

SECURITY ASSISTANCE PERSPECTIVES

FMS CASE FINANCIAL MANAGEMENT PROCEDURES

By

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INTRODUCTION

Foreign military organizations are interested in doing business with the United States; but like any customer, they have limited funding. The task of the Business/Financial Manager on a Program Manager's staff is to protect the financial interests of U.S. citizens (taxpayers) by tracking the financial health of Foreign Military Sales (FMS) programs and insuring that collections are made in consonance with requirements. This paper describes some successful procedures used by the Business/Financial Manager of a Program Manager's staff within the U.S. Navy in managing an FMS program.

BACKGROUND

The FMS Financing Program (FMSFP) is that part of the U.S. Security Assistance Program through which the U.S. Government provides defense items, military training, and other defense-related services to friendly foreign governments and international organizations, such as NATO. Authority for the conduct of the FMSFP is granted to the President by the Arms Export Control Act, as amended. Within the Executive Branch, the Secretary of State is responsible for the continuous supervision and general direction of the program, with the Secretary of Defense responsible for general program implementation. The actual administration of the program is managed by the Director, Defense Security Assistance Agency (DSAA).

Several agencies play a role in the financial accounting of FMS cases. Obligational authority for FMS programs is placed with the Security Assistance Accounting Center (SAAC), which records all billings and collections for FMS cases. The Authorized Accounting Activity (AAA) for most of the FMS cases managed by the U.S. Navy is the Naval International Logistics Control Office (NAVILCO). In addition, DSAA collects financial information directly from the Program Managers for use in preparing internal and external reports and analyses, including the quarterly "DSAA FMS Program Financial Report."

FMS agreements are contractual arrangements between governments. The foreign government is responsible for all costs associated with a sale, but the U.S. Government makes the actual payments to the contractors. An FMS case is initiated when a Letter of Request (LOR) is received from a foreign country. A letter of Offer and Acceptance (LOA) is then prepared and signed by

both countries. Essentially a contract, the LOA specifies the terms of the sale and delivery of the items or services.

The most usual financing arrangement available to a foreign country for financing its FMS procurements is by a "dependable undertaking," under which the customer agrees to pay for a purchase in amounts and at times specified by the U.S. Government. As authorized under Section 22 of the AECA, this arrangement provides for commitments to much larger programs than would be possible with one lump sum payment. The amount of each payment usually includes costs for which the U.S. Government would be responsible if the purchaser were to cancel the LOA and estimates of advance and progress payments that must be made to suppliers. The amount of payment is based on delivery forecasts or evidence of constructive delivery. It is U.S. government policy to obtain these funds 90 days before making payments on behalf of the purchaser.

Once an LOA has been countersigned by the foreign country and returned to the Chief of Naval Operations (OP 63), the obligational authority for a particular FMS case is transferred through SAAC and NAVILCO to a Program Manager. The Program Manager directs this obligational authority through a program directive (PD) to the Participating Activities Resource Manager (PARM) who will manage the procurement. The PD serves as a contract between the Program Manager and the PARM, describing the schedule and the financial, technical, and reporting responsibilities the PARM will assume. The documentation thus follows this trail: signed LOA - OP63 - SAAC - NAVILCO(\$) - Program Manager - PARMs.

FMS FINANCIAL MANAGEMENT

The Program Manager's primary FMS financial management activity is tracking the funds flow. As in any business organization, government or commercial, financial data must also be reported to higher or outside authority.

To illustrate how a Program Manager's financial management system works, we describe in the paragraphs below the situation of a country with a number of FMS cases handled by a single program management office. The situation we describe is not meant to be typical; rather, it is intended to show how the system might work in a particular instance. We will discuss some problems encountered in managing this program, and will demonstrate how the Program Manager's financial management system can be used to solve such problems. Although the discussion which follows reflects the management of FMS cases for a particular country by one military service, the techniques described herein are readily adaptable to other countries/services.

The Accounting System

In our example, DSAA is the agency responsible for collecting financial data from the Program Management Office.

The Program Manager drafts an instruction requesting information from the PARMs in a form that will comply with DSAA's reporting requirements. A Matrix (see Exhibit 1) showing the activities and the cases they must report

on accompanies the Program Manager's instruction. Such a matrix is convenient because more than one PARM may report on an FMS case, and some PARMs report on several cases.

EXHIBIT 1
FINANCIAL REPORTING MATRIX FOR QUARTER ENDING 31 MARCH 1984

NOTE 7290 OF MARCH 1984
DATA AS OF 31 MARCH 1984

COG CAO/PARM	FMS CASES													
	★	★	★		★			★	★	★			★	★
					B.C									
CINCLANT FLT					B.C									
					B.C									
NAVAIR	B.C	B.C												
NAVELEX							★ AC	B.C						B.C
NAVSEA				★ AC	B.C			B.C		B.C	★ AC	★ AC	B.C	
NAVSUP						★ A			B.C					
					B.C									
NAVILCO									B.C					B.C
SPCC			B						B.C					
FMSO									B.C					
CNET								B.C						B.C
								B.C					B.C	B.C
NTEC								B.C					B.C	

LEGEND:

- ★ CASE ADMINISTERING OFFICE (CAO)
- A. ACTIVE CASES TO BE REPORTED ON AT THE CASE LEVEL BY COG CAO.
- B. ACTIVE CASES IMPLEMENTED BY TO BE REPORTED ON BY PROJECT DIRECTIVE LINE ITEM (PDL) OR RECORD SERIAL NUMBER (RSN) BY COG CAO OR PARM.
- C. SUPPLEMENTAL FINANCIAL DATA REQUIRED.

EXHIBIT 2
FMS PROGRAM FINANCIAL REPORT

FMS Program Financial Report (SAMPLE 8/9/83)
12907 AUG 83

(\$ - Thousands) From: NAVSTA ANYWHERE

Date Prepared: 21 OCTOBER 1983 Date "As Of": 30 SEPT 1983

Out Quarters: I 12/31/83 II 3/31/84 III 6/30/84 IV 9/30/84 V 12/31/84 VI 3/31/85

Point of Contact: MR. W.T. DOOR AIV 123-4567

Line	Report	Notes	Item	TOTAL	RSN OR PDLI	RSN OR PDLI	RSN OR PDLI
1	N a, b		Case Designator	ABC			
2	N		IMP/Date (Mo/CY)	7/76			
3	N c		Case Line No.		1620	2620	3620
4	N d, f		Case/Line Descrip.	WIDGETS	SERVICES	MATERIAL	OTHER
5	N		Value (NET)	900000	300000	500000	100000
6	S e		O/A Issues				
7	N		Actual Oblig	700000	200000	420000	80000
8	S		Deliv				
9	S e, h		Col't thru "as of"				
10	N		DISB-Navy	570000	180000	350000	60000
11	S e, j		DISB-SAAC				
12	D e		Cash Avail T/F				
13	S e		Cash Avail FRB				
14	D e		Cash Avail Total				
15	N g		Work Fund Qtr I	44000	15000	24000	5000
16	N g		Work Fund Qtr II	43000	15000	23000	5000
17	N g		Work Fund Qtr III	42000	15000	22000	5000
18	N g		Work Fund Qtr IV	41000	15000	21000	5000
19	N g		Work Fund Qtr V	40000	15000	20000	5000
20	N g		Work Fund Qtr VI	39000	15000	19000	5000
21	N		Term.Liab. End I	50000	5000	45000	0
22	N		Term.Liab. End II	40000	5000	35000	0
23	N		Term.Liab. End III	30000	5000	25000	0
24	N		Term.Liab. End IV	25000	5000	20000	0
25	N		Term.Liab. End V	20000	5000	15000	0
26	N		Term.Liab. End VI	15000	5000	10000	0
27	N		Cont. H/B End I	-			
28	N		Cont. H/B End II	-			
29	N		Cont. H/B End III	-			
30	N		Cont. H/B End IV	-			
31	N		Cont. H/B End V	-			
32	N		Cont. H/B End VI	-			
33	S e		DD 645 Due "As of"				
34	S e		Collect Qtr I				
35	N, S i		Footnotes				
36			W/F Beyond Qtr VI	61000	30000	21000	10000
37			Gross Commitments Expenditures	800000	265000	450000	85000
38			Expected completion Date	400000	100000	280000	20000
39				6/85			
40							

SAMPLE

The format of the report, shown in Exhibit 2, allows the PARMs either to handwrite or to type the information. The financial data requested includes net case value, actual obligations, and incurred costs. Working fund requirements, termination liability, and contractor holdback are projected for six quarters, and working fund requirements are projected beyond the sixth quarter to complete the case. Gross commitments and expenditures to date are also reported. The following definitions are offered as those used by the Program Manager and the PARMs:

Net case value is the total current value of the FMS case less administrative and accessorial charges.

Actual obligations are the gross cumulative obligations of FMS funds posted to the official accounting records; for example, when a requisition item is ordered, a contract is awarded and accepted, or a work request is accepted.

Incurred costs (used in place of disbursements) are all the costs that have been accrued by the contractor or the Government. Funds are considered expended whether or not the bill, voucher, or other accounting document has been posted to the U.S. Government accounting records.

Disbursements are funds paid out (by check or by appropriations reimbursement from the U.S. Government) to contractors for work associated with an FMS case.

Working Fund (W/F) requirements for future quarters are the anticipated incurred costs. These funds do not include termination liability or contractor holdback.

Termination Liability (T/L) is the cost that would be incurred by the U.S. Government if the FMS case were terminated before scheduled completion. It takes into consideration the status of requisitions in process (shipped but not billed, obligated, or committed); additional costs that would be incurred if a contract were prematurely terminated (labor costs, continued manufacturing, facilities and equipment, unabsorbed overhead, penalties, etc.); and U.S. Government reimbursables (leases, salaries, supplies, transportation, etc.). The T/L reported on the DSAA report for future quarters is the predicted T/L on the last day of each quarter.

Contractor Holdback (H/B) is the amount earned by the contractor or supplier but held back to ensure future performance.

After these reports are submitted and all input from the PARMs is consolidated, a report in the same format as that shown in Exhibit 2 is sent to DSAA. When DSAA combines this information with case collection information reported by SAAC, a cash position for each case is developed. By aggregating all the FMS case information for a particular country, DSAA can develop an overall position for that country.

This information can be used in a number of ways in managing FMS cases. The financial accounting provides historical data that, when coupled with future plans, can be used to forecast future cash requirements, set up payment schedules, and adjust existing schedules. When payment questions

arise, the accurate picture of the situation it provides is essential to solving the problem. In the sections that follow, we will look at how this information can be used to manage FMS cases, and also discuss a few problems that we have experienced.

Deriving Accurate Payment Schedules

One complaint of FMS customers is that the U.S. Government does not adjust payment schedules and cash requirements to match program performance. To solve this problem, we have developed a report of funding shortfalls that compares purchaser payments to actual cash requirements for six future quarters. Since payments from a foreign country must be made in advance of work or product delivery, payment schedules must show projected requirements. For example, on the DSAA report shown on Exhibit 2, requirements through June 30, 1984, must be paid by the foreign country by the 15th of the last month of the previous quarter (i.e., due by March 15, 1984). Thus, the amount due on March 15, 1984, would be calculated as follows:

- + Cumulative Incurred Cost through 12/31/83
- + W/F 1/1/84 through 3/31/84
- + W/F 4/1/84 through 6/30/84
- + T/L on 6/30/84
- + H/B on 6/30/84
- Collections to date
- = Amount due on 3/15/84

The incremental payment requirement for the next quarter (due on June 15, 1984) would be projected as follows:

- + Amount due on 3/15/84 carried forward
- + W/F 7/1/84 through 9/30/84
- + T/L (T/L on 9/30/84 - T/L on 6/30/84)
- + H/B (H/B on 9/30/84 - H/B on 6/30/84)
- Collections on 3/15/84 (assume paid)
- = Amount due on 6/15/84

For the remaining payments, the process is repeated until all W/F is covered and the T/L and H/B reach zero. W/F requirements for a particular quarter may be greater or less than payments required because of the buildup and liquidation of T/L and H/B.

Measuring Accounting Lag

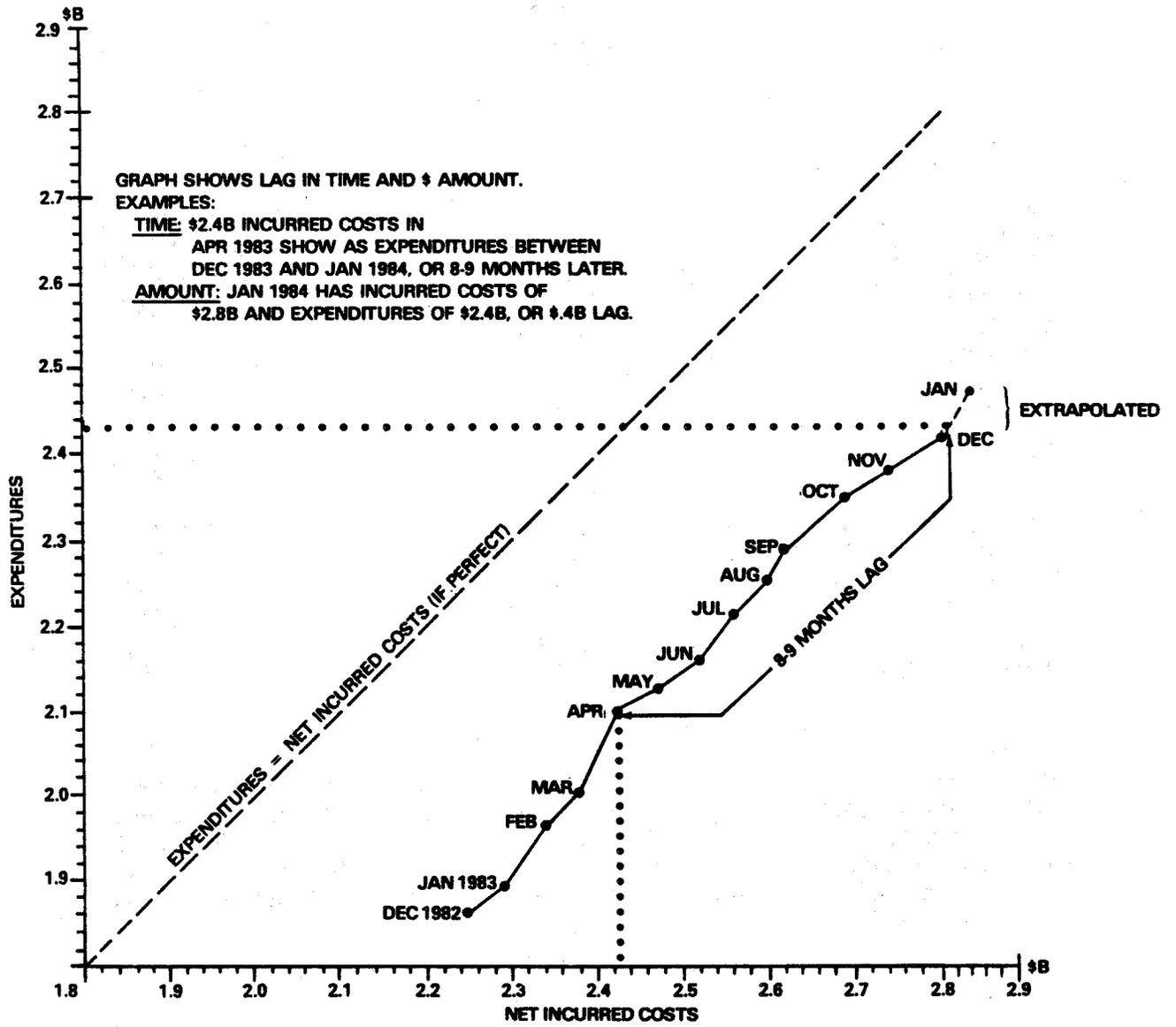
Since accounting systems are not real time, there may be many months of lag between the time a cost is incurred by government or industry and the time it shows up in the accounting records as an expenditure. A rough measure of this lag can be made by accumulating monthly data on incurred costs and expenditures. By comparing these data to the past month in which the incurred costs were about equal to latest expenditure, the lag time can be found (Exhibit 3). Similarly, the amount of dollar lag is found by subtracting the total cumulative expenditure from the cumulative incurred cost for the same month's data. By plotting several months' data for both incurred costs and expenditure, any change in the rate of lag can be determined (Exhibit 4).

EXHIBIT 3
EXPENDITURES AND NET INCURRED
COSTS (CUMULATIVE) FOR
FMS CASES
(\$Millions)

<u>For the Month Ending</u>	<u>Net Incurred Costs</u>	<u>Expenditures Per Monthly NC 2025</u>
DEC 1982	\$ 2,248	\$ 1,860
JAN 1983	2,293	1,892
FEB 1983	2,339	1,966
MAR 1983	2,384	2,013
APR 1983	2,429	2,070
MAY 1983	2,474	2,118
JUN 1983	2,519	2,147
JUL 1983	2,557	2,207
AUG 1983	2,596	2,252
SEP 1983	2,635	2,288
OCT 1983	2,689	2,351
NOV 1983	2,744	2,383
DEC 1983	2,798	2,417
JAN 1984	2,844	2,456
Average Monthly Growth	\$ 46	\$ 46

These data show the lag in both time and dollar amount between new incurred costs and when they are recorded as expenditures. For example, the amount of net incurred costs for APR 1983 (\$2,429M) roughly fall between DEC 1983 and JAN 1984 expenditures, a lag of 8-9 months. The latest dollar lag shown is \$388M (\$2844-\$2,456M).

**EXHIBIT 4
EXPENDITURES AND NET INCURRED COSTS FOR FMS CASES**



Determining Forecasting Accuracy

A large FMS program with many PARMs and many FMS cases generates enough data on W/F requirements to measure the accuracy of the PARM forecasts. The PARMs must report on future W/F requirements (for six out quarters) in the quarterly DSAA report; since the predicted amount of W/F for the sixth quarter out becomes the W/F for the fifth quarter in the next report, and so on until it becomes the W/F for the current quarter, there are six opportunities to revise that prediction. After a few quarters of actual reporting, the amount of overestimate or underestimate becomes evident, as shown on the worksheet in Exhibit 5. The Program Manager may want to adjust estimates received from the PARMs for his own financial forecasting of case requirements.

EXHIBIT 5 PROJECTED NET WORKING FUND REQUIREMENTS FOR FMS CASES (\$ Million)

FOR THE	QTR	ENDING	DEC '82	MAR '83	JUN '83	SEP '83	DEC '83		
31 MAR 1983	\$	211	\$	136*					
30 JUN 1983		195		211	\$	135*			
30 SEP 1983		186		181		\$	116*		
31 DEC 1983		163		138		160	\$	163*	
31 MAR 1984		110		103		141		111	
30 JUN 1984				82		123		123	
30 SEP 1984				76		89		100	65
31 DEC 1984						73		71	49
31 MAR 1985								75	35
30 JUN 1985									24

These data show CAP/PARM forecasting accuracy in projecting working fund requirements for six future quarters.

* Actual requirements

SUMMARY

The procedures described in this paper have been used successfully in tracking the financial health of an FMS program. With a good data base, the Program manager can manipulate information to play "what if" games and support decision making, answer questions from other agencies within our government and from foreign governments, and document the amount and the schedule on which a customer must pay. The data can also provide accurate answers to how the U.S. should respond to requests for increases in a program or to sudden terminations. The Business/Financial Manager, who gathers and analyzes data and forecasts financial position, plays a key role in providing this information and in maintaining the financial health of an FMS program.

ABOUT THE AUTHORS

Lieutenant Commander Norman Messenger, Supply Corps, U.S. Navy, is currently assigned to the Chief of Naval Operations, OP914C, Resource/Readiness Appraisal Branch. He previously served as the Business/Financial Manager on a Program Manager Staff in the Naval Material Command. LCDR Messenger has a B.A. in Accounting from the University of West Florida, and an M.B.A. from the University of Georgia.

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