The Evolution of FMS Financial Management

By

Mr. John J. Williams
and
Dr. Larry A. Mortsolf

The universal regard for money is the one hopeful fact in our civilization.

- George Bernard Shaw, 1907

INTRODUCTION

The term "Foreign Military Sales (FMS) financial management" very likely triggers varying images in the minds of different groups of people. To the "FMS financial manager"--be that person a budget analyst, cost analyst, accountant, or a billing technician to name but a few relevant positions--the term may bring visions of concepts such as standard prices, surcharges, obligational authority, performance reporting, reconciliation, and most important of all, professional respect for the importance of FMS financial management in its entirety. To the FMS program or case manager, the term may be associated with such phenomena as delays, controls, constraints, and "green eyeshades." To the audit community, FMS financial management may be thought of as a fertile area for the production of audit reports. In essence, the old adage--where you stand depends on where you sit--probably reveals a lot regarding what different groups of people know about and how they feel about FMS financial management.

Notwithstanding the above perspectives, FMS financial management is here to stay and, at the same time, is an evolving professional discipline. Accordingly, it behooves the entire FMS community to continually try to enhance their understanding of this important function. It is the purpose of this article to examine the evolution of FMS financial management, bringing it from the post-Military Assistance Program (MAP) period to present day.

THE OLD MAP ERA

The predecessor of modern-day FMS financial management was born during the period after World War II at a time when Security Assistance was, for the most part, confined to the Military Assistance Program (MAP). This "old MAP," as some refer to it today, was a program under which military hardware, services, and training were provided to foreign governments on a grant basis. The program was funded each year by an authorization and an appropriation. During this period, financial management involved documenting the allocation and use of the MAP funds. At the field level, this was typically done in a manner similar to other DOD appropriations by the budget and accounting staffs within the comptroller organizations. The guidance for MAP processing was contained in Part II of the now-superceded *Military Assistance and Sales Manual (MASM).*

Authors' Note: The authors are indebted to Mr. Michael J. Melburn, Director, Accounting Policy, DASD(C/MS), for his review of this article and for permission to incorporate background information from an earlier article which he co-authored, "FMS Pricing Policy Implementation: Taking the Bull by the Horns," *DISAM Newsletter*, Vol. 3, No. 2, Winter 1980-81.

In examining the old MAP financial management environment, the following steps are illustrative of the process. Those working in the budget area recorded the availability of funds in the context of funded MAP orders, and the subsequent incurrence of commitments/obligations as requisitions and purchase requests were issued. Special attention was directed at unobligated commitments since this could result in the loss of fiscal year constrained funds. Controls were also in place to avoid over-obligation and over-expenditure, with a certification of funds taking place at each step. The accounting and finance officers paid the suppliers or reimbursed the military department appropriations for inventory issues or other work done organically. Moreover, since MAP was a grant program, the recipients' interest was directed toward the receipt of hardware and not toward the financial support system which made such deliveries possible.

FROM MAP TO FMS

It was during the early sixties that foreign military sales began to evolve into a major security assistance program. Under FMS, military departments engaged in agreements with foreign purchasers to provide articles and services either from service stocks/resources or from procurement sources on the basis that the foreign purchaser would reimburse the military services for the costs involved. Each service established a treasury account (trust fund) to hold customer receipts.

As the FMS program grew in size, forecasting anticipated reimbursements to the services' appropriations became increasingly difficult. FMS purchaser funds, unlike the old MAP funds, had no fiscal year limitations and were obligated and expended through military department reimbursable and direct citation accounts. However, unlike today, the financial controls were generally less stringent and computer tracking systems were less sophisticated.

FMS FINANCIAL MANAGEMENT COMES OF AGE

In the mid-1970s, concern was expressed by the Congress and the General Accounting Office (GAO) that DOD was not effectively managing the foreign military sales program in a financial sense. The audit community continued to detect more and more flaws in the financial management process. As critical reports were issued, the Office of the Assistant Secretary of Defense (Comptroller) [OASD(C)] took steps to correct the weaknesses by issuing additional guidance.

Early Guidance

By way of background, until 1975 the grant aid procedures for computing reimbursments were basically extended to the pricing of services and materials sold under the FMS program. However, Congressional review of the DOD FY 1974 supplemental appropriation request resulted in criticism of DOD for selling items from inventory at less than replacement cost and then requesting appropriated funds to make up the difference. The need to recoup inventory replacement cost was addressed in the International Security Assistance and Arms Export Control Act of 1976, which was in turn signed into law by President Ford on 30 June 1976. In addition to changing the title of the then Foreign Military Sales Act (FMSA) to the Arms Export Control Act (AECA), this amendatory legislation revised some of the methodology under which the DOD priced FMS materiel and services. In essence, the expressed intent of the Congress was to place greater emphasis on putting FMS generally on a "no profit - no loss" basis, at least as far as the U.S. Government was concerned in its capacity as the "middleman" between the foreign purchaser and the supply source or contractor community.

Prior to the aforementioned statutory change, in June 1975, OASD(C) reissued DODI 2140.1, *Pricing and Sales of Defense Articles and Defense Services to Foreign Countries and International Organizations*, which provided the military departments with pricing policy. This 1975 reissued instruction contained more specific guidance than the January 1970 version which was superceded. However, this action was short-lived in that it became necessary to again revise and reissue DODI 2140.1 in response to the pricing mandates contained in the June 1976 provisions of the AECA. This action occurred in March 1977 as OASD(C) released another updated version of DODI 2140.1. Furthermore, only two months earlier in January 1977, DODD 2140.2, *Recoupment of Nonrecurring Costs on Sales of USG Products and Technology*, was similarly revised and reissued in order to assure DOD compliance with the AECA. Thus, by the Spring of 1977, DOD FMS pricing policy was effectively in place, with only relatively minor policy modifications to occur from that point forward.

If pricing was one management area needing attention, FMS funds control was yet another. Prior to 1977, it was the standing practice for the military services to view FMS obligational authority on a "no-year" basis, thereby removing FMS from the traditional fiscal-year controls common to MAP and DOD monies. The rationale for the practice was that FMS involved the receipt and expenditure of non-appropriated foreign customer funds, which were not directly tied to the DOD budgetary process. In retrospect, this caused certain problems to include: (1) the "no-year" FMS obligational authority nonetheless had to be integrated with the reimbursable budget control process, which for the most part did involve fiscal-year constraints; (2) the process involved the release of the obligational authority for the entire net case value at the time of case implementation, even though the funds would not necessarily be obligated until subsequent years, thereby leading to substantial year-end unobligated balances and the appearance that DOD was not efficiently obligating its funds in a timely manner; and (3) a sense of management laxness because of the feeling "why worry, it's only FMS, not DOD, money." In short, the system was long overdue for some enhancements.

These enhancements came in June 1977 when Assistance Secretary of Defense (Comptroller), Fred Wacker, issued a memo relative to FMS obligational authority controls. This memo placed a requirement on the services to control FMS dollars on a fiscal year basis, just as is done for their own appropriations, through the vehicle of the DD Forms 2060 and 2061. Not only did the military services have to identify the fiscal year in which funds were expected to be obligated, they also had to identify the performing appropriations and return any unused funding authorities at the end of the fiscal year. The monitoring activity was the Security Assistance Accounting Center (SAAC), formed in 1976, to serve, among other things, as a clearing house for FMS obligational and expenditure authorities.

In addition to its funds control function, SAAC's charter extended to its being the central billing activity with respect to the FMS customer. The formats for the FMS Billing Statement (DD Form 645) and the Detail Billing Card (DD-COMP(M) 1517 Report) were spelled out in DODI 2140.3, *Foreign Military Sales Billing and Reimbursement Procedures*, reissued in September 1979. DODI 2140.4, *Collecting and Reporting of Foreign Indebtedness within the Department of Defense*, issued in June 1977, provided procedures for the computation of interest on net arrearages in the event of delayed payments on the part of FMS customers.

Development of an FMS Financial Manual

In the late 1970s and early 1980s, OASD(C) increased its concern as military department appropriations began to be penalized by the Congress based on reported losses in their appropriations. At the same time, it was recognized that FMS financial management education would be enhanced by development of a special manual, which would incorporate selected DOD instructions and add guidance in areas not already covered. In June 1981, OASD(C) issued the *Foreign Military Sales Financial Management Manual* (DOD 7290.3-M) and in this publication provided the policy and direction to execute an FMS case, starting with the price and availability response to a letter of request through budget execution and subsequent case closure. The Manual is divided in nine chapters. Some of the essential features of these chapters are as follows:

- Chapter 1 contains the basic statutory provisions which require sound financial management practice to insure that items are properly priced, funds collected in advance of need, and so on.

- The DD Forms 2060 and 2061 and the attendant obligational authority guidelines are explained in Chapter 2, Budget Authority.

- Chapter 3 addresses the accounting procedures and internal controls which must be employed relative to an FMS case. Within this chapter, an FMS case is described as "an accounting unit similar to a commercial job order."

- Cash management characteristics and policies are the subject of Chapter 4. This chapter further outlines the respective responsibilities of SAAC and the military services relative to cash management.

- Budget execution requirements are addressed in Chapter 5. Among the reports covered is the DD Form 1176, Report on Budget Execution, which gives a picture of the FMS trust fund in the context of funds realized, obligated balances, disbursements, and the like.

- In Chapter 6, detailed guidance is presented relative to the format and maintenance of the FMS case file. The case file consists of multiple "tabs" of relevant documentation, designed to facilitate case management and control.

- Pricing policy is stated in Chapter 7. The basic rules for the pricing of articles and services are specified. These rules apply both to the prices indicated on the Letter of Offer and at the time of billing. This chapter deserves careful reading.

- Once an item is delivered or a service is performed, it must ultimately be billed to the FMS customer. Billing and reimbursement procedures are covered in detail in Chapter 8.

- Finally, Chapter 9 establishes procedures to be used for the collecting and reporting of FMS indebtedness.

While DOD 7290.3-M represents a big step in putting FMS financial policy guidance in one manual, it did not replace the need for certain DOD directives, such as DODD 2140.2. In August 1985, it became necessary for OASD(C) to reissue DODD 2140.2 relative to the recovery of nonrecurring costs. This was required due to policy refinements associated with the computation and collection of nonrecurring cost recoupment charges. In particular, the current DODD 2140.2 provides for a more simplified method of computing recoupment charges for non-major defense equipment.

Other Initiatives

In November 1982, or about 17 months following the promulgation of DOD 7290.3-M, Deputy Secretary of Defense Frank Carlucci issued a memorandum which chartered the FMS Financial Management Improvement Program (FFMIP) Office. This office, placed under the direction of the Assistant Secretary of Defense (Comptroller), was assigned the mission of providing centralized and coordinated direction to the military departments and DOD components to ensure the consistent and cost-effective implementation of DOD-wide financial management policies, procedures, and practices in support of the FMS program. The impetus for the FFMIP came, in part, from the House Appropriations Committee (HAC) report concerning the FY 1982 Defense Appropriations Bill. Among other things, the HAC report made reference to the assignment of a case manager, who would be responsible for the total financial and logistical aspects of each active FMS case, as well as the designation of a program manager for the FFMIP. Since its establishment, the FFMIP has identified a number of system deficiencies and attendant improvements.

While much of the discussion has focused on the OASD(C) directives, instructions, and manuals relating to FMS financial management, it is pertinent to note that the Defense Security Assistance Agency (DSAA) also prescribes policies and procedures which affect FMS financial management. In particular, Chapter 7, Section III, of the DSAA-issued *Security Assistance Management Manual (SAMM)*, DOD 5105.38-M, (replacing the now superseded *Military Assistance and Sales Manual*) relates to the development of financial annex payment schedules, termination liability worksheets, type of assistance codes, terms of sale, and the like. Chapter 7, Section V, addresses the concept of FMS case management, and the specific responsibilities of the case manager. In this regard, from a financial perspective, the case manager must: develop a financial and logistics management plan; integrate the program and logistics financial plan with the execution of the case; validate that costs are accurate and billed; ensure Defense Integrated Financial System (DIFS) and DOD component case records are in agreement; and ensure records are retained in accordance with DOD 7290.3-M and the SAMM.

Chapter 9 of the SAMM addresses the FMS credit program, a key source of funding for FMS cases. In a similar manner, MAP funds are discussed in Chapter 11. Finally, Chapter 13, Section III, contains guidance relative to the DSAA Financial Management Review Program--a program established to identify and resolve current financial problems and to provide an "early warning" system for emerging problems.

The bottom line is that FMS financial management is a complex process, involving DSAA, as well as OASD(C), guidance. Furthermore, the military services and defense agencies also typically produce supplemental procedures relative to the financial management process.

MODERN-DAY FMS FINANCIAL MANAGEMENT

Functional Elements

With this brief review of where we've been in FMS financial management, we can now attempt to answer what FMS financial management is in today's terms. Simply stated, it involves all the management of funds associated with the execution of an FMS case. This management includes cost analysis, pricing, accounting, funds control, reporting, forecasting, billing, auditing, system design, and internal control, to name but some of the key aspects. To integrate these multiple aspects into a more generalized framework, the DISAM one-week Financial Management (SAM-CF) Course tends to examine FMS financial management in the context of three primary functional elements: pricing, funds management, and billing.

Pricing starts with providing reasonable approximations of a final price on the Letter of Offer provided to an FMS purchaser. FMS pricing guidance is contained in Chapter 7 of DOD 7290.3-M. In many ways, pricing is the genesis of the FMS financial management process in that it provides the estimated dollar totals which ultimately must be presented in the context of a payment schedule (Financial Annex) and a funding plan (DD Forms 2060 and 2061). Pricing concludes with the determination of a final price to the customer which is in accordance with the AECA.

Funds management is a multi-dimensional term which includes such aspects as the payment schedule, funding plan, estimating obligational authority requirements, ensuring case level cash balances are sufficient to meet anticipated outlays, and that the overall concept of funds control is in operation. In today's environment we have what are generally referred to as customer order control systems (COCS) to track the request and approval cycles of obligational authority (and in some instances, expenditure authority as well). Unlike pricing, which involves initial estimates and eventual finalized costs, the funds management process permeates the entire financial management cycle, with less obvious beginning and completion milestones.

Billing may be thought of as, first, military service performance/delivery reporting to SAAC and, second, the subsequent presentation of forecast and historical delivery data to the FMS purchaser. In this first dimension, billing involves work in process (e.g., progress payments), followed by liquidating deliveries. In many ways, the billing process is the ultimate test to see if the intent of the Arms Export Control Act (AECA) is followed. In this regard, the AECA is interpreted to mean that the FMS program (in absence of congressional reductions, waivers, or funds grants) is to be fully sustained with foreign purchaser monies--the so-called "no profit, no loss" principle. Unless a country is promptly and properly billed for defense articles and services, it gets unauthorized support from DOD appropriation accounts. More likely, the military service is reluctant to close the FMS case knowing that certain billing information may be missing, which further leads to customer dissatisfaction because forecasted funds must be held until the case is financially complete. In accomplishing the second dimension of billing, SAAC consolidates the work in process and delivery data, together with the forecast data from the payment schedule, into an FMS Billing Statement (DD Form 645) which is sent to the FMS customer on a quarterly basis. The DD Form 645 also contains a requirement for payment by a specified date.

Reconciliation and Auditing Processes

Inherent in the three functional areas of pricing, funds management, and billing are the ongoing processes of reconciliation and auditing. Plainly speaking, reconciliation amounts to ensuring that the SAAC, U.S. Treasury, and military service, as well as the inter- and intra-service, records are in balance with one another and that this balance carries through the system for each FMS case to the extent that each case is in balance throughout its life cycle. In this regard, reconciliation should be a full-time, cradle-to-grave process. Auditing, on the other hand, is a selective, often random-sample process designed to see if major policies are being followed as a matter of intent, and that this intent is being translated into sound, correct actions.

Future

If one could gaze into a crystal ball which would tell the future of FMS financial management, one would immediately see a revised DOD 7290.3-M on the horizon. This manual is currently in the final stage of revision and should be reissued in the next few weeks. From a data-processing standpoint, SAAC--in conjunction with OASD(C), the FFMIP, DSAA, and the military services and DOD components--is in the process of developing the FMS Accounting and Billing System (FABS), which will replace the Defense Integrated Financial System (DIFS). In addition, the military services are responsible for the development of an FMS Financial Integrated Control System (FICS), to improve data reporting between themselves and SAAC. In summary, the FMS community will soon be exposed to a reworked policy manual, to be followed by the implementation of improved data-base management systems. As a result of this improvement, FMS financial managers will be better able to do a more thorough analysis of financial data with the purpose of improving the return on both U.S. defense dollars and foreign purchaser defense dollars.

CONCLUDING REMARKS

This article has examined the evolution of FMS financial management from its predecessor, the old MAP program, to modern-day functions and processes. All told, FMS financial management is a relatively complex area; however, it is not as esoteric as some may imagine. Essentially, FMS financial management involves the implementation of time-tested principles and procedures, the foundations of which are prescribed in DOD 7290.3-M.

ABOUT THE AUTHORS

Mr. John J. Williams has been with DISAM since 1981 and is an Assistant Professor of Security Assistance Management. His area of expertise is in financial management. In addition to being an honor student at the Industrial College of the Armed Forces and a distinguished graduate of the Financial Administration Course, Mr. Williams holds a Bachelor's Degree in Industrial Arts from Iowa State University and a Master of Business Administration in Personnel Management and Industrial Relations from the University of Missouri.

Dr. Larry A. Mortsolf is the Deputy for Consultation and a Professor at DISAM. He holds a PhD in Political Science from the University of Cincinnati and an MS in Logistics Management from the Air Force Institute of Technology. Prior to coming to DISAM, he served several years with the U.S. Navy and was recently selected for promotion to the rank of Captain, Supply Corps, in the Naval Reserve.