CASH MANAGEMENT OF REQUISITION CASES

By

LIEUTENANT COMMANDER JAMES T. CHAPMAN, USN
DISAM Instructor

Nearly every participant in the United States' Foreign Military Sales Program needs to be concerned with the problem of "cash flow." Close management of cash is the rule rather than the exception. The U.S. manager of a FMS case or program has a responsibility to the foreign customer to assist in the management of that country's funds -- to ensure that demands are not placed needlessly and that funds are not retained in the U.S. in excess of those required by law and necessary to support the particular case or program.

Payment schedule construction is an important component of this aspect of case management. Undoubtedly, the preparation of payment schedules for major system sales requires an exceptional amount of effort and, frequently, sophistication. However, because of their visibility, major system sales probably receive their due attention; and, if the input from the various sources (contractors, provisioners, training activities, etc.) has been reasonably accurate, the resultant payment schedule will be reasonably accurate. Additionally, since major system sales frequently have dedicated case managers, they should be better managed so that subsequent changes are more likely to be identified quickly and incorporated without great trauma.

Major system sales are the big dollar value cases, and accuracy in payment schedule construction has the potential to reduce the customer's cash requirements by large amounts on a "per case" basis. Requisitioning cases [Blanket Order or Cooperative Logistics Supply Support Arrangement, Foreign Military Sales Order (FMSO 2)], on the other hand, involve smaller dollar values; but because of the cumulative effect of the number of cases, substantial reductions in cash requirements can be achieved on a country basis by being accurate in payment schedule preparation. It is "requisitioning" cases with which we will be concerned here.

DoD 5105.38-M (Military Assistance and Sales Manual or MASM) discusses payment schedule preparation. Part III, Appendix III, paragraphs 4a and 4b draw attention to the fact that payment schedules, by nature, require "the preparation of budgetary estimates under conditions of inflationary" and other uncertainties, including the dates when deliveries of items will occur. In view of this, it is noted that "Actual outlays therefore can be expected to vary from initial payment schedules." Paragraph 4b(b) further states: "For cases involving purchaser-initiated requisitions (i.e., open-end or blanket order cases expressed in dollars) over a one-year period, phase payments quarterly for one-fourth of the estimated case value. The first payment should be scheduled 90 days after the estimated date of case acceptance and initial deposit." Thus, under the guidance of the MASM, a one-year requisition case payment schedule would have an initial deposit and three quarterly payments, each equal to one-fourth of the case value.

DoD 7290.3-M (Foreign Military Sales Financial Management Manual) states in paragraph 40205 that: "Exceptional forecasting procedures will be used for requisition cases (i.e., Supply Support Arrangement, FMSO 2, and other major repair part cases). Experience has shown that most payment schedules for these cases tend to be overstated because of variations in both requisitioning and supply actions."

Two goals should be stated at this point. One is meeting the statutory requirement to collect monies from the customer in advance of a requirement to make a payment on his behalf. This requirement is sufficiently met by receiving payment in the quarter prior to that in which payment will be made. (Receipt of customer monies in advance of one quarter prior to making payment is overbilling.) The second goal is the construction of a payment schedule which, as nearly as possible, accurately states the amount and timing of those payments so that the customer can plan his payments and budget for them. In other words, wild swings between Financial Annex payment schedule amounts and what is eventually billed does not achieve the second goal, although perhaps it does the first.

To understand the importance of careful payment schedule preparation for requisition cases requires a brief review of Obligational Authority (OA) and Expenditure Authority (EA) and what is required for each. Obligational Authority is issued by the Security Assistance Accounting Center and allows obligations to be incurred against a given FMS case. OA allows case performance (commitments and obligations for services and/or supplies) to begin. OA is not an approval to make disbursements, and thus it can be issued in excess of cash received from the customer. OA is required to process a customer-initiated requisition. The Security Assistance Accounting Center (SAAC) can issue OA (as requested by the implementing agency) up to 110% of net case value (Block 21 of the DD 1513). The basis for SAAC granting OA is an accepted DD 1513, the required initial deposit, and a request from the implementing agency. Thus, SAAC can issue OA which will allow requisitions totalling 110% of net case value to be processed against the case.

Expenditure Authority is required to make payments or to reimburse performing appropriation accounts. SAAC can grant EA up to the amount of cash received from the customer. The importance of the understanding of OA/EA in requisition cases is that cash is not required to accept customer requisitions, only to fill them.

A requisition case payment schedule, to be accurate, should reflect rates at which requisitions are filled, not received from the customer. The MASM guidance for the preparation of blanket order-type payment schedules contains two implicit assumptions: (1) that the foreign purchaser will submit requisitions at a continuous, even rate over the period of the case, and (2) that requisitions will be filled shortly after receipt. In the real world of FMS, things do not always work that way. For one thing, the purchaser may submit requisitions at a much lower (or higher) rate, thereby impacting on cash flow. For another, many requisitions result in procurement actions with attendantly longer leadtimes. However, over time, the U.S. military services have been able to accumulate historical trends which are a reflection of both aggregate purchaser requisition rates and associated delivery/expenditure timeframes. For example, the Air Force's International Logistics Center (ILC) Regulation 400-77 takes this into account in its instructions on constructing payment schedules for repair parts cases (USAF "KB" and "R" cases). If, for example, a requisition case with a one-year ordering period has an initial deposit period of three months, the payment schedule consists of an initial deposit and 14 quarterly payments, with the amount of each cash requirement expressed as a percentage of total case value (Block 26 of the DD 1513). If in this example the total case value was $1,000,000, the payment schedule would look like this:

		AMOUNT
Initial Deposit (ID)		$130,000
Quarterly Payment	#1	$150,000
	#2	$140,000
	#3	$ 90,000
	#4	$ 80,000
	#5	$ 60,000
	#6	$ 50,000
	#7	$ 50,000
	#8	$ 50,000
	#9	$ 50,000
	#10	$ 50,000
	#11	$ 40,000
	#12	$ 20,000
	#13	$ 20,000
	#14	$ 20,000

ILC Regulation 400-77 further states that if the case manager has some idea when items will be delivered or some historical data on the purchaser, that information may be used to construct the payment schedule. Under this system of payment schedule construction, the customer's cash is received when it is genuinely needed, when requisitions are expected to be filled, rather than when they are expected to be issued by the customer.

As noted earlier, despite the fact that we may start with an accurate payment schedule (i.e., one which reflects deliveries rather than requisitions), there may be cause for subsequent modification of the payment schedule because of uncertainties in requisition rates and fill rates and variations between predicted rates and actual rates. DoD 7290.3-M procedures cover payment schedule changes in both directions -- when the payment schedule provides too little cash and when it provides too much cash.

Paragraph 40208 of DoD 7290.3-M requires that the financial and delivery status of each FMS case be reviewed at least quarterly by the implementing agency to ascertain whether the payment schedule will provide sufficient cash to meet the requirements of paragraph 40002 (customer cash deposits into the FMS trust fund shall be made in advance of delivery). If not, it is necessary to provide SAAC a quarterly forecast of fund requirements. Paragraph 40204 also allows for emergency revision of a payment schedule by message (if a DD 1513-2 cannot reach SAAC by the 15th day of the last month of a calendar quarter) with immediate follow-up by a DD 1513-2 modification to the payment schedule. Remembering that SAAC will normally bill payment schedule amounts, these reports and procedures adequately cover the case of underbilling.

Overbilling is prevented by a report titled "Committed Values for Requisition Cases," which is required to be submitted to SAAC by implementing agencies to arrive by the 15th day of the last month of each calendar quarter. This Committed Values report (or K-card) is to reflect the latest status of on-hand unfilled requisitions. SAAC compares the committed value to the payment schedule quarterly deposit. If the committed value is less than the quarterly amount from the payment schedule, the committed value is used as the forecasted requirement in column 11 of the DD 645 in lieu of the payment schedule amount. If the committed value is greater than the payment schedule amount, the committed value is disregarded.

As examples of the effect of the committed values report on the bill, two sample cases are shown in columns 6 through 14 of the DD 645 on the next page. The two cases are KBA and KBB, both FMSO 2 cases with a total case value of $1,000,000. The payment schedule for case KBA was prepared in accordance with the MASM. The payment schedule for KBB is that shown above (IAW ILCR 400-77). In each example the customer has submitted requisitions totalling $150,000 during the first quarter, of which $100,000 were delivered and $50,000 unfilled.

If no committed value report is submitted, the Amount Due and Payable (Column 14) will match the quarterly amount from the payment schedule. In order to make this happen, an adjustment must be made to column 11 so that column 10 plus column 11 equals column 12 and so that column 12 minus column 13 equals column 14. This adjustment in column 11 is called an Unearned Advance.

Obviously the committed value report has the capability to substantially alter the amount billed to the customer. More examples could be shown which, especially when extreme examples (i.e., CV = Ø) are cited, might seem to place the case in a risky financial condition -- i.e., efforts to prevent overbilling could induce underbilling. Three points need to be made. One, the risk is reduced because requisitions are not filled so rapidly. If requisitions were generally filled within a quarter or two, there would not be overbilling to the degree that presently exists; and a level, MASM-type payment schedule would not be unreasonable. Two, a specific case may be in a deficit cash position with the deficit being funded by the customer's cash advances on other cases (an undesirable and necessarily temporary condition). Three, SAAC generates several preliminary bills prior to the final bill that is sent to the customer. Preliminary bills are subject to manual intervention by SAAC's technicians, the object being to inject a human element of judgment into an otherwise mechanical result.

To reiterate, payment schedules for any type of case should be accurate. That is, they should be designed to require payment from the customer in the quarter prior to that in which disbursements against the case will be made. Requisition cases present unique problems because of the inherent uncertainties, but historical information should be able to assist in more accurate payment schedule construction, and procedures are in effect which can prevent underbilling and substantial overbilling.

PCN: FS-07-321

FOREIGN MILITARY SALES BILLING STATEMENT	UNITED STATES OF AMERICA DEPARTMENT OF DEFENSE/

1. TO:	2. THIS IS A BILLING STATEMENT BASED ON CASH REQUIREMENTS. PAYMENT IS DUE BY:	3. STATEMENT NUMBER:	4. FOR PERIOD ENDED:	5. DATE PREPARED:

CASE IDENTIFICATION AND DELIVERY STATUS				FINANCIAL STATUS				
6. CASE & RSN	7. TOTAL VALUE ORDERED	8. CUMULATIVE DELIVERY COSTS END PRIOR PERIOD	9. CURRENT PERIOD DELIVERY COSTS (ATTACHMENT 1)	10. CUMULATIVE DELIVERY COSTS & WORK IN PROCESS	11. FORECASTED REQUIREMENTS (NOTE A)	12. TOTAL FINANCIAL REQUIREMENTS	13. CUMULATIVE PAYMENTS RECEIVED	14. AMOUNT DUE AND PAYABLE
			NO COMMITTED VALUE REPORT SUBMITTED					
KBA	1,000,000	0	100,000	100,000	400,000	500,000	250,000	250,000
KBB	1,000,000	0	100,000	100,000	180,000	280,000	130,000	150,000
			COMMITTED VALUE OF $50,000 REPORTED					
KBA	1,000,000	0	100,000	100,000	50,000	150,000	250,000	0
KBB	1,000,000	0	100,000	100,000	50,000	150,000	130,000	20,000

REVIEW PROCESS

SIGNATURE

ANALYST: __________

BRANCH CHIEF: __________

QUALITY ASSURANCE:

EXPLANATORY NOTES

NOTE A: THE TERMS OF THE U.S. PUBLIC LAW, THE ARMS EXPORT CONTROL ACT, REQUIRE THE DEPARTMENT OF DEFENSE TO COLLECT PAYMENTS FROM FOREIGN PURCHASERS IN ADVANCE OF THE TIME THAT DOD INCURS COSTS ON THE PURCHASER'S BEHALF. THEREFORE, THIS BILLING STATEMENT REQUESTS PAYMENT OF MONIES THAT ARE ANTICIPATED TO BE EXPENDED BETWEEN THE TIME THIS BILLING STATEMENT IS PAID AND THE FOLLOWING BILLING STATEMENT IS PAID.

* DENOTES CASES CLOSED DURING THE CURRENT PERIOD.

AUTHENTICATION

SIGNATURE

OFFICE OF THE DIRECTOR
SECURITY ASSISTANCE ACCOUNTING CENTER

PAYMENT INSTRUCTIONS

YOUR PAYMENTS MAY BE MADE BY USING EITHER CHECKS OR WIRE TRANSFER PROCEDURES. WIRE TRANSFERS ARE PREFERRED AND SHOULD BE SENT TO THE FEDERAL RESERVE BANK OF KANSAS CITY, DENVER BRANCH, WITH THE FOLLOWING IDENTIFICATION: FRB/DVR (3601) AIR FORCE AFAFC/SAAC. CHECK MADE PAYABLE TO THE TREASURER OF THE UNITED STATES SHOULD BE IN U.S. DOLLARS AND FORWARDED DIRECTLY TO: AFAFC/SAAC P.O. BOX 20030 DENVER CO 80220 USA

DD FORM 645 (JUN 78) PREVIOUS EDITIONS ARE OBSOLETE

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ABOUT THE AUTHOR

Lieutenant Commander James T. Chapman, USN, joined the DISAM faculty in November 1981. His subject matter specialties include the process and financial management of Foreign Military Sales. Commander Chapman holds a B.S. degree in Industrial Distribution from Clarkson College and an M.B.A. from the University of Louisville.