

## **PRICING, FINANCE, AND USG COST RECOVERY**

Pricing, financing, and cost recovery for security cooperation are broad and intricate processes primarily due to legislative mandates. The sale price of items/services, subsequent payments, and recovering costs for which inadequate direct reimbursement is currently received, are sources of concern for foreign purchasers, industry, and the USG. Based on data received from numerous sources (Strategic Planning surveys, routine customer complaints, DISAM customer feedback), the areas below are targets for change.

### **ISSUES:**

Foreign purchasers complain that Foreign Military Sales (FMS) cases are priced too high and change too often. Contract audit information is perceived by foreign customers as difficult to access. Customers cannot explain to the Ministries what they are getting for their money, and cannot budget using the FMS price fluctuations that occur throughout the life of an FMS case.

Foreign purchasers' funds are tied up unnecessarily when LOA prices are too high or payments are collected too early. Some service-level customers prefer to retain excess money on the case for future use, whereas foreign ministry-level and financial counterparts prefer to free this money for other purposes.

US Industry desires stronger USG advocacy for their products and increased USG involvement with their sales efforts. In order to fully implement the FMS reinvention intent to increase partnering with industry in the area of direct commercial sales opportunities, legislative authority to obtain, retain, and use funds to pay for DoD resources must be explored. In addition to supporting DCS, the USG administers Security Cooperation programs for which inadequate direct reimbursement is received.

### **CURRENT ENVIRONMENT:**

**Pricing** - DoD pricing as applied to FMS is intricate. Detailed information is not visible to the customer under the single selling price concept. Customers compare FMS and Direct Commercial Sales (DCS) prices and, at times, find the FMS prices to be (what some view as disproportionately) higher. These "apples to oranges" comparisons create customer misperceptions regarding what material/services are provided under FMS versus DCS. Customers view FMS surcharges and other service charges embedded within the FMS case as redundant and costly. The USG's reluctance to disclose detailed FMS financial information aggravates this confusion. The foreign purchaser is responsible for all costs associated with FMS, including those that exceed the estimated value on the LOA. Foreign purchasers want firm fixed priced LOAs and better explanations of what is included in the FMS single selling price. The policy precludes firm-fixed pricing of LOAs for articles and services from new procurement. The law and policy do not preclude firm-fixed pricing of LOAs from stock. The military services do not exercise this option, however, because problems would arise

should costs exceed those included on the LOA. These problems, and possible resolutions, need to be explored. In addition, Defense-wide Working Capital Fund (DWCF) consists of some elements for which FMS customers receive minimal direct benefit (i.e., obsolescence, pre-stockage, etc.). The USG prices LOAs based upon customer requirements, but does not include the customer in the pricing activities.

**Finance (Payments)** - Normally, customer funds are collected at the beginning of a case based on a current DoD policy of collecting fifty percent of the administrative surcharge (to cover the administrative expenses incurred prior to sales consummation) and termination liability in advance. A balance must be struck between the need to meet the to collect funds in advance, and avoid over-collecting/retaining customer funds too far in advance of actual financial requirements. Payment schedule accuracy must be improved, and upfront collections reduced as much as possible. The international customer perceives that the USG does not manage its money well. Customers are looking for creative ways to finance both FMS and DCS cases.

**USG Cost Recovery** - Excess Defense Articles (EDA), leases, drawdowns, and Foreign Military Financing of Direct Commercial Contracts (FMF/DCC), and DCS support, are other areas supported by the Security Cooperation community. Customers complain that the administrative surcharge they pay is not directly correlated to services received, but is instead used to support the programs listed above. Section 30 of the AECA currently allows the sale of material and defense services to US contractors under certain conditions. However, it does not provide authority for support that U.S. contractors desire from the DoD.

## **RECOMMENDATIONS:**

**Firm-Fixed Price (FFP) and Not-To-Exceed (NTE) LOAs - Explore changes to allow flexibility, such as establishing a revolving fund cost recovery concept to FMS. Explore exempting FMS sales from Defense-wide Working Capital Fund (DWCF) rate changes.**

**FMS Surcharges** - Examine the possibility of using activity based costing to determine appropriate FMS surcharges. Examine an alternative method of charging FMS customer by using actual costs versus surcharges for current administrative charges based on rates. Recommend changes in USD Comptroller policies, based on the results of the examinations.

**Provide Price Breakouts on LOAs** - Change the LOA preparation criteria to allow the visibility of requirements and costs for each line, such as the amount of Contract Administration Services (CAS), Logistics Support Charge (LSC), and Nonrecurring Costs Recoupment Charges (NRC) included on the line. These data are for information purposes only. With the breakout of LOA line item pricing, differences between original contractor price and the ultimate USG price will be easily identifiable, and customers would have a better understanding of what they are paying and why. The process of foreign customers

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access to contract audit information should be improved, subject to U.S. contractor proprietary limitations.

**Review DWCF Pricing** - Review DWCF to ensure FMS customers are paying equitable prices and receiving equitable defense articles and services.

**LOA Financial Management** - Determine maximum application of commercial practices, where appropriate, to how USG handles LOA financing issues, such as termination liability, case closure, and flow of foreign purchaser funds. Such determinations should be compared with current policies and changes required should be recommended to the USD Comptroller.

**Alternatives to USG LOA Administration** - Explore feasibility of outsourcing these functions.

**Delay Collection of Administrative Surcharge Until Earned** - Evaluate the currency of collecting half of the administrative charge on the basis of capturing the portion of costs incurred to the point of FMS case implementation. Review FMS case histories and recommend to the USD Comptroller an appropriate percentage, with a cap on the upfront amount to be collected, that reflects the maximum amount required to prepare a case regardless of the dollar value.

**Reimbursement for USG Assistance with Direct Commercial Sales** - Examine using "consideration arrangements" vice straight fee for service. Explore changing section 30, AECA, to make requirements for sales of USG materials and services to contractors less restrictive.