA plans to audit the trust fund, as well as other security assistance accounts, in fiscal year 2022, in conjunction with DSCA's financial

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<sup>55</sup>DSCA approved CAS obligation authority of about \$4.7 million for the Air Force and \$150,000 for DISA in fiscal year 2017. In January 2018, DSCA officials indicated that they were unsure about whether any additional steps would be taken to determine how much funding was inappropriately used in prior years, or to correct the issue for prior years.

<sup>56</sup>Although Army and Navy officials indicated that their components do not conduct transactions testing of their administrative costs, Air Force officials indicated that the Air Force conducts transactions testing related to its use of administrative funds.

<sup>57</sup>Although the administrative fee is to be based on a percentage to recover the estimated cost of the administration of sales, best practices for cost estimating and assessment that we have previously identified note that criteria for effective cost estimating include the use of historical actual cost data to calibrate modeling. In addition, internal control standards note that managers need financial data to determine whether they are meeting their accountability goals for effective and efficient use of resources. See GAO, *GAO Cost Estimating and Assessment Guide*, [GAO-09-3SP](#) (Washington, D.C.: March 2009) and [GAO-14-704G](#). As noted earlier, GAO has listed DOD financial management as a high-risk area for the federal government since 1995 partly because of long-standing, uncorrected issues with related systems and business processes and weaknesses in material internal control and financial reporting.

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statement audit.<sup>58</sup> DOD has previously found that such an audit can help drive enterprise-wide improvements to standardize business processes and improve data quality, as well as transparency and accountability.<sup>59</sup> DSCA's Financial Improvement and Audit Readiness (FIAR) team is considering incorporating FMS into its financial transactions testing in the future, for purposes of financial statement auditability, according to DSCA officials. DOD's FIAR guidance provides suggested test procedures that include the use of actual costs in testing. DSCA's FIAR team shared documentation with us from "mock" audit testing that they conducted for DSCA's use of fiscal years 2015 and 2016 appropriated funds, which included data reliability questions and testing procedures that generally appeared to be appropriately designed.<sup>60</sup> We did not independently evaluate or perform any testing of the mock audit.<sup>61</sup>

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## DSCA Has Inadequate Policies and Procedures to Provide Reliable Data and Ensure CAS

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<sup>58</sup>A financial statement audit is an examination of an entity's financial statements by an independent auditor. The purpose of a financial statement audit is to add credibility to an entity's reported financial position and performance, and it can also enhance management oversight. DSCA is currently undergoing an audit examination of its use of non-FMS appropriated funds, in preparation for its financial statement audit readiness. Also, according to DSCA officials, in fiscal year 2017, DSCA began a review of the FMS trust fund to assess audit readiness and identify necessary corrective actions in preparation for a full financial audit of the FMS trust fund in fiscal year 2022. DSCA officials indicated that their efforts are in the early stages, and that focus areas for initial corrective actions to enhance DOD financial management of the FMS trust fund will include undertaking a full reconciliation of administrative funds across the entire universe of DOD components' financial systems, and incorporating administrative funds data from across the department into a reconciliation and reporting tool to standardize the department's reconciliation and oversight capabilities for these funds.

<sup>59</sup>For example, DOD has previously reported that a financial statement audit can help improve transparency by providing a reliable picture of liabilities and spending. For accountability, such an audit can provide feedback on new investments in business systems, to better hold vendors accountable for their solutions. See DOD, *Department of Defense Update on the Financial Improvement and Audit Remediation (FIAR) Plan, Testimony Before the House Armed Services Committee* (January 10, 2018).

<sup>60</sup>According to DSCA officials, DSCA conducted "mock" audit testing of appropriated funds that DSCA received to implement activities under section 10 of the United States code, such as supporting U.S. contingency operations.

<sup>61</sup>Specifically, we reviewed the FIAR team's "mock" audit documentation to understand what their review entailed. We found that the procedures appeared to be appropriately designed; however, because this work did not include FMS funds, we did not perform any audit procedures on their work.

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## Funds Are Used for Allowable and Approved Purposes

DSCA has not developed adequate controls to ensure that it has reliable data on DOD components' use of CAS funds and to provide assurance that components' use of these funds is allowable and approved. We found certain deficiencies in DSCA's controls for financial oversight of DOD components' use of CAS funds related to monitoring, information and communication, and control activities. First, related to monitoring, and information and communication, DSCA lacks reliable data on DOD components' use of CAS funds. Second, related to control activities, DSCA has not conducted periodic, targeted financial reviews of DOD components' obligations and disbursements of CAS funds. The internal control framework prescribed for federal agencies calls for designing control activities at various levels, which commonly include top-level reviews by management and entity-level controls pertaining to multiple components.<sup>62</sup> Without conducting periodic, targeted reviews to verify CAS costs and controls, DSCA raises the risk of unallowable or unapproved payments that could lead to fraud, waste, or abuse of funds.

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### DSCA Lacks Reliable Data on DOD Components' Use of CAS Funds

Although DSCA has collected some data on components' use of CAS funds from budgeting through execution, DSCA lacks reliable data on DOD components' actual spending due to gaps and inconsistencies in the data it has collected for fiscal years 2012 through 2016.<sup>63</sup> DSCA officials noted that DSCA did not have an application capable of tracking CAS funds across DOD components from budgeting through execution, as of January 2018. DSCA officials indicated that financial oversight processes have been less formal for CAS, because relatively less funding is provided for CAS than for administrative costs. For actual spending, DSCA received monthly status of funds reports from DFAS on DOD

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<sup>62</sup>See [GAO-14-704G](#).

<sup>63</sup>DOD Financial Management Regulation, vol. 4, ch. 19, notes that the *Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards 4* provides cost management guidance and direction to be used to support management decision-making across DOD, as well as to provide accurate and timely reporting of cost information.

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components' overall CAS disbursements against obligation authority for fiscal years 2012 through 2016, according to DSCA and DFAS officials. We found gaps and inconsistencies in these reports, including no, or low, reported disbursements in some years for three of the four DOD components that received CAS obligation authority in fiscal years 2012 through 2016, which did not align with information and data provided to us by the components on their CAS spending. DFAS officials indicated that they generally have not conducted any reconciliation of the disbursements data to components' source systems to ensure that it is reliable.<sup>64</sup> The internal control framework prescribed for federal agencies calls for management to perform monitoring activities, and also for management to use quality information to achieve an entity's objectives.<sup>65</sup>

DSCA officials indicated that DSCA's primary mechanism for oversight of DOD components' actual spending of CAS funds on an ongoing basis is its review of monthly status of funds reports regarding components' overall CAS disbursements against obligation authority, provided by DFAS. However, we identified gaps and discrepancies in the status of funds reports that DFAS provided for fiscal years 2012 through 2016, as of November 2017. For example:

- **DCMA.** The monthly status of funds reports showed about \$64 million in fiscal year 2016 CAS disbursements for DCMA—the primary recipient of these funds, whereas DCMA's approved obligation authority for fiscal year 2016 was \$194 million. DCMA officials provided data to us showing that DCMA had disbursed about \$187 million in fiscal year 2016.
- **The Army.** The reports also showed low disbursements—about \$174,000—for the Army in fiscal year 2015, and no disbursements for the Army in fiscal year 2016, whereas the Army's approved obligation authority was a total of about \$7.4 million for those fiscal years. We obtained data from the Army that showed a total of about \$6.3 million in disbursements for those fiscal years.
- **The Navy.** The reports also showed no disbursements for the Navy in fiscal years 2013 through 2016, whereas the Navy's approved

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<sup>64</sup>According to DSCA officials, DOD Financial Management Regulation, DOD 7000.14-R, vol. 6A, ch.2 applies to administrative and CAS funds. This section of the Financial Management Regulation notes that the reconciliation of source data is a joint responsibility of DFAS and the DOD components.

<sup>65</sup>See [GAO-14-704G](#).

obligation authority was about \$41.1 million for those fiscal years. We obtained data from the Navy that showed approximately \$16 million in disbursements for those fiscal years.

Although DSCA officials stated that DFAS, as DSCA's financial service provider for FMS, has a responsibility to provide reliable data, DFAS officials noted that they generally do not conduct any reconciliation of the CAS disbursements data in the status of funds reports to the components' source data.

In addition, the monthly CAS status of funds reports do not include actual obligations data or a more detailed breakdown of the disbursements data, such as by object class or by CAS service provided. The four DOD components that received CAS funds in fiscal years 2012 through 2016 generally indicated that they are able to provide data on their CAS obligations and disbursements by object class or labor category. DSCA began requiring components to provide actual CAS obligations, by object class, for the prior fiscal year as part of their annual budget requests beginning in July 2016, but we found that the data that DSCA received as part of components' fiscal year 2017 CAS budget submissions for fiscal year 2016 were incomplete. For example, the budget request for the overseas portion of DCMA's budget in fiscal year 2017 did not include prior actual obligations in an object class table. According to DSCA officials, DCMA had the data in its source file but the data was inadvertently hidden when it was formatted before it was provided to DSCA. DSCA officials added that their focus in reviewing the CAS budget requests is on the budgets, rather than prior actual costs.<sup>66</sup>

Since 2014, DSCA's annual requests for CAS budget submissions have noted that DSCA has been planning to begin use an application capable of tracking CAS funds across DOD components from budgeting through execution, by object class. However, officials noted that as of January 2018 DSCA had not yet implemented such an application for CAS. In April 2018, DSCA officials indicated that, to improve their oversight of CAS funds, they were beginning to use a new application to collect data on CAS budgets as part of the fiscal year 2020 budget review process, and they plan to track CAS execution data from components' accounting systems through an automated process in this application. However,

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<sup>66</sup>In addition, according to DSCA officials, DCMA's fiscal year 2017 CAS budget request included obligation authority, rather than actual obligations, for the domestic portion—which represents the majority of DCMA's funding—of its CAS funds for fiscal year 2016.

without adequate procedures for monitoring the reliability of the data that it receives on DOD components' use of CAS funds, DSCA is unable to fully perform its overall financial management responsibility for these funds.

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### DSCA Has Not Developed a Process for Targeted Financial Reviews of Use of CAS Funds

DSCA also has not developed a process for conducting targeted financial reviews of DOD components' obligations and disbursements of CAS funds, including any review of supporting documentation to verify that spending is allowable and approved.<sup>67</sup> DSCA has periodically communicated with DOD components regarding problem issues, such as reported under-disbursements and inadequate contractor oversight, identified through DSCA's review of status of funds reports on components' CAS disbursements, as well as components' CAS budget requests. DSCA officials indicated that DSCA relies primarily on components to ensure funds are spent for allowable and approved purposes and to identify any deficiencies in internal controls or issues needing corrective action. Nevertheless, DOD's Financial Management Regulation and DSCA's SAMM require DSCA to periodically monitor the use of funds, as part of its financial management responsibility for the FMS trust fund. Targeted financial reviews can also help identify potential gaps and areas for improvement in internal controls, and provide a reliable picture of liabilities and spending. The internal control framework prescribed for federal agencies calls for management to design control activities, which commonly include entity-level controls pertaining to multiple components and top-level reviews by management, to achieve objectives and respond to risks.<sup>68</sup>

DSCA officials provided documentation to us showing that they generally followed up with DCMA, DCAA, the Army, and the Navy via email about once or twice a year in fiscal years 2013 through 2016 with reminders about timely billing and reporting requirements for CAS or in response to reported under-disbursements in the CAS monthly status of funds reports

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<sup>67</sup>Such documentation could include timesheets and personnel reports; invoices or receipts related to components' use of CAS funds for supplies, equipment, or contractual costs; and documentation from DOD components' reviews of their execution of CAS funds.

<sup>68</sup>See [GAO-14-704G](#).



that DSCA receives from DFAS.<sup>69</sup> However, DSCA and DFAS officials noted that they generally do not take steps to verify costs or that the components have identified and addressed any internal control deficiencies that may have caused the issues identified in these reports. For example:

- **DCMA.** Systems interface issues and potential inadequate systems controls led to reported under-disbursements for CAS in fiscal year 2016 for DCMA. However, DSCA did not specifically follow up with DCMA about the issue until December 2016, even though DCMA normally regularly bills for its use of CAS funds, according to DSCA officials.<sup>70</sup> According to DCMA officials, this issue arose following their transition to a new accounting system in late 2015. They noted that DFAS had informed DCMA that DCMA was responsible for fixing the problem. However, the DCMA officials indicated that in their view, DSCA, DFAS, and the Defense Logistics Agency—which was the lead DOD component responsible for implementing the new accounting system—needed to have a role in resolving it. DCMA officials added that they had communicated about the issue with officials from DSCA, DFAS, and the Defense Logistics Agency in recent months. In January 2018, DFAS officials informed us that they had processed corrections totaling about \$89 million for a portion of DCMA’s CAS bills for fiscal year 2016, which they determined had been incorrectly processed from a different FMS account. However, as of March 2018, the cause of the issue, including any internal control deficiencies, was not clear, and we found that a discrepancy remained between the amount of fiscal year 2016 CAS disbursements

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<sup>69</sup>DSCA’s documentation also showed an increase in follow up communications with the Army and Navy regarding these issues in fiscal year 2017 and early fiscal year 2018, at least partly in response to our requests for information during the course of our review.

<sup>70</sup>For CAS funds, DOD components are required to validate and submit monthly billings that reflect the actual or proportionate share of CAS funds that they have executed and for which they need reimbursement, in accordance with DOD Financial Management Regulation, DOD 7000.14-R, vol. 15, ch. 8. DSCA provided documentation to us showing that it had sent a general reminder email to DCMA, along with other DOD components, about timely reporting and billing requirements in August 2016. According to DSCA officials, they did not conduct any other follow up with DCMA about this issue until December 2016, when DSCA officials conducting an annual review of the CAS account balance noticed the issue and asked DFAS and DCMA officials to look into the cause and to resolve it.

that DCMA reported to us (\$187 million) and the amount that DSCA and DFAS reported processing for DCMA (\$154 million).<sup>71</sup>

- **The Army.** In addition to sending the general reminders to DOD components regarding timely CAS reporting and billing requirements, DSCA communicated specifically with the Army regarding its reported low, or no CAS disbursements in DSCA's status of funds reports in fiscal years 2015 and 2016.<sup>72</sup> We obtained data from the Army on its CAS disbursements that showed approximately \$2.6 million in disbursements in fiscal year 2015 and \$3.7 million in disbursements in fiscal year 2016, whereas DSCA's data in status of funds reports for the Army showed only \$174,000 in disbursements in fiscal year 2015 and no disbursements in fiscal year 2016. Documentation that DSCA provided to us showed that DSCA communicated with the Army to remind them about the issue in December 2017 and January 2018. According to DSCA officials, DSCA believes that a systems issue related to the Army's CAS invoicing may have caused the reported under-disbursements. However, DSCA has not taken any additional steps to verify that the Army investigated and corrected the issue, and as of March 2018, the problem had not been resolved.
- **The Navy.** In addition to the general reminders that DSCA sent to DOD components regarding timely CAS reporting and billing requirements, DSCA also communicated specifically with the Navy about its reported under-disbursements for fiscal years 2013 through 2016.<sup>73</sup> DFAS's reports show no disbursements for the Navy in fiscal years 2013 through 2016; we obtained data from the Navy that showed approximately \$16 million in disbursements for those years. DSCA provided documentation to us showing that it had communicated via email with Navy officials twice in fiscal year 2014 and once in fiscal year 2016 about the Navy's reported under-disbursements going back to fiscal year 2012. DSCA also provided

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<sup>71</sup>We previously reported on data reliability issues related to DSCA's CAS account balance data, and on DCMA's CAS disbursements issues, in [GAO-18-401](#). In that report, we noted that DFAS had incorrectly processed a portion of DCMA's CAS bills for fiscal year 2016, totaling about \$89 million, out of a different FMS account. However, as of March 2018, DSCA was unable to fully explain the cause of the issue. That report included a recommendation for DSCA to ensure that DCMA and DFAS work together to correct the issue.

<sup>72</sup>We obtained data from DFAS on the Army's CAS disbursements, and from the Army on its CAS disbursements, as of November 2017.

<sup>73</sup>We obtained data from DFAS on the Navy's CAS disbursements, and from the Navy on its CAS disbursements, as of November 2017.

copies of multiple emails with Navy officials from fiscal year 2017, which showed that DSCA de-obligated \$71,122.62 in FY 2012 CAS funds on September 30, 2017 as a result of delayed billing by the Navy, and that DSCA had instructed the Navy that it needed to take steps to ensure that the issue did not recur.<sup>74</sup> However, DSCA has not taken additional steps to verify that the Navy has identified and corrected any internal control deficiencies that may have caused the reported disbursements issues, and the reported lack of disbursements for fiscal years 2013 through 2016 remains unresolved as of March 2018.

In addition, we found that DSCA approved over \$200,000 in CAS funds in fiscal years 2014 and 2015 to repair poor-quality renovations of overseas housing for DCAA auditing officials that had previously been completed with fiscal year 2010 CAS funds, thereby raising questions about the potential risk of wasteful use of funds to redo work that was not properly completed.<sup>75</sup> Specifically, DCAA officials informed DSCA that the work needed to be redone because of a lack of construction oversight or inspection during the initial renovations work. The officials noted that DCAA had found problems following the initial renovations including significant cracks in exterior walls, leaking windows and plumbing, and electrical and roofing issues. DSCA required DCAA to submit supporting documentation, including a line item budget, before it approved the additional funding for the work to be redone. The additional requests for fiscal years 2014 and 2015 included budgeted funds for quality control and contract oversight to address concerns about the previous work. However, DSCA has not conducted any further reviews to verify that any internal controls issues that led to the poor quality work were addressed and that these funds were actually used for allowable and approved purposes.

Although DOD components are responsible for their own internal control programs, DSCA has overall oversight responsibility to ensure that CAS funds are used correctly by DOD components, including DCMA, DCAA,

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<sup>74</sup>Specifically, DSCA provided documentation to us showing that it had de-obligated \$71,122.62 in fiscal year 2012 CAS funds on September 30, 2017 as a result of delayed billing by the Navy, and that any future valid bills would need to be paid out of current year funds.

<sup>75</sup>DSCA and DCAA officials provided supporting documentation to show that CAS funds may be used for this type of cost, but our review of the documentation provided also raised questions about the potential risk of wasteful use of funds to redo work that was not properly completed.

and the military departments. DCMA, DCAA, and Navy officials indicated that their organizations conduct reviews of their CAS funding execution to ensure that their use of CAS funds is allowable and approved. However, Army officials stated that their organization does not conduct any reviews to verify CAS expenditures, raising the possibility that no DOD component conducts this oversight for the Army.<sup>76</sup> Without conducting periodic, targeted financial reviews to verify components' CAS costs and internal controls, DSCA cannot be assured, in its oversight role, that components have the proper controls in place to achieve FMS program objectives.<sup>77</sup>

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## Conclusions

The FMS program generates billions of dollars in sales and it has grown significantly in recent years. DSCA has overall responsibility for the financial management and monitoring of DOD components' use of administrative and CAS funds for costs associated with implementing and supporting the program. Establishing effective internal controls for financial oversight helps agencies achieve objectives related to reliable reporting, efficient and effective operations, and compliance with laws and regulations. Prior audits over the past three decades have raised questions about DOD's financial oversight of the FMS trust fund, including administrative and CAS costs. While DSCA has undertaken initiatives to enhance controls for financial oversight, we found certain deficiencies in its oversight. For example, DSCA does not have reliable data on DOD components' use of administrative funds. In addition, DSCA has not adhered to requirements for its reviews to assess military departments' business processes for administrative funds or conducted any reviews of

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<sup>76</sup>Army officials stated that their reviews have focused on the Army's requests for CAS obligation authority. However, in April 2018 the officials indicated that going forward, the Army plans to begin conducting reviews of the appropriateness of the Army's CAS execution.

<sup>77</sup>DSCA's FIAR team is considering incorporating FMS into its financial transactions testing in the future, for purposes of financial statement auditability. According to DSCA officials, in fiscal year 2017, DSCA began a review of the FMS trust fund to assess audit readiness and identify necessary corrective actions in preparation for a full financial audit of the FMS trust fund in fiscal year 2022. DSCA officials indicated that their efforts are in the early stages, and that focus areas for initial corrective actions to enhance DOD financial management of the FMS trust fund will include undertaking a full reconciliation of CAS funds across the entire universe of DOD components' financial systems, and incorporating CAS funds data from across the department into a reconciliation and reporting tool to standardize the department's reconciliation and oversight capabilities for these funds.

other DOD components' (e.g., other than military departments) business processes. DSCA also has not established a risk-based approach to selecting organizations for review, nor has it ensured that the officials conducting these reviews formally track corrective action items. These reviews provide an opportunity for information-sharing about security assistance policies and requirements and positive practices. They can also identify potential issues, such as overlap or inefficiencies in staffing. Moreover, DSCA has not conducted periodic, targeted financial reviews to verify that DOD components' spending of administrative funds is allowable and approved. Finally, DSCA lacks reliable data on DOD components' use of CAS funds for costs such as contract management, and it has not conducted targeted financial reviews of CAS funds. As a result of these deficiencies, DSCA lacks key information needed to fulfill its financial management responsibility, such as having reliable spending data that could help DSCA identify trends in the use of funds and inform its budget decisions. DSCA also is unable to provide reasonable assurance that DOD components' use of administrative and CAS funds is allowable and approved, increasing the risk of the potential fraud, waste, or abuse of these funds.

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## Recommendations for Executive Action

We are making the following 11 recommendations to the Secretary of Defense and the Director of DSCA:

The Secretary of Defense should ensure that the Director of DSCA takes steps to work with DFAS—DSCA's financial service provider—and other DOD components, as appropriate, to improve the reliability of the data the DSCA obtains on all DOD components' use of FMS administrative funds, including actual execution data, at an appropriate level of detail, such as by object class. (Recommendation 1)

The Secretary of Defense should ensure that the Director of DSCA works with DFAS to conduct regular reconciliations of the data that DSCA collects on DOD components' use of administrative funds, to help ensure that the data are reliable. (Recommendation 2)

The Director of DSCA should follow its requirement to conduct at least two annual reviews of military department business processes for administrative funds. (Recommendation 3)

The Director of DSCA should conduct periodic (e.g., annual or biennial) reviews of other DOD components' (e.g., other than military departments) business processes for administrative funds, based on a risk-based approach. Such an approach could include consideration of whether an entity has received a prior review or representative sampling over time, as well as consideration of factors such as the results of prior audits or other identified risks. (Recommendation 4)

The Director of DSCA should create and maintain a complete list of military department organizations or offices that receive administrative funds and are subject to DSCA's business process reviews. (Recommendation 5)

The Director of DSCA should update DSCA's policy for selecting military department organizations for reviews of their business processes for administrative funds, to better ensure that it reflects a risk-based approach. (Recommendation 6)

The Director of DSCA should clarify guidance to ensure that the DSCA officials conducting reviews of business processes for administrative funds periodically track action items until they are completed. (Recommendation 7)

The Director of DSCA should develop a process for conducting periodic (e.g., quarterly or annual), targeted reviews of DOD components' use of administrative funds, including transactions testing, to verify that actual costs incurred are allowable and approved. (Recommendation 8)

The Secretary of Defense should ensure that the Director of DSCA takes steps to work with DFAS and other DOD components, as appropriate, to improve the reliability of the data that DSCA obtains on all DOD components' use of CAS funds, including actual execution data, at an appropriate level of detail, such as by object class. (Recommendation 9)

The Secretary of Defense should ensure that the Director of DSCA works with DFAS to conduct regular reconciliations of the data that DSCA collects on DOD components' use of CAS funds, to help ensure that the data are reliable. (Recommendation 10)

The Director of DSCA should develop a process for conducting periodic (e.g., quarterly or annual), targeted reviews of DOD components' use of CAS funds, including transactions testing, to verify that actual costs incurred are allowable and approved. (Recommendation 11)

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## Agency Comments

We provided a draft of this report for review and comment to DOD and State. DSCA provided written comments on behalf of DOD, which we reproduce in appendix II. DOD also provided technical comments, which we incorporated as appropriate in this report. In its comments, DOD concurred with our 11 recommendations. State did not comment on the report.

We are sending copies of this report to the appropriate congressional committees; the Secretaries of Defense and State; the Secretaries of the Army, Navy, and Air Force; and the Director of DSCA.

If you or your staff have any questions about this report, please contact Thomas Melito at (202) 512-9601 or [MelitoT@gao.gov](mailto:MelitoT@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this reports are listed in appendix III.

A handwritten signature in black ink that reads "Thomas M" followed by a long horizontal flourish.

Thomas Melito  
Managing Director, International Affairs and Trade

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*List of Committees*

The Honorable John McCain  
Chairman  
The Honorable Jack Reed  
Ranking Member  
Committee on Armed Services  
United States Senate

The Honorable Bob Corker  
Chairman  
The Honorable Robert Menendez  
Ranking Member  
Committee on Foreign Relations  
United States Senate

The Honorable Richard Shelby  
Chairman  
The Honorable Dick Durbin  
Ranking Member  
Subcommittee on Defense  
Committee on Appropriations  
United States Senate

The Honorable Lindsey Graham  
Chairman  
The Honorable Patrick Leahy  
Ranking Member  
Subcommittee on State, Foreign Operations, and Related Programs  
Committee on Appropriations  
United States Senate

The Honorable Mac Thornberry  
Chairman  
The Honorable Adam Smith  
Ranking Member  
Committee on Armed Services  
House of Representatives

The Honorable Ed Royce  
Chairman  
The Honorable Eliot Engel  
Ranking Member



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Committee on Foreign Affairs  
House of Representatives

The Honorable Kay Granger  
Chairwoman  
The Honorable Pete Visclosky  
Ranking Member  
Subcommittee on Defense  
Committee on Appropriations  
House of Representatives

The Honorable Hal Rogers  
Chairman  
The Honorable Nita Lowey  
Ranking Member  
Subcommittee on State, Foreign Operations, and Related Programs  
Committee on Appropriations  
House of Representatives

# Appendix I: Objectives, Scope, and Methodology

We examined (1) the extent to which the Defense Security Cooperation Agency (DSCA) has established and carried out financial oversight policies and procedures to ensure its data on Department of Defense (DOD) components' use of *administrative* funds are reliable, and that the use of these funds is allowable and approved; and (2) the extent to which DSCA has established and carried out financial oversight policies and procedures to ensure its data on DOD components' use of *Contract Administration Services (CAS)* funds are reliable, and that the use of these funds is allowable and approved.

To address our first objective, we reviewed DOD documents, including DOD and DSCA policies, procedures, and guidance related to the use of administrative funds, such as DOD's Financial Management Regulation, DSCA's Security Assistance Management Manual (SAMM), and DSCA's annual security assistance programming and budget guidance for administrative funds, as well as documentation from other DOD components related to their use of these funds.<sup>1</sup>

In addition, to assess the extent to which DSCA established and carried out financial oversight policies and procedures to ensure that data on DOD components' use of administrative funds are reliable, we reviewed budget, obligations, and disbursements<sup>2</sup> data that DSCA has collected on

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<sup>1</sup>We did not review DSCA's Security Assistance Program and Budget Review process because it was not within the scope of our review, which focused on DSCA's financial oversight of DOD components' actual spending (e.g., obligations and disbursements) of administrative funds.

<sup>2</sup>For the purposes of this report, a budget is defined as anticipated expenditures during an accounting period (e.g., fiscal year). An allotment is an authorization to incur obligations. An obligation is defined as a commitment that creates a legal liability of the government for the payment of goods and services ordered or received that can be paid immediately or in the future. Disbursements are defined as amounts paid by federal agencies during the fiscal year to liquidate government obligations.

DOD components' use of these funds in fiscal years 2012 through 2016,<sup>3</sup> at both the DOD component and the object class level, in its Budgeting, Programming, and Execution Submission Management and Reporting Tool (BeSMART) application.<sup>4</sup> We also reviewed monthly status of funds reports from BeSMART that the Defense Finance and Accounting Service (DFAS) provided to DSCA on the Air Force's, the Army's, the Navy's, and the overseas combatant commands' administrative obligations and disbursements from January 2015 through June 2017. We assessed the reliability of DSCA's data by reviewing it for potential gaps, inconsistencies, or obvious errors and by conducting interviews with DOD officials about the data. We contacted certain DOD components, including the Defense Contract Management Agency (DCMA), the Defense Information Systems Agency, the Defense Logistics Agency, the Joint Strike Fighter Program, the Missile Defense Agency, the National Geospatial-Intelligence Agency, and the National Security Agency, with questions about the data they had submitted to BeSMART and to determine whether we could obtain reliable data from those components directly. However, the responses that we received did not establish the reliability of the BeSMART data or provide us with reliable data across the components. Due to gaps and inconsistencies that we identified in the BeSMART data that we reviewed, both within and across DOD components, we found that both the DOD component-level and object class data were not reliable for our purposes. We report on these problems with the administrative funding data in the body of our report.

Additionally, to assess the extent to which DSCA established and carried out financial oversight policies and procedures to ensure that the use of these funds is allowable and approved, we reviewed documentation on DSCA's Financial Improvement and Audit Readiness (FIAR) and

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<sup>3</sup>We did not include fiscal year 2017 data on DOD components' use of administrative and CAS funding in our scope because fiscal year 2017 data were not yet finalized at the time of our review. GAO previously reviewed data reliability for DSCA's overall administrative and CAS account balances (e.g., DSCA's collections into the accounts and overall expenditures out of the accounts) for fiscal years 2007 to 2017, and found the data to generally be reliable for our purposes, except for gaps in the fiscal years 2016 to 2017 CAS data. See [GAO-18-401](#) for more information.

<sup>4</sup>Office of Management and Budget (OMB) Circular No. A-11 provides guidance to federal agencies on classifying obligations by object class, or items or services provided. Major object classes include personnel compensation and benefits, contractual services and supplies, acquisition of assets, and grants and fixed charges. DSCA officials noted that OMB Circular No. A-11 does not require them to collect administrative funds data at the object class level; however, DSCA established a requirement for DOD components to provide the object class data to better inform DSCA's resource decisions.

Managers' Internal Control Program activities related to the FMS program.<sup>5</sup> We also reviewed documentation such as meeting minutes and action items for FMS business process reviews that DSCA conducted with the Air Force, the Army, and the Navy in fiscal years 2012 to 2016. We also conducted interviews with DOD officials, including from the Office of the Under Secretary of Defense (Comptroller), DSCA, DFAS, the Air Force, the Army, and the Navy.

To assess the extent to which DSCA established and carried out financial oversight policies and procedures to ensure that its data on DOD components' use of CAS funds are reliable, and that the use of these funds is allowable and approved, we reviewed DOD documents, including policies, procedures, and guidance related to the use of CAS funds, such as DOD's Financial Management Regulation, as well as documentation from other DOD components related to their use of these funds. We also conducted interviews with DOD officials, including officials from DSCA, DFAS, and from the four DOD components that received CAS funding in fiscal years 2012 through 2016—DCMA, the Defense Contract Audit Agency (DCAA), the Army, and the Navy. In addition, we reviewed data that DSCA obtained on components' CAS disbursements in fiscal years 2012 through 2016 from the Defense Integrated Financial System (DIFS).<sup>6</sup> We were not able to review data on components' CAS disbursements by object class, or on CAS obligations, from DIFS because this data was not available in DIFS, according to DFAS officials.<sup>7</sup> As a result, we contacted DCMA, DCAA, the Army, and the Navy to determine whether we could obtain reliable data from them directly on CAS obligations and disbursements, by object class. However, we were not able to obtain reliable data directly from the components. We assessed the reliability of the CAS disbursements data from DIFS, as well

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<sup>5</sup>DSCA is currently undergoing an audit examination of its use of Title 10 (non-FMS) appropriated funds, in preparation for its financial statement audit readiness. We reviewed the FIAR team's "mock" audit documentation to understand what their review entailed. We found that the procedures appeared to be appropriately designed; however, because this work did not include FMS funds, we did not perform any audit procedures on the team's work.

<sup>6</sup>DIFS is DFAS's primary system used to consolidate FMS delivery and disbursement data, and it is used to account for and report the status of DOD's Foreign Military Sales program.

<sup>7</sup>We did not review DSCA's annual CAS budget review and approval process because it was not within the scope of our review, which focused on DSCA's financial oversight of DOD components' actual spending (e.g., obligations and disbursements) of CAS funds.

as the data that we received from the components directly, by reviewing it for potential gaps, inconsistencies, or obvious errors and by conducting interviews with DOD officials about the data. We found that the data were not reliable for our purposes due to gaps and inconsistencies that we identified in the data. We report on these data problems in the body of this report.

We conducted this performance audit from February 2017 to July 2018 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.

## Appendix II: Comments from the Department of Defense



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

JUL 17 2018

Mr. Thomas Melito  
Director, International Affairs & Trade  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Melito:

Enclosed is the Department of Defense (DoD)'s response to the Government Accountability Office (GAO) Draft Report, GA0-18-553SU "FOREIGN MILITARY SALES: Financial Oversight of the Use of Overhead Funds Needs Strengthening," dated June 18, 2018 (GAO Code 102501).

Please direct any questions or comments regarding this response to my primary action officer for this matter, Ms. Jeneen Caldwell, [jeneen.k.caldwell.civ@mail.mil](mailto:jeneen.k.caldwell.civ@mail.mil), (703) 697-8923, or the DSCA audit liaison officer, Mr. Eric Ferguson, [dsc.audit@mail.mil](mailto:dsc.audit@mail.mil), (703) 697-9261.

Sincerely,

A handwritten signature in black ink, appearing to read "C. Hooper", is written over the typed name.

Charles W. Hooper  
Lieutenant General, USA  
Director

Enclosure:  
As stated

GAO DRAFT REPORT DATED JUNE 18, 2018  
GAO-18-553SU (GAO CODE 102501)

“FOREIGN MILITARY SALES: FINANCIAL OVERSIGHT OF THE USE OF  
OVERHEAD FUNDS NEEDS STRENGTHENING”

DEPARTMENT OF DEFENSE COMMENTS  
TO THE GAO RECOMMENDATION

**RECOMMENDATION 1:** The GAO recommends that the Secretary of Defense should ensure that the Director of DSCA takes steps to work with DFAS-DSCA's financial service provider and other DOD components, as appropriate, to improve the reliability of the data the DSCA obtains on all DOD components' use of FMS administrative funds, including actual execution data, at an appropriate level of detail, such as by object class.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 2:** The GAO recommends that the Secretary of Defense should ensure that the Director of DSCA works with DFAS to conduct regular reconciliations of the data that DSCA collects on DOD components' use of administrative funds, to help ensure that the data are reliable.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 3:** The GAO recommends that the Director of DSCA should follow its requirement to conduct at least two annual reviews of military department business processes for administrative funds

**DoD RESPONSE:** Concur.

**RECOMMENDATION 4:** The GAO recommends that the Director of DSCA should conduct periodic (e.g., annual or biennial) reviews of other DOD components' (e.g., other than military departments) business processes for administrative funds, based on a risk-based approach. Such an approach could include consideration of whether an entity has received a prior review or representative sampling over time, as well as consideration of factors such as the results of prior audits or other identified risks.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 5:** The GAO recommends that the Director of DSCA should create and maintain a complete list of military department organizations or offices that receive administrative funds and are subject to DSCA's business process reviews.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 6:** The GAO recommends that the Director of DSCA should update DSCA's policy for selecting military department organizations for reviews of their business processes for administrative funds, to better ensure that it reflects a risk-based approach.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 7:** The GAO recommends that the Director of DSCA should clarify guidance to ensure that the DSCA officials conducting reviews of business processes for administrative funds periodically track action items until they are completed.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 8:** The GAO recommends that the Director of DSCA should develop a process for conducting periodic (e.g., quarterly or annual), targeted reviews of DOD components' use of administrative funds, including transactions testing, to verify that actual costs incurred are allowable and approved.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 9:** The GAO recommends that the Secretary of Defense should ensure that the Director of DSCA takes steps to work with DFAS and other DOD components, as appropriate, to improve the reliability of the data that DSCA obtains on all DOD components' use of CAS funds, including actual execution data, at an appropriate level of detail, such as by object class.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 10:** The GAO recommends that the Secretary of Defense should ensure that the Director of DSCA works with DFAS to conduct regular reconciliations of the data that DSCA collects on DOD components' use of CAS funds, to help ensure that the data are reliable.

**DoD RESPONSE:** Concur.



**RECOMMENDATION 11:** The GAO recommends that the Director of DSCA should develop a process for conducting periodic (e.g., quarterly or annual), targeted reviews of DOD components' use of CAS funds, including transactions testing, to verify that actual costs incurred are allowable and approved.

**DoD RESPONSE:** Concur.

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

Thomas Melito, (202) 512-9601 or [MelitoT@gao.gov](mailto:MelitoT@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Hynek Kalkus (Assistant Director), Elisabeth Helmer, Martin De Alteriis, Kelly Friedman, Jeff Isaacs, Heather Latta, Grace Lui, Susan Murphy, Moon Parks, Laurel Plume, Heather Rasmussen, Chanetta Reed, and Aldo Salerno made key contributions to this report. Jaime Allentuck, Amanda Bartine, Emily Desai, Dave Hancock, Chris Keblitis, Reid Lowe, and Kira Self provided technical assistance.

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# Appendix IV: Accessible Data

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## Agency Comment Letter

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Text of Appendix II: Comments from the Department of Defense

Page 1

July 17, 2018

Mr. Thomas Melito  
Director, International Affairs & Trade  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

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Sincerely,

Charles W. Hooper  
Lieutenant General, USA  
Director

Enclosure:  
As stated

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Page 2

**GAO DRAFT REPORT DATED JUNE 18, 2018 GAO-18-553SU (GAO  
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**DoD RESPONSE:** Concur.

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**DoD RESPONSE:** Concur.

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