



Report to the Subcommittee on
Oversight and Investigations,
Committee on Armed Services, House
of Representatives

January 2018

FOREIGN MILITARY SALES

DOD Should Take
Additional Steps to
Streamline Process
for Assessing
Potential Recovery of
Certain Acquisition
Costs

GAO Highlights

Highlights of [GAO-18-242](#), a report to the Subcommittee on Oversight and Investigations Committee on Armed Services, House of Representatives

Why GAO Did This Study

Under the Arms Export Control Act and its implementing regulations, DOD is required to recover nonrecurring costs—unique one-time program-wide expenditures—for certain major defense equipment sold under the FMS program. These costs include research, development, and one-time production costs, such as expenses for testing equipment. The Act also permits those costs to be waived under certain circumstances, such as to standardize equipment with select allies or to avoid a loss of sale.

GAO was asked to review DOD's use of nonrecurring cost waivers. This report addresses the (1) nonrecurring cost waivers approved by DOD from fiscal years 2012 through 2017, (2) factors DOD considers when reviewing waivers, and (3) efficiency of the waiver review process.

To conduct this work, GAO analyzed DOD data of nonrecurring cost waivers for fiscal years 2012 through 2017, the most recent and complete data, to identify the value of waivers. GAO then reviewed a non-generalizable sample of 24 of these waivers that included a mix of justifications and geographic regions. GAO reviewed relevant DOD policy and interviewed DOD officials about the process to assess these waivers.

What GAO Recommends

DSCA should continue to identify opportunities to streamline the waiver review process. DSCA concurred with GAO's recommendation.

View [GAO-18-242](#). For more information, contact Marie A. Mak at (202) 512-4841 or MakM@gao.gov.

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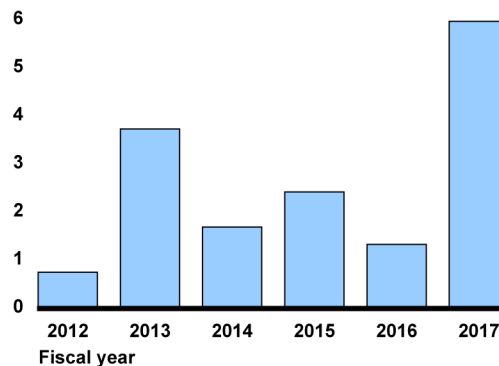
DOD Should Take Additional Steps to Streamline Process for Assessing Potential Recovery of Certain Acquisition Costs

What GAO Found

In the past 6 years, the Department of Defense (DOD) approved waivers valued at nearly \$16 billion that it might otherwise have collected from foreign governments as part of its sales of major defense equipment through the Foreign Military Sales (FMS) program. The Arms Export Control Act, as delegated, authorizes the Defense Security Cooperation Agency (DSCA) within DOD to waive nonrecurring costs under certain circumstances, such as to standardize equipment with allies. From fiscal years 2012 through 2017, DSCA reviewed 813 waivers and denied 3, resulting in an approval rate of 99 percent. As shown in the figure below, the value of approved waivers significantly increased to nearly \$6 billion last year, which is due to 2 waivers totaling nearly \$3.5 billion for sales of missiles and related support systems.

Total Value of Approved Foreign Military Sales Nonrecurring Cost Waivers from Fiscal Years 2012 through 2017

Dollars (in billions)



Source: GAO analysis of Department of Defense data. | GAO-18-242

When reviewing waivers, DSCA considers foreign policy and national security factors, such as interoperability with allies, and economic factors, such as support for the U.S. defense industrial base. Agency officials stated that approving waivers helps ensure sales go through and such broader benefits are realized. DSCA's practice to approve waivers is consistent with the authority it has been delegated under the Arms Export Control Act and is influenced by these benefits.

The process DOD has established to consider waivers is, at times, inefficient and repetitive. DSCA has final approval authority; however, multiple DOD offices must review and provide input on each waiver, with some offices reviewing waivers for the same purpose. Federal standards for internal control call for agencies to allocate resources and assign responsibilities to achieve efficiency and effectiveness. DOD has already taken steps to improve the efficiency of the waiver review process; for example, by reducing the time a few offices take to review the waivers. Nonrecurring cost waivers are one part of the larger FMS process, and continuing to streamline the waiver review process would better position DSCA and the military departments to identify opportunities to maximize efficiencies.

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Abbreviations

AT&L	Acquisition, Technology, and Logistics
DOD	Department of Defense
DSAMS	Defense Security Assistance Management System
DSCA	Defense Security Cooperation Agency
FMS	Foreign Military Sales
NATO	North Atlantic Treaty Organization
OUSD	Office of the Under Secretary of Defense
State	Department of State

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January 31, 2018

The Honorable Vicky Hartzler
Chairwoman
The Honorable Jackie Speier
Ranking Member
Subcommittee on Oversight and Investigations
Committee on Armed Services
House of Representatives

The Department of Defense (DOD) invests billions of dollars to research, develop, and produce defense equipment for weapons programs. Part of DOD's investment typically includes nonrecurring research, development, test, evaluation, and production costs, such as DOD expenditures for testing equipment. In cases where major defense equipment, which has nonrecurring research and development costs greater than \$50 million or total production costs greater than \$200 million, is sold to foreign governments and international organizations through the Foreign Military Sales (FMS) program, DOD is required under the Arms Export Control Act and its implementing regulations to recover nonrecurring costs.¹ For fiscal years 2012 through 2017, DOD reported sales under the FMS program totaling over \$250 billion. These sales, which include major defense equipment, create the potential for DOD to charge and recover billions of dollars of nonrecurring costs from foreign governments. The Arms Export Control Act, as delegated, also authorizes DOD to waive collection of nonrecurring costs based on one of three primary justifications: (1) to standardize U.S. military equipment with the North

¹The Arms Export Control Act defines major defense equipment as any item of significant military equipment on the United States Munitions List whose nonrecurring research and development costs exceeds the \$50 million threshold or whose total production cost exceeds the \$200 million threshold. Significant military equipment is defined as articles "(A) for which special export controls are warranted because of the capacity of such articles for substantial military utility or capability; and (B) identified on the United States Munitions List." See 22 U.S.C. § 2794. For the purpose of this report, we do not focus on exceptions in the Arms Export Control Act for equipment paid for from certain funds (e.g., funds transferred under the Foreign Assistance Act of 1961 to provide military assistance). See 22 U.S.C. § 2761(e)(1)(b).

Atlantic Treaty Organization (NATO) and select U.S. allies, (2) to achieve cost savings for the U.S. government, or (3) to avoid a loss of sale.²

Within DOD, the Defense Security Cooperation Agency (DSCA) is principally responsible for overseeing and administering the FMS program. In recent years, we have made recommendations to address concerns about timeliness and other program management functions within the FMS program.³ In light of these recommendations and ongoing congressional oversight, DSCA has undertaken a number of initiatives aimed at enhancing the FMS program. For example, DSCA adopted digital signatures to help improve timeliness after examining its process for reviewing requests from foreign governments to waive nonrecurring costs.

You asked us to review DOD's use of its authority to waive nonrecurring costs. This report addresses the (1) nonrecurring cost waivers approved by DOD from fiscal years 2012 through 2017, (2) factors DOD considers when reviewing waivers, and (3) efficiency of the waiver review process.

To address our objectives, we reviewed DSCA data on FMS nonrecurring cost waivers requested by foreign governments from fiscal years 2012 through 2017, the years for which data are the most complete. To determine the nonrecurring cost waivers approved by DOD during this time frame, we analyzed the data to determine the number and dollar value of waivers requested and approved by fiscal year and geographic region. We also analyzed the data to determine the number of waivers that were denied. Due to certain data limitations, we were unable to determine the percentage of all eligible sales that included a waiver

²See 22 U.S.C. § 2761(e)(2)(A), (B) (describing these simplified justifications in greater detail). The Arms Export Control Act also permits waivers that would advance U.S. government interests in foreign procurement in the United States under coproduction arrangements, and further authorizes waivers of increases in a charge or charges resulting from a correction of an estimate (reasonable when originally made) of the production quantity base used for calculating the charge or charges. See 22 U.S.C. § 2761(e)(2)(A), (C). We did not focus on these justifications as the data DSCA provided did not include waiver requests for these justifications.

³GAO, *Foreign Military Sales: DOD Need to Improve Its Use of Performance Information to Manage the Program*, [GAO-17-703](#) (Washington, D.C.: Aug. 22, 2017); *Foreign Military Sales: Expanding Use of Tools to Sufficiently Define Requirements Could Enable More Timely Acquisitions*, [GAO-17-682](#) (Washington, D.C.: Aug. 14, 2017); and *Security Assistance: DOD's Ongoing Reforms Address Some Challenges, but Additional Information Is Needed to Further Enhance Program Management*, [GAO-13-84](#) (Washington, D.C.: Nov. 16, 2012).

request and the total amount of nonrecurring costs that DOD actually waived after the waiver was approved and the sale was finalized.⁴ To assess the reliability of the data, we compared them to waiver documentation we obtained from DSCA and interviewed DSCA officials responsible for the data. Based on these steps, we determined the data were sufficiently reliable for the purposes of our reporting objectives.

To determine the factors that DOD considers when reviewing waiver requests, we selected a non-generalizable sample of 24 waiver requests to identify the information the foreign government submitted as part of the request. The sample included a mix of waiver justifications and geographic regions. After reviewing the waiver requests, we interviewed officials from the military departments—Air Force, Army, and Navy—to discuss them. We also interviewed officials from DSCA, the Office of the Undersecretary of Defense (OUSD) Comptroller, OUSD for Policy, and OUSD for Acquisition, Technology, and Logistics (AT&L) to discuss the factors they consider when reviewing nonrecurring cost waiver requests.

To determine the efficiency of the waiver review process, we identified offices that review waiver requests for the same or similar information and reviewed the 24 waiver requests to identify the steps taken by these offices during the review. In addition, we reviewed relevant DOD policy and interviewed officials from all of the offices involved in the waiver process to discuss the steps they take during their review. We compared these offices' practices for reviewing the waivers with the *Standards for Internal Control in the Federal Government*, which calls for agencies to assign and delegate responsibilities in a manner that maximizes efficiency and effectiveness.⁵ Appendix I contains additional detail on our objectives, scope, and methodology.

We conducted this performance audit from March 2017 to January 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

⁴Approved nonrecurring cost waivers are based on planned item quantities before a sale is finalized. A foreign government may purchase fewer items than originally planned, thus reducing the nonrecurring costs relative to the amount of the approved waiver. Waived costs refer to nonrecurring costs actually waived at the close of a sale when item quantities are delivered.

⁵GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#), (Washington, D.C.: Sept. 10, 2014).

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.

Background

The Arms Export Control Act of 1976 gives the President authority to sell defense articles and services to eligible foreign governments and international organizations. This Act is the basis of the FMS program, which the U.S. government considers to be an integral component of U.S. national security and foreign policy. Under the FMS program, foreign governments pay the U.S. government to administer the acquisition of defense articles and services on their behalf. Typically, defense equipment made available for transfer or sale to foreign governments falls under an acquisition program managed by one or more of the U.S. military departments. Generally, this equipment has gone through operational testing and has entered or is entering full-rate production.

Multiple federal entities have a role in the FMS program, including DOD and the Department of State (State). Within DOD, DSCA and the military departments play an extensive role in administering the program and managing FMS acquisitions, respectively. DSCA carries out key administrative functions, such as coordinating the development and execution of sales through the FMS program and conducting negotiations with foreign governments. The military departments are involved early in the development of the potential sale when the foreign government identifies the defense equipment it needs to buy to achieve a desired capability. Congressional oversight of the FMS program has resulted in amendments to the Arms Export Control Act and other relevant legislation to improve the FMS program.

The first phase of the FMS process generally involves a foreign government submitting a request, usually to State or DOD, to express interest in purchasing defense articles or services. Depending on the size and complexity of the items being purchased and the foreign government's available budget, the process to finalize the terms of a sale can take from a few days to years. In response to concerns that the FMS process is slow and burdensome, Congress has increased oversight of the program and recently passed legislation intended to improve the timeliness of the FMS process. For example, in the National Defense Authorization Act for Fiscal Year 2017, Congress required DOD to revise its acquisition regulations to place new requirements on FMS contracting

and to establish a pilot program to seek ways to accelerate contracting and pricing processes for FMS.⁶

According to DSCA officials, foreign governments interested in having nonrecurring costs waived must request a waiver before DOD develops and sends the sales agreement to the foreign government for acceptance and signature.⁷ The sales agreement—formally referred to as a letter of offer and acceptance—details the specific items, quantities, and total estimated costs, among other things. The sales agreement, once signed, is commonly referred to as a FMS case. For a given FMS case, DSCA's decision regarding whether or not to waive nonrecurring costs would also be articulated in the agreement.

Consistent with the Arms Export Control Act and DOD policy, foreign governments may request that nonrecurring costs be waived based on one of three justifications:

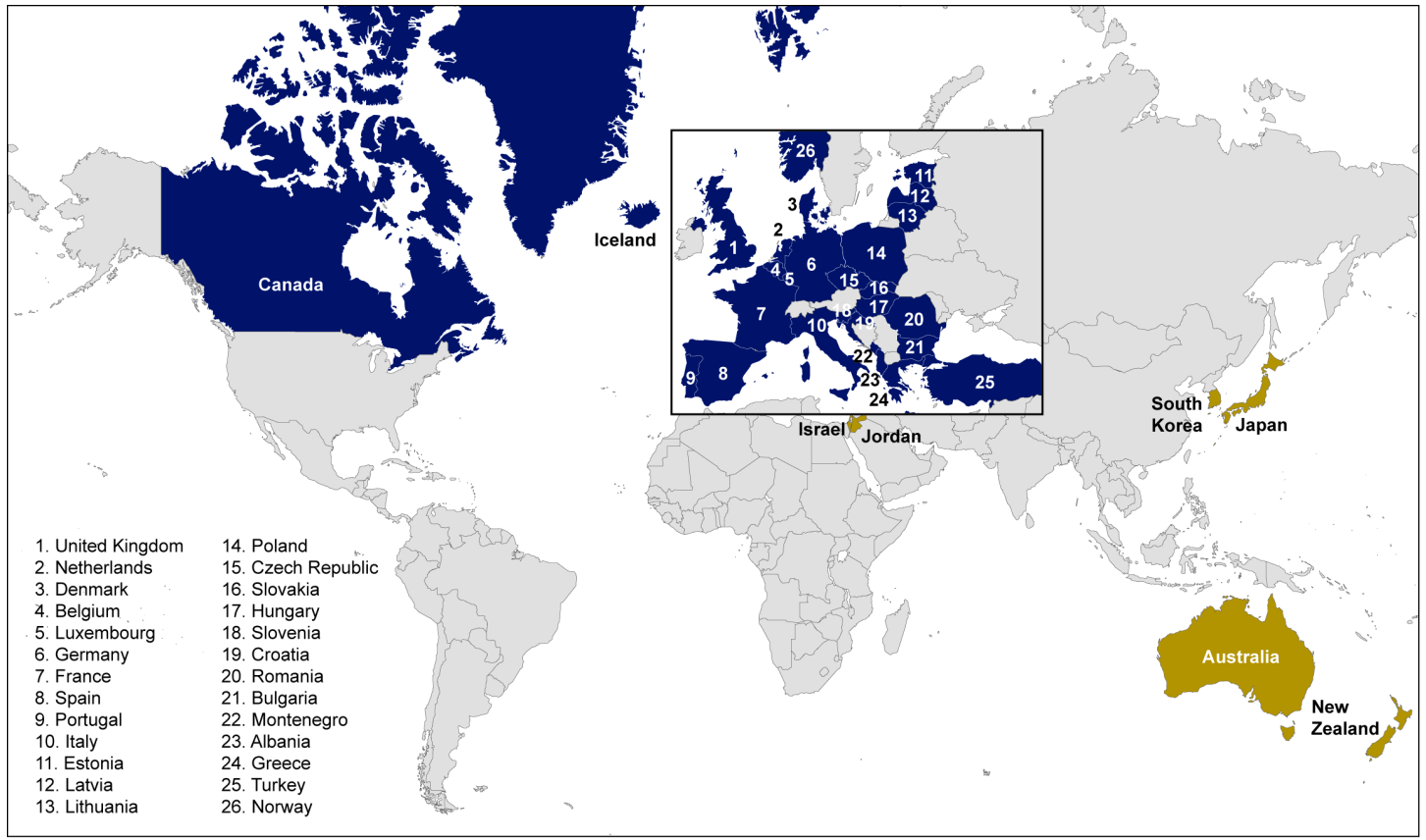
- To achieve **equipment standardization** with NATO and select allies (Australia, Israel, Japan, Jordan, New Zealand, and the Republic of Korea). In addition to NATO itself, there are currently 34 countries that qualify for the equipment standardization waiver justification, as shown in figure 1.
- To avoid a potential **loss of sale** that could likely result from imposing nonrecurring costs.
- To obtain **cost savings** through economies of scale on major defense equipment also procured for the U.S. military that substantially offsets the revenue that will be lost if the nonrecurring costs are waived.⁸

⁶Pub. L. No. 114-328, § 830 (2016).

⁷Waiver requests may be submitted by a foreign customer—typically a foreign government or an international organization, specifically NATO. For the purposes of this report, unless otherwise noted, we generally refer to foreign governments, which predominantly requested waivers.

⁸Combining requirements on the same contract can allow the U.S. government and FMS customer to benefit from economies of scale, which materialize in the form of cost savings when additional units are procured.

Figure 1: Map of Countries Eligible for Equipment Standardization Nonrecurring Cost Waivers



North Atlantic Treaty Organization (NATO) members
 Other countries

Source: GAO analysis of Department of Defense data (data); MapResources (map). | GAO-18-242

The Code of Federal Regulations states that all waiver requests should originate with the foreign government and must specify the reasons or justifications for the requests. A foreign government generally initiates the process by submitting a written request to waive the nonrecurring costs for the major defense equipment it plans to purchase. For example, a NATO member country planning to purchase P-8A patrol aircraft would submit a request to waive nonrecurring costs for that equipment to the Navy, stating that the purchase would promote equipment standardization.

The letter of offer and acceptance the military department sends to the foreign government states the estimated costs and the quantity of major

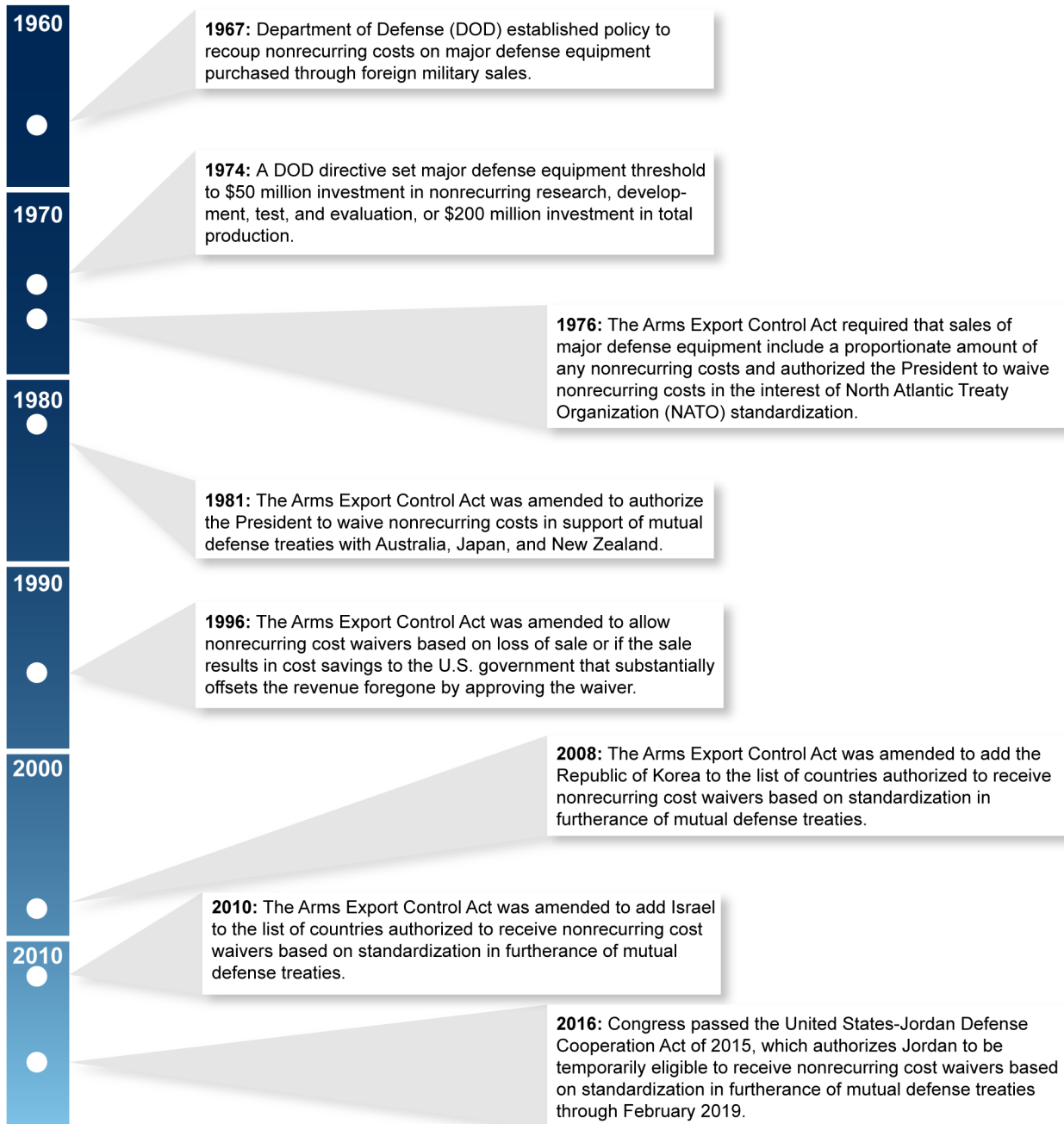
defense equipment for which nonrecurring costs will be waived. Once the letter of offer and acceptance has been signed by the foreign government, any increase in the quantity of items requires that the foreign government submit a request to waive nonrecurring costs for the additional equipment. If equipment quantities are reduced after the waiver is approved, the total amount of nonrecurring costs waived will be less than the value at the time the waiver was approved. For example, in 2013, DSCA approved a waiver for up to \$799 million in nonrecurring costs for 768 Patriot missiles. However, the foreign government reduced its planned procurement to 248 missiles. As of December 2017, DSCA estimated that the amount of nonrecurring costs that will be waived decreased to \$258 million—about two-thirds less than was originally approved.

Congressional and DOD Actions Regarding Nonrecurring Costs

The laws, regulations, and policies regarding nonrecurring costs have been revised several times over the past 50 years. DOD has had a process in place to recover nonrecurring research and development and production costs on sales of major defense equipment to foreign governments and international organizations since 1967. The requirement to recover a proportionate amount of these costs was codified in the Arms Export Control Act of 1976, which authorizes arms sales in furtherance of U.S. security objectives.⁹ Significant legal, regulatory, and policy changes regarding the justifications that can be used to waive nonrecurring costs are summarized in figure 2.

⁹International Security Assistance and Arms Export Control Act of 1976, 94 P.L. 329, 90 Stat. 729 (1976). See 22 U.S.C. § 2751; 22 U.S.C. § 2761 (e)(1)(B).

Figure 2: Timeline of Significant Legal, Regulatory, and Policy Requirements Regarding Nonrecurring Cost Waivers in the Foreign Military Sales Program



Source: GAO summary of Department of Defense policy and the Arms Export Control Act. | GAO-18-242

Determining Nonrecurring Costs for Sales of Major Defense Equipment under the FMS Program

The Arms Export Control Act requires recovery of a proportionate amount of nonrecurring research, development, and production costs for foreign sales of major defense equipment.¹⁰ For example, in the F-35 Joint Strike Fighter program, costs for production testing and tooling equipment are considered nonrecurring costs. The military departments, as delegated under the Code of Federal Regulations, are responsible for determining the per-unit nonrecurring cost for each type of major defense equipment.¹¹ In practice, DOD components submit requests to establish nonrecurring costs to DSCA, which—if approved by DSCA—are made publicly available on the agency’s website.

In practice, determining what nonrecurring costs will be charged entails the following steps:

1. Charges are calculated by dividing total program nonrecurring costs by the total number of planned production units. For example, the Air Force determined that the nonrecurring costs for a sensor program were \$660 million and estimated that a total of 250,000 units would be procured by DOD and from sales under the FMS program. Based on these estimates, the Air Force calculated a nonrecurring cost charge of \$2,640 per unit.¹²
2. For each individual FMS case that includes major defense equipment, the military department calculates the amount of nonrecurring costs for the sale by multiplying the quantity of items by the per-unit nonrecurring cost charge. For instance, in the example described above, if a foreign government wants to purchase 10 sensors, a

¹⁰The Code of Federal Regulations defines nonrecurring research, development, test, and evaluation costs as those costs funded by a research, development, test, and evaluation appropriation to develop or improve the product or technology under consideration either through contract or in-house DOD effort. Nonrecurring production costs are defined as one-time costs incurred in support of previous production of the model specified and those costs specifically incurred in support of the total projected production run. 32 C.F.R. § 165.3.

¹¹See 32 C.F.R. § 165.5.

¹²For cooperative programs where the United States and partner countries collaboratively develop a weapon system, the responsible military department calculates separate nonrecurring cost charges for the costs paid by the United States and the partner countries. For example, sales of the Evolved Sea Sparrow Missile include both a U.S. nonrecurring cost charge of \$47,442 and an international charge of \$35,279 that is collected on behalf of the partner countries. DOD can only waive U.S. nonrecurring costs.

nonrecurring cost charge of \$26,400 would be added as part of the sale.

Roles and Responsibilities of DOD Offices in Reviewing Nonrecurring Cost Waiver Requests

DOD policy requires that waivers also be reviewed on a case-by-case basis and tied to a specific sale that defines the quantities of each item to be procured. This policy prohibits blanket waivers, those that would waive nonrecurring costs on all sales to a particular country or all sales pertaining to specific equipment. For example, DSCA cannot grant a blanket waiver for the Patriot missile that would automatically waive nonrecurring costs on all subsequent sales of that missile.

Within DOD, the Director of DSCA has been delegated authority to waive nonrecurring costs for sales of major defense equipment to foreign governments and international organizations.¹³ While DSCA has primary responsibility for determining whether waiver requests meet all legal and regulatory criteria, we observed that multiple DOD offices are involved in the waiver review process, as illustrated in figure 3.

Figure 3: Simplified Illustration of the Process for Reviewing Nonrecurring Cost Waivers



Source: GAO analysis of Department of Defense information. | GAO-18-242

In practice, the military departments receive waiver requests from a foreign government or international organization and ensure that all required information is submitted, including the equipment type and quantity, as well as the justification for the waiver. Based on this information, the military department determines whether or not to endorse the waiver request. The military department then compiles a package of relevant documentation, including calculation of the estimated total amount of nonrecurring costs to be waived, the original waiver request, and a memo documenting its decision regarding the waiver request. In

¹³Department of Defense Directives 5105.65(7)(e) (2012) and 2140.02(4)(a) (2013).

the course of our work, we found that, within each military department, the offices involved in the waiver review process include:

- The U.S. Army Security Assistance Command, which initially reviews the waiver request, and the Office of the Deputy Assistant Secretary of the Army for Defense Exports and Cooperation, which provides the Army's decision whether to endorse the waiver request;
- The Navy International Program Office, which reviews the waiver request and provides the Navy's decision whether to endorse the waiver request; and
- The Air Force Security Assistance and Cooperation Directorate, which initially reviews the waiver request, and the Office of the Secretary of the Air Force, International Affairs, which provides the Air Force's decision whether to endorse the waiver request.

Apart from DSCA, all waiver requests are reviewed by the OUSD (AT&L) and OUSD (Comptroller), while the OUSD for Policy only reviews waivers that cite the loss of sale justification.

DOD Approved Nonrecurring Cost Waivers Valued at Billions of Dollars over the Past 6 Years

From fiscal years 2012 through 2017, DOD approved nonrecurring cost waivers valued at nearly \$16 billion that it might otherwise have collected from foreign governments as part of its major defense equipment sales. Over this period, DSCA approved 810 of the 813 waiver requests it received, resulting in an approval rate of more than 99 percent. However, the dollar value of the approved waivers does not, in all instances, reflect the total amount that will ultimately be waived once sales are finalized. Rather, it reflects a ceiling for the nonrecurring costs that DOD could waive. During this time frame, DSCA collected \$106 million in nonrecurring costs; however, this amount may be associated with FMS cases prior to fiscal year 2012. We were not able to determine the exact amount actually waived once sales agreements were finalized due to data limitations.

DOD Approved Nearly All Requested Nonrecurring Cost Waivers

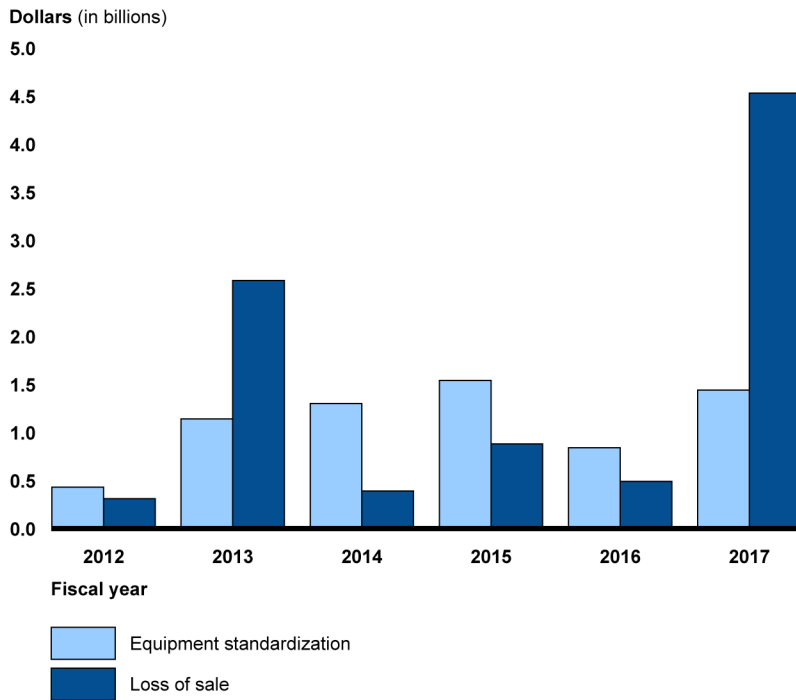
From fiscal years 2012 through 2017, DOD approved 99 percent of the 813 nonrecurring cost waiver requests for major defense equipment sold through the FMS program. In our analysis of DSCA's data on waivers requested for the 6-year period, we found that:

- DOD approved all 471 waiver requests that cited equipment standardization submitted by 25 countries and NATO, totaling approximately \$6.7 billion.

- DOD approved all but 2 of the 340 waiver requests that cited loss of sale submitted by 34 countries, totaling almost \$9.2 billion.
- DOD also approved a waiver of \$460,000 for one of the two cost savings waiver requests it received.

In total, these approved nonrecurring cost waivers amounted to nearly \$16 billion over the past 6 years. The value of approved waivers increased more in fiscal year 2017 than in prior years, as shown in figure 4. The increase is primarily due to 2 approved waivers totaling nearly \$3.5 billion for sales of missiles and related support systems.

Figure 4: Total Value of Approved Nonrecurring Cost Waivers Based on Equipment Standardization and Loss of Sale Justifications, Fiscal Years 2012 through 2017

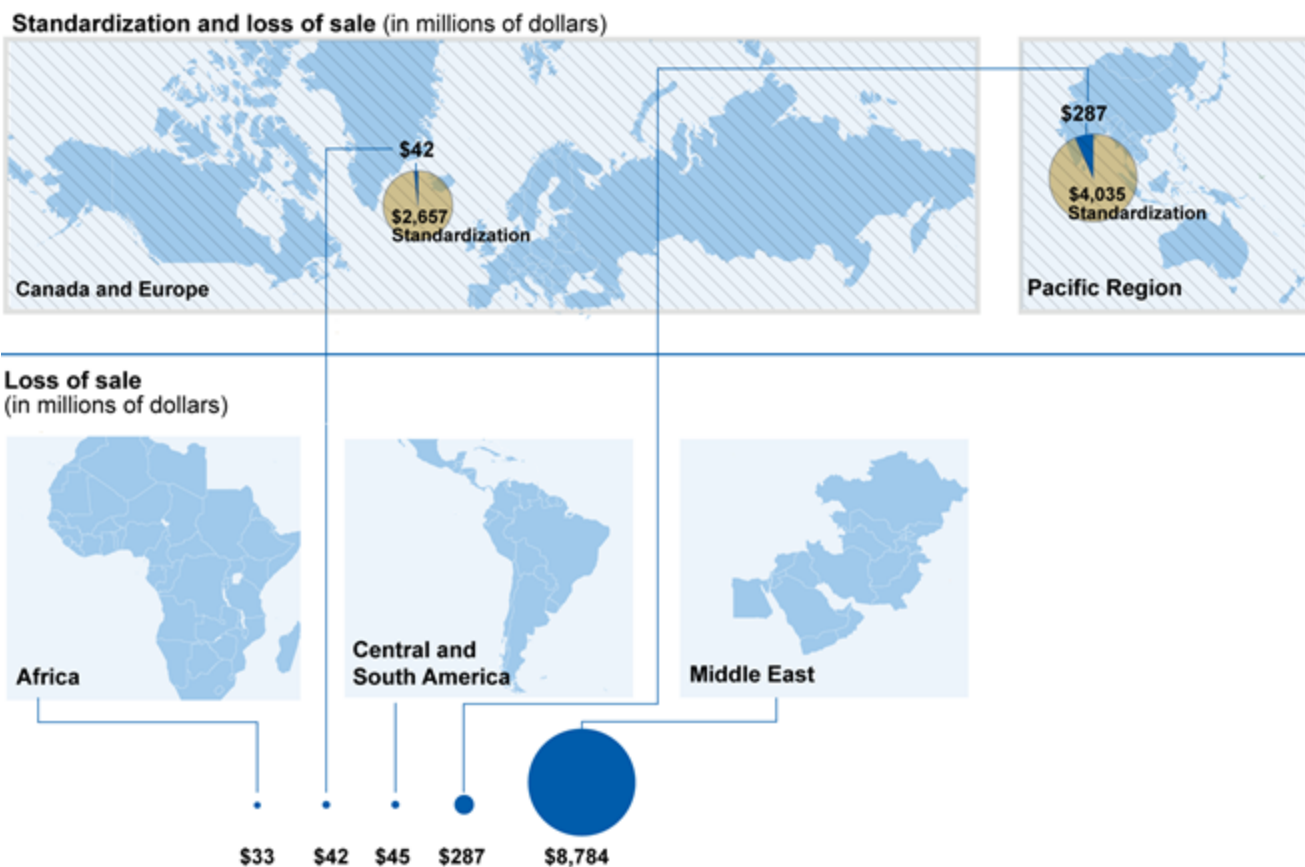


Source: GAO analysis of Department of Defense data. | GAO-18-242

From fiscal years 2012 through 2017, approximately 93 percent of nonrecurring cost waivers were approved for countries in Europe, the Middle East, and the Pacific region. Based on our review of data obtained from DSCA, we found that countries eligible for equipment standardization waivers always cited this justification in their waiver requests, with one exception. We found that only eligible countries received a waiver for equipment standardization. All other countries that

did not qualify for equipment standardization submitted waiver requests for loss of sale, except for 2 waiver requests that cited cost savings to the U.S. government. As shown in figure 5, all countries that utilized the equipment standardization justification are located in Europe and the Pacific region, and nearly all the \$9.2 billion approved loss of sale waivers were for countries in the Middle East.

Figure 5: Total Value of Approved Equipment Standardization and Loss of Sale Nonrecurring Cost Waivers by Region for Fiscal Years 2012 through 2017



Source: GAO analysis of Department of Defense (data); MapResources (map). | GAO-18-242

Various Factors Limit Insight about the Extent of Total Nonrecurring Costs DOD Waived and Collected

Currently, DSCA uses the Defense Security Assistance Management System (DSAMS) to maintain records on FMS case initiation and execution, but an official stated the system was not designed to track nonrecurring cost data, such as data on waivers requested or actual costs waived, for each individual FMS case. DSCA uses separate methods for tracking data on approved waivers and the equipment that was purchased as part of an individual FMS case. DSCA officials stated that to calculate the amount of nonrecurring costs actually waived for each approved waiver, they manually review DSAMS records for individual FMS cases to identify the planned quantity of items to be purchased. While DSCA provided data on actual costs waived, we were unable to independently verify these calculations and, as a result, are unable to report on the actual costs waived for waivers that were approved for fiscal years 2012 through 2017.¹⁴ Other complexities make it difficult to conclusively determine how much has been waived, including:

- Approved waivers do not have expiration dates but are tied to a specific sale. DSCA officials stated that waivers are generally used within 5 years, which coincides with the expiration date of the sales agreement.
- The lag time between when a waiver is approved and when the amount of equipment is finalized can take years.

According to DSCA officials, nearly all nonrecurring costs are waived rather than collected. Officials also noted that DSCA has collected approximately \$106 million in nonrecurring costs for fiscal years 2012 through 2017; however, this amount may include costs collected from FMS cases that were finalized prior to our time frame. DSCA officials could not confirm whether the 813 waiver requests that they received during fiscal years 2012 through 2017 represented the universe of all sales eligible for waivers under the FMS program, as DSAMS does not consistently track whether an individual FMS case includes major defense equipment and therefore would be eligible for a waiver or subject to the collection of nonrecurring costs. According to DSCA officials, foreign governments rarely forego submitting waiver requests and, invariably, submission of these requests is considered a standard practice. As a result, with few exceptions, DSCA officials said that DOD waives nearly all nonrecurring costs associated with eligible sales in the FMS program.

¹⁴Appendix I includes additional information on our methodology and data limitations.

We have previously reported that DSCA has efforts underway to develop a new system, the Security Cooperation Enterprise Solution, which is expected to address longstanding information management challenges.¹⁵ The new system is being developed with the goal of aggregating data from multiple information management systems in order to provide increased insight into the acquisition process, among other things. During our current review, DSCA officials noted that the new system will include requirements to incorporate nonrecurring cost data, but it is unclear whether the system will automate reporting of nonrecurring costs actually waived. We previously reported that the deployment schedule for the new system has been delayed and is being revised.¹⁶ DSCA officials were uncertain of a new deployment date as system requirements are currently being re-validated and expected to continue through 2020.

DOD Considers Foreign Policy, National Security, and Economic Factors When Reviewing Waiver Requests

Our review found that DOD considers a variety of factors when reviewing nonrecurring cost waiver requests, but, ultimately, the department wants to ensure that sales are not jeopardized. Individually and collectively, these sales complement various foreign policy, national security, and economic objectives. The ability to waive nonrecurring costs assists in keeping FMS competitive and ensuring sales are not jeopardized, according to DSCA and other DOD officials.

While there is a decades-old requirement to recover the U.S. government's investment in the nonrecurring costs of major defense equipment it develops and later sells to foreign governments, DOD is authorized to waive collection of these costs, which it implements through DSCA. Under the Arms Export Control Act and its implementing regulations, DSCA has considerable latitude to approve all waivers that meet the criteria for each justification. DSCA's approval of nearly all waivers is in accordance with statutory requirements. When reviewing nonrecurring cost waiver requests, DSCA, consistent with DOD guidance, factors the legal requirements for the justification cited for a waiver request, in addition to broader benefits to achieve foreign policy, national security, and economic objectives, which are interrelated. DOD offices that play a role in reviewing and deciding on waiver requests may also consider these factors.

¹⁵[GAO-13-84](#).

¹⁶[GAO-17-703](#).

Foreign policy and national security benefits: DSCA and other DOD officials weigh the effect of equipment sales under the FMS program on foreign policy and national security objectives. DSCA officials stated that avoiding a potential lost sale is paramount and outweighs the benefits of collecting nonrecurring costs, which may only be a small fraction of the overall sale. DSCA officials added that if a waiver request is not approved, U.S. relations with the foreign government could become strained or otherwise be negatively affected. DSCA officials indicated that one of the goals of the FMS program is to facilitate building and maintaining international relationships. Further, officials added that nonrecurring cost waivers help achieve that goal by making the FMS program competitive.

The precedent for waiving nonrecurring costs has existed for decades, and foreign governments know to request waivers and expect they will be approved, according to DOD officials. In addition, Air Force officials stated that foreign governments seek to negotiate the price when purchasing U.S. defense equipment. DSCA officials stated that foreign governments view the nonrecurring cost waivers as a way to realize some form of cost savings when purchasing defense equipment under the FMS program. DSCA officials stated that, regardless of the amount, waiving nonrecurring costs can be viewed as significant because it gives the appearance of the foreign government achieving some cost savings.

The U.S. National Military Strategy prioritizes increasing U.S. interoperability with coalition partners.¹⁷ Sales of defense equipment to U.S. allies are a means to achieve these interoperability goals. Equipment standardization with NATO member countries and other select allies is one of the available justifications for which a waiver can be requested and approved. Interoperability helps strengthen relationships with allies and advances U.S. and allied security interests in these regions. Navy officials stated that increasing the capabilities available to U.S. allies through FMS reduces the need to locate U.S. military forces and equipment in proximity to these allies.

Economic benefits: Sales through the FMS program can result in cost savings for the U.S. government, which is also one of the permissible justifications in the Arms Export Control Act for foregoing collection of

¹⁷See Chairman of the Joint Chiefs of Staff, *The National Military Strategy of the United States of America 2015*, (June 2015), 7, 9, 15-16.

nonrecurring costs. Both the U.S. and foreign governments can benefit from economies of scale where increasing the volume of defense equipment purchased decreases the cost per unit. Navy officials also explained that they always consider the possibility of cost savings in sales through the FMS program, and added that they coordinate their own procurement plans with FMS purchases to achieve cost savings. However, DSCA officials stated that the efforts to obtain required data and conduct analysis to quantify the amount of cost savings are extensive. As a result, this analysis is generally only performed when required to justify cost savings waiver requests.

In addition to the potential for lower unit prices, the FMS program helps to sustain the U.S. defense industrial base and allows it to remain globally competitive. This level of competition has increased as NATO allies also sell their military equipment. Navy officials stated there are always competing items, since foreign governments can purchase more equipment with less capability at a lower price from another country, which can expand the foreign government's buying power relative to what it can afford when buying from the United States. In addition to competing offers, budget constraints may pose a challenge for some foreign governments seeking to purchase U.S. defense equipment and the added expense of paying nonrecurring costs could threaten a potential sale. DOD officials stated that risking a lost sale if a waiver is not approved could have potentially negative effects for the U.S. companies that manufacture defense equipment sold under the FMS program. Specifically, DOD officials indicated that if the sale is lost, U.S. jobs and economic viability could be affected, particularly because some FMS cases can be valued at billions of dollars in equipment purchases.

DOD Could Take Steps to Enhance Efficiency of Waiver Review Process

DOD's waiver review process is, at times, inefficient, includes repetitive steps, and does not account for the value of the waiver request. Waiver justifications are broadly defined in the Arms Export Control Act, which—as delegated—gives DSCA flexibility to determine how to review requests and grant waivers. DSCA has implemented a review process that involves up to 12 offices including the military departments, DSCA, and various OUSD offices. In some cases, these offices are reviewing waivers to verify similar information, at times leading to repetitive reviews. The same process is applied despite the amount of nonrecurring costs requested to be waived, complexity of the case, or ease (or difficulty) in assessing the validity of the justification cited in the waiver request. DOD has taken steps to reduce the time for a few offices to review waivers, but we found there are opportunities for additional efficiencies to be realized.

For 23 of the 24 waiver requests we reviewed, on average, the military departments determined whether to endorse requested waivers around 270 days after they were submitted by the foreign government.¹⁸ DSCA then, on average, took less than 60 days to decide whether to approve the waiver, which is consistent with its policy to respond to waiver requests within 60 days of receipt. There is no policy regarding the time frame for military departments to review a waiver request, as military officials stated the review time can vary depending on whether additional information must be obtained from the foreign government. However, recognizing an opportunity to streamline the review process, DSCA has worked with the Air Force to identify one office that did not add value, reducing the Air Force review process from three offices to two. Officials stated this action decreased the amount of time required for review. DSCA officials also stated that they have improved their review times by using digital signatures when concurring on waiver decisions. Our prior work has indicated that concerns have been raised about the timeliness of the FMS program, and a DSCA official stated that these efforts were part of a DSCA initiative to increase efficiencies in the overall FMS process.¹⁹

Further, we found repetitive steps in the process for assessing potential U.S. foreign policy and national security benefits from a sale where equipment standardization is cited as the justification for the requested waiver. These benefits are already assessed for certain FMS cases by an in-country team that is comprised of officials from State and the relevant DOD combatant command that manages military operations in designated areas of responsibility.²⁰ Once the waiver is requested by the foreign government, DSCA and OUSD (AT&L) officials review the waiver request to assess these benefits, even though military officials stated an assessment has already been conducted to determine how the proposed sale will advance U.S. national security objectives within the region. In addition, DSCA officials stated that since foreign governments are procuring equipment also used by the U.S. military, by default, purchasing

¹⁸For one of the waiver requests we reviewed, we were unable to determine the amount of time the military department took to determine whether to endorse the requested waiver because the date the request was submitted by the foreign government was missing.

¹⁹[GAO-17-682](#).

²⁰DSCA policy requires a country team assessment be conducted when a sale is likely to require Congressional notification pursuant to section 36(b) of the Arms Export Control Act (22 U.S.C. § 2776(b)).

the equipment would result in standardization. After a potential sale has received a favorable country team assessment, the only additional requirement is to determine whether the customer is NATO or among the 34 countries eligible for the standardization waiver. Yet while this requirement is easily confirmed, the waiver request may still be reviewed by as many as 11 offices within the military department and DSCA, as well as at the OUSD level.

However, we found, for example, DSCA did not adjust its review process based on the value of the nonrecurring costs to be waived. In one case, for a cost savings waiver request with estimated nonrecurring costs just under \$12,000, the Air Force took 112 days to coordinate its review and endorsement of the waiver before submitting it to DSCA. DSCA then took 47 days to coordinate input from various OUSD offices to reach a final decision on the requested waiver. Similarly, in another instance where the value of the requested loss of sale waiver was substantially higher—\$337 million—it took the Army 160 days to coordinate its review before passing it on to DSCA, which took 29 days to finalize its decision. Other than OUSD Policy’s review of the loss of sale waiver, both of these waiver requests required the same review process despite the substantial difference in costs.

For waiver requests that cite the loss of sale justification, DSCA and military department officials told us that it is difficult to prove or disprove a foreign government’s claim that not waiving nonrecurring costs will likely lead to a loss of sale. DOD guidance states these waiver requests should include information on competing items and their cost, if available; however, the guidance does not specify the type of information or level of detail that should be provided. DSCA officials stated that they interpret this guidance to mean this information is optional and therefore not required. According to DOD officials, a foreign government’s budget constraints could limit its ability to pay nonrecurring costs. Of the 18 loss of sale waiver requests that we reviewed, none included any additional information on competing offers or spending limits, beyond the basic loss of sale statement. Even if DOD received this type of information from the foreign government, DSCA officials told us that corroborating this information would be difficult. Therefore, DOD officials stated that they do not assess the likelihood of loss of sale beyond the minimum criteria. Although this assessment requires no additional analysis, loss of sale waiver requests are subject to the same review process, but with OUSD Policy as another required layer of review, bringing the possible total up to 12 offices. DSCA and OUSD Policy officials were unsure of the origin of the requirement for OUSD Policy to weigh in on waiver requests that

cite loss of sale. Further, OUSD Policy officials stated that they review waiver requests for similar elements as other DOD entities, such as whether the sale will support security objectives in the region.

DSCA officials have acknowledged that identifying further opportunities to streamline waiver reviews through a risk-based approach could enhance efficiencies in the FMS program. Federal standards for internal controls state that agencies should assign and delegate responsibilities in a manner that maximizes efficiency and effectiveness.²¹ In light of the significant growth in the FMS program in recent years, as well as the resulting workload for DSCA and other cognizant DOD components, continuing to streamline the waiver review process would better position DSCA and the military departments in maximizing efficiencies in the FMS process.

Conclusions

The FMS program is a central component of U.S. foreign policy. Our work has shown it enhances the capabilities of our allies, fosters interoperability with foreign militaries, helps sustain our defense industrial base, and serves our national security interests. In 1976, Congress codified the requirement for DOD to recoup nonrecurring costs on sales of major defense equipment to help ensure that FMS customers pay their share of the full cost of this equipment. At the same time, Congress provided for waiving nonrecurring costs for specified reasons. Over the past 6 years, DOD has prioritized the benefits of the FMS program and has typically waived rather than collected nonrecurring costs under these specified reasons.

Within DOD, there are opportunities to consider streamlining the waiver review process to eliminate efforts that are potentially repetitive or inefficient. The review process for waiver requests requires that multiple offices review all waiver requests, regardless of the amount of nonrecurring costs to be waived or the complexity of the specific circumstances. The FMS program has been criticized for being slow and burdensome. To create efficiencies in the overall FMS program, DOD could take additional steps to streamline the FMS waivers review process.

²¹ [GAO-14-704G](#).

Recommendation for Executive Action

We are making the following recommendation to DSCA:

The DSCA Director should continue to identify opportunities to streamline the review process for nonrecurring cost waiver requests.
(Recommendation 1)

Agency Comments

We provided a draft of this report to DOD for comment. In its comments, reproduced in appendix II, DOD concurred with our recommendation. DOD also provided technical comments, which we incorporated, as appropriate.

We are sending copies of this report to the appropriate congressional committees and the Secretary of Defense. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-4841 or MakM@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 key contributions to this report are listed in appendix III.



Marie A. Mak
Director, Acquisition and Sourcing Management

Appendix I: Objectives, Scope and Methodology

In this report, we addressed the (1) nonrecurring cost waivers approved by the Department of Defense (DOD) from fiscal years 2012 through 2017, (2) factors DOD considers when reviewing waivers, and (3) efficiency of the waiver review process.

To address all objectives, we analyzed data from the Defense Security Cooperation Agency (DSCA) on requests made by foreign governments to waive nonrecurring costs on purchases of major defense equipment under the Foreign Military Sales (FMS) program. We reviewed data for fiscal years 2012 through 2017, as these years provided the most complete data available to facilitate our analysis and gain insights about the waivers requested based on the three allowable justifications within the scope of our review—equipment standardization, loss of sale avoidance, and cost savings to the U.S. government.¹ DSCA uses the Defense Security Assistance Management System (DSAMS) to maintain records on FMS case data from the time the case is initiated; however, the system does not track nonrecurring cost data, such as data on waivers requested or costs waived, for each individual FMS case. Instead, DSCA provided a dataset on waivers requested that is maintained in a spreadsheet. To assess the reliability of DSCA's data, we tested for missing data, inconsistent coding, and compared data on selected waiver requests to waiver documentation we obtained from DSCA. In reviewing the documentation relative to the dataset we obtained, we found a small amount of data that were incorrectly coded, but these miscodings had minimal potential to affect our analysis. DSCA corrected these miscodings when we brought the errors to their attention. Overall, we found that the documentation for the selected waiver requests generally matched the data DSCA provided. We interviewed DSCA officials responsible for the data to identify the quality controls in place to ensure the data are accurate and reliable. Based on these steps, we determined the data were sufficiently reliable to identify the extent to which DOD approved nonrecurring cost waivers and to select a sample of waiver requests to review.

¹The Arms Export Control Act also permits waivers that would advance U.S. Government interests in foreign procurement in the United States under coproduction arrangements, and further authorizes waivers of increases in a charge or charges resulting from a correction of an estimate (reasonable when originally made) of the production quantity base used for calculating the charge or charges. 22 U.S.C. § 2761 (e)(2)(A), (C). None of the documents that we reviewed in our sample cited this as justification.

To identify the extent to which DOD approved nonrecurring cost waivers for fiscal years 2012 through 2017, we analyzed data on nonrecurring cost waiver requests, which included: the country requesting the waiver, the justification under which the waiver was requested, the requested amount of the waiver, whether or not the waiver was approved, the approved value of the waiver, and the military department responsible for managing the procurement of the major defense equipment associated with the requested waiver. We analyzed the data to determine the number and dollar value of waivers requested for each waiver justification in total and by fiscal year. We also analyzed the data to determine the value of nonrecurring cost waivers approved by geographic region.

DSCA has various information management systems and methods to track data related to FMS cases. However, these systems are not integrated and data limitations precluded certain analysis:

- A DSCA official stated that DSCA does not track which FMS cases include major defense equipment, which impeded our ability to conclusively report on the total universe of all eligible FMS cases during fiscal years 2012 through 2017 for which a nonrecurring cost waiver could have been requested, and the percentage of cases represented by the 813 requested waivers. DSCA processes thousands of FMS cases each year; however, not all FMS cases meet the threshold for collecting or waiving nonrecurring costs as this requirement only applies to FMS cases where major defense equipment is being purchased.² We interviewed DSCA officials to obtain information on how major defense equipment is recorded in DSAMS and the process they use to determine whether a FMS case includes major defense equipment. To identify the universe of eligible FMS cases would have required a manual review of thousands of cases to match the nonrecurring cost waiver data that DSCA maintains in a separate spreadsheet with the case data captured in DSAMS that itemizes the equipment purchased for each individual FMS case. Because a FMS case can have multiple waivers, there is an added challenge to accurately match the waiver with the corresponding case.

²The Arms Export Control Act defines major defense equipment as any item of significant military equipment on the U.S. Munitions List having a nonrecurring research and development cost greater than \$50 million or total production costs greater than \$200 million. Significant military equipment means articles (A) for which special export controls are warranted because of their capacity for substantial military utility or capability; and (B) identified on the United States Munitions List. 22 U.S.C. § 2794.

- While DSCA maintains internal records that track the extent to which waivers are used to their fullest value, we were unable to fully validate certain data elements on equipment quantities. This precluded our ability to report on the amount of total costs waived relative to the value of the approved waiver. DSCA officials stated that when DSCA grants a waiver there is a ceiling on the value of the waiver, which functions similar to a coupon in that it cannot be used to waive nonrecurring costs that exceed the value of the approved waiver. DSCA maintains information on the equipment quantities for each FMS case in DSAMS. However, in order to estimate the costs waived, DSCA officials stated that they manually review each FMS case associated with a waiver to identify the quantities purchased, which may change through amendments to the FMS case. DSCA provided a dataset that compares approved waivers to costs waived; however, we could not verify equipment quantities from DSAMS. We also interviewed DSCA officials to gain insight about their quality control process to ensure the data are reliable. Our ability to verify equipment quantities made it difficult to report on actual costs waived.

To determine the factors DOD considers when reviewing waiver requests, we selected a non-generalizable sample of 24 waiver requests and the related documentation and files to identify the information the foreign government submitted as part of the request, including any information on competing items, and how these waivers are considered as part of the overall FMS program. We selected the sample from the dataset provided by DSCA on the total waiver requests from fiscal years 2012 through April 2017. The sample included waiver requests citing each of the three justifications and represented different geographical regions. To enhance our understanding of how anomaly waivers are processed, we selected 5 waiver requests to include in our sample because of their unique characteristics:

- The only 2 waiver requests that cited cost savings to the U.S. government
- The only 2 loss of sale waiver requests that were denied.
- One waiver request from a foreign government that would have been eligible to use the equipment standardization justification but cited the loss of sale justification in its waiver request.

To select the remaining 19 waivers, we set a threshold for waivers approved where the value of the nonrecurring cost was over \$20 million to capture high-value waivers, as these waivers represented 80 percent of the total value of approved waivers within our time frame for our

sample selection. Next, we selected at least 2 waiver requests from each fiscal year for the 6-year period included in our review and ensured a mix of waivers requested by various foreign governments, including those that had the highest value of waivers approved. We also ensured that the waivers reflected a mix of FMS cases to be managed by the Air Force, Army, and Navy, which also review and provide input to DSCA on the waiver requests. Our sample includes a higher number of loss of sale justifications to provide greater insight about how DOD considers these requests given the minimal requirements and that these requests represent the majority of costs requested to be waived. While our findings are based on a non-generalizable sample and cannot be used to make inferences about all FMS nonrecurring cost waivers requested, the sample provides insight on the specific circumstances of waiver requests and DSCA's decision in these cases.

We recorded the information obtained from our review of the waiver request files in a data collection instrument. One analyst entered information in the data collection instrument and another analyst independently reviewed the information to ensure accuracy. After reviewing the waiver requests, we interviewed officials from military departments associated with the waiver request files that we reviewed to obtain clarifying information about specific waiver requests.

To determine the efficiency of the waiver review process, we reviewed documentation for the 24 selected waiver requests to identify the offices involved in the review process, and the length of time taken to review and decide on the waiver request from the time of submission. We used the same data collection instrument to record this information as part of the two analysts' reviews. We compared these offices' practices to review the waivers with the *Standards for Internal Control in the Federal Government*, which calls for agencies to assign and delegate responsibilities in a manner that maximizes efficiency and effectiveness.³ In addition, we reviewed relevant DOD policy and interviewed officials from the military departments, DSCA, the Office of the Undersecretary of Defense (OUSD) Comptroller, OUSD for Policy, and OUSD for Acquisition, Technology, and Logistics (AT&L) to discuss their roles in reviewing nonrecurring cost waiver requests and the steps they take during their review.

³GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#), (Washington, D.C.: Sept. 10, 2014).

We conducted this performance audit from March 2017 to January 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 12TH STREET SOUTH, STE 203
ARLINGTON, VA 22202-5408

JAN 19 2018

Ms. Marie Mak
Director, Acquisition and Sourcing Management
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Mak:

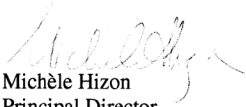
This is the Department of Defense (DoD) response to the Government Accountability Office (GAO) Draft Report, GAO-18-242, "FOREIGN MILITARY SALES: DoD Should Take Additional Steps to Streamline Process for Assessing Potential Recovery of Certain Acquisition Costs" dated December 18, 2017 (GAO Code 101900).

RECOMMENDATION: The GAO recommends the DSCA Director should continue to identify opportunities to streamline the review process for nonrecurring cost waiver requests.

DOD RESPONSE: Concur.

We appreciate the opportunity to comment on this draft report. Additional technical comments and recommendations to improve the overall accuracy of the report were provided separately. Please direct any questions or comments you may have regarding the DOD's response to my action officer, Ms. Susan Kidd, (703) 697-9673, or the DSCA audit liaison, Mr. Eric Ferguson, (703) 697-9261.

Sincerely,


Michèle Hizon
Principal Director
Directorate of Security Assistance

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Marie A. Mak, (202)512-4841 or MakM@gao.gov

Staff

Acknowledgments:

In addition to the contact named above, Candice Wright (Assistant Director), Jessica Karnis (Analyst-in-Charge), Emily Bond, Lorraine Ettaro, Cale Jones, William Lamping, Miranda Riemer, and Roxanna Sun made key contributions to this report.

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