

June 2004

FOREIGN MILITARY SALES

Improved Navy Controls Could Prevent Unauthorized Shipments of Classified and Controlled Spare Parts to Foreign Countries



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Highlights of [GAO-04-507](#), a report to the Honorable Tom Harkin, U.S. Senate

Why GAO Did This Study

From 1993 through 2002, the Department of Defense (DOD) delivered over \$150 billion in services and defense articles, including classified and controlled items, to foreign countries through foreign military sales programs administered by the military. Foreign countries may request items using blanket orders, which are for a specific dollar value and are used to simplify supply actions on certain types of items. GAO was asked to review whether the Navy's key internal controls restricted blanket orders for (1) classified spare parts and (2) controlled items sold to foreign countries. Also, GAO was asked to determine if periodic tests were conducted to ensure that the Navy's system is working as intended.

What GAO Recommends

GAO recommends that the Navy resolve the differences between DOD and Navy policy on foreign countries' use of waivers, establish policies to recover items shipped to countries not entitled to receive them, and document the reasons for overriding the Navy's system. Also, GAO recommends that the Navy strengthen the system's internal controls to ensure that blanket orders are always reviewed and revalidated, and periodically test these controls.

DOD concurred with five of GAO's recommendations and partially concurred with three other recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-04-507.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William M. Solis at (202) 512-8365 or solisw@gao.gov.

FOREIGN MILITARY SALES

Improved Navy Controls Could Prevent Unauthorized Shipments of Classified and Controlled Spare Parts to Foreign Countries

What GAO Found

The Navy's internal controls over foreign military sales using blanket orders are not adequate, placing classified and controlled spare parts at risk of being shipped to foreign countries that may not be eligible to receive them. The internal control inadequacies are as follows:

- The Navy might not have followed DOD policy when it approved 26 blanket orders leading to the release of classified spare parts to foreign countries. Navy policy states that classified parts can be requested under blanket orders when countries obtain waivers, but the Defense Security Cooperation Agency indicated that this Navy policy contradicts DOD policy, which prohibits the use of waivers. Navy officials have no plans to recoup these parts because the countries were approved to purchase them, and they were entitled to receive the parts under a different process. GAO agrees. However, Navy officials stated, there are no written policies to recover parts that countries should not have requested and received under blanket orders.
- The Navy does not always document the reasons for overriding its system and releasing classified parts. According to the Standards for Internal Control in the Federal Government, all transactions and other significant events need to be clearly documented. GAO identified four blanket orders for which the Navy's country managers overrode the system, but the files did not contain documents explaining the reasons for releasing the parts.
- The Navy lacks written policies to process blanket orders from countries requesting spare parts by manufacturer or vendor part numbers. GAO identified two blanket orders for which the Navy released four classified parts. The release occurred because the Navy's country manager substituted classified parts for parts ordered, which caused the system to bypass the control-edit function designed to check a country's eligibility to receive the parts.
- The Navy's system lacked control edits over controlled cryptographic parts and allowed countries to obtain them under blanket orders without determining the countries' eligibility to receive the parts. GAO identified five blanket orders for which the Navy's system approved and released 32 controlled cryptographic circuit card assemblies. According to DOD and Navy officials, the system has been modified and now reviews controlled cryptographic codes. Also, Navy officials do not plan to recover these parts because the countries were approved to purchase the parts and GAO agrees.
- The Navy has not conducted periodic tests to ensure that its system is accurately reviewing and approving blanket orders in accordance with its foreign military sales policies. DOD and Navy officials said that the last systemwide test was conducted in 2000. However, according to the Defense Security Cooperation Agency, the Navy is not prohibited from periodically testing the system.

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Abbreviations

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| DOD | Department of Defense |
| GAO | General Accounting Office |

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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

June 25, 2004

The Honorable Tom Harkin
United States Senate

Dear Senator Harkin:

From 1993 through 2002, the Department of Defense (DOD) delivered over \$150 billion worth of services and defense articles—including classified and controlled cryptographic spare parts¹—to foreign countries through foreign military sales programs administered by the military services. Some sales occurred under blanket orders, which are cases that specify a specific dollar value rather than specific items. They are designed to simplify supply actions on certain categories of items for which foreign military sales customers will have a recurring need, such as unclassified spare parts, repair parts, minor components, training films, and publications. According to DOD policy, the management of classified and controlled spare parts is particularly important, given their potential to be released to foreign countries that may use them against U.S. interests.² Also, according to DOD policy, DOD is required to control the export of technology, goods, and services that contribute to the military potential of any country or combination of countries that could prove detrimental to U.S. security interests. Under blanket orders,³ the Navy's policy is intended to restrict certain categories of items from being ordered without review such as classified materials.

As requested, this report focuses on whether the Navy has adequate internal controls in place to prevent foreign countries from requisitioning and receiving, under blanket orders, classified and controlled spare parts. Internal control activities include policies, procedures, and processes that are essential for the proper stewardship of and accountability for government resources, and for achieving effective and efficient program

¹ Classified parts are restricted for national security reasons; controlled parts are not classified but contain military technology/applications or are controlled cryptographic parts, hereafter referred to as "controlled parts."

² *Security Assistance Management Manual*, DOD 5105.38-M (Oct. 3, 2003).

³ The Navy commonly refers to blanket orders as "direct requisitioning procedures," "open end requisitioning," or "pull requisitioning."

results.⁴ Our overall objective was to determine the adequacy of the Navy's internal controls for foreign military sales under blanket orders. More specifically, we assessed and tested whether key internal controls adequately restrict blanket order sales of classified and controlled spare parts to foreign countries and determined whether periodic tests were conducted to ensure that the Navy's Management Information System for International Logistics⁵ was working as intended.

As agreed with your office, this report is one in a series on DOD's foreign military sales program administered by the military services. This particular report focuses on the Navy, which sold classified and controlled spare parts to foreign countries valued at over \$2.5 million for the period October 1, 1997, through April 30, 2003. In July 2003 we reported on the adequacy of the Air Force's internal controls over shipments of classified and controlled spare parts to foreign countries.⁶ Also, in September 2003 we reported on the adequacy of the Air Force's internal controls over shipments of spare parts containing military technology to foreign countries.⁷ Furthermore, in April 2004 we reported on the adequacy of the Army's internal controls over shipments of classified spare parts and items containing military technology to foreign countries.⁸

To accomplish our review, we obtained data from the system on classified and controlled spare parts that were purchased under blanket orders from October 1, 1997, through April 30, 2003. During this period, a total of 38

⁴ Internal control activities help ensure that management directives are carried out. The control activities should be effective and efficient in accomplishing the agency's control objectives. U.S. General Accounting Office, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

⁵ The Management Information System for International Logistics, hereafter referred to as "the system," is the Navy's logistics information and tracking system for foreign military sales. It validates foreign customers' requisitions and determines whether items requested are authorized.

⁶ U.S. General Accounting Office, *Foreign Military Sales: Improved Air Force Controls Could Prevent Unauthorized Shipments of Classified and Controlled Spare Parts to Foreign Countries*, [GAO-03-664](#) (Washington, D.C.: July 29, 2003).

⁷ U.S. General Accounting Office, *Foreign Military Sales: Air Force Does Not Use Controls to Prevent Spare Parts Containing Sensitive Military Technology from Being Released to Foreign Countries*, [GAO-03-939R](#) (Washington, D.C.: Sept. 10, 2003).

⁸ U.S. General Accounting Office, *Foreign Military Sales: Improved Army Controls Could Prevent Unauthorized Shipments of Classified Spare Parts and Items Containing Military Technology to Foreign Countries*, [GAO-04-327](#) (Washington, D.C.: Apr. 15, 2004).

blanket order requisitions for classified and controlled spare parts were processed for shipments to foreign countries. We verified the Navy's system to determine whether it approved and released the selected blanket order requisitions in accordance with DOD foreign military sales policies. To conduct this work, we obtained from the Navy all blanket order shipments to foreign countries for the period mentioned above and matched the spare parts' stock numbers to a government database⁹ to identify the classified and controlled parts that were shipped to foreign countries. We conducted our review in accordance with generally accepted government auditing standards. Further details are presented in the Scope and Methodology section of this report.

Results in Brief

The Navy's internal controls over foreign military sales pursuant to blanket orders are not adequate, placing classified and controlled spare parts at risk of being shipped to foreign countries that may not be eligible to receive them. The internal control inadequacies we identified are as follows:

- The Navy might not have followed DOD policy when it approved blanket order requisitions leading to the release of classified spare parts to foreign countries. According to Navy policy, classified material can be requisitioned under blanket orders when foreign countries obtain waivers from the Navy. We identified 26 of 38 requisitions in our review for which foreign countries obtained waivers from the Navy to release 108 classified spare parts such as circuit card assemblies and radar receivers. According to the Defense Security Cooperation Agency, the Navy policy contradicts DOD policy, which prohibits the services from using waivers to allow foreign countries to obtain classified material under blanket orders. Also, according to the policy, the agency is not required to approve all blanket order cases and their corresponding notes. Nonetheless, Navy officials stated that the Defense Security Cooperation Agency approves the Navy's blanket order agreements, which contain notes authorizing the Navy to release restricted items on a case-by-case basis. In addition, the Navy provided examples of blanket order cases that were approved by the Defense Security Cooperation Agency and contained the notes allowing foreign countries to obtain classified material under blanket orders. Also, Navy

⁹ We used the government database called "FEDLOG," which contains logistics information on items in the supply system and provides the identification of spare part numbers and their security classifications.

officials indicated that they have no plans to recover these classified parts because the countries were approved to purchase the parts under different procedures. We agree with the Navy officials' decision. In addition, according to Navy officials, there are no written policies or procedures that address the return of materials that foreign countries should not have requisitioned and received under blanket orders. Without written policies or procedures, the Navy cannot be assured that appropriate steps will be taken to recover materials shipped to foreign countries that are not eligible to receive them.

- The Navy did not always document its reasons for overriding the system to release classified spare parts to foreign countries as required. According to the *Standards for Internal Control in the Federal Government*,¹⁰ all transactions and other significant events need to be clearly documented. The standard states that such documentation should be properly managed and maintained and should be readily available for examination. We identified 4 of the 38 requisitions where the Navy's country managers¹¹ overrode the system and shipped classified antennas, radar receivers, and circuit card assemblies, but the case files did not contain any documentation for the transactions explaining the reasons for the release of the classified parts. According to Navy records, the Navy country managers manually entered four blanket order requisitions into the system. According to records from the Naval Inventory Control Point, Navy International Programs Directorate,¹² the Navy's country managers incorrectly submitted these blanket order requisitions as "pushed requisitions,"¹³ which caused the requisitions to bypass the control-edit function the system. Also, the Navy International Programs Directorate officials did not locate any documentation in the case files to indicate if a waiver had been obtained for these requisitions.

¹⁰ U.S. General Accounting Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

¹¹ We use the term "Navy country manager" to mean an official who performs such functions as supply and financial technical work in support of the foreign military sales program.

¹² Hereafter referred to as "Navy International Programs Directorate."

¹³ Requisitions prepared by the U.S. supply system for the customer are called "push" requisitions because the U.S. supply system sends material to the customer (i.e., as part of the initial set of spare parts that accompany a weapon system).

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- The Navy lacks written policies and procedures to guide the processing of blanket order requisitions from foreign countries requesting spare parts by manufacturer or vendor part numbers. Consequently, and in violation of DOD and Navy policy, the Navy International Programs Directorate allowed the release of classified spare parts under blanket orders to foreign countries that requested parts by using manufacturer or vendor part numbers. We identified 2 of the 38 requisitions in our review for which the Navy released four classified spare parts under blanket orders. When a foreign country submits a blanket order requisition for parts by manufacturer or vendor part numbers, the Navy's system, which does not recognize part numbers, will stop processing the requisition and identify it for manual review. If a corresponding government-classified spare part (national stock number)¹⁴ is identified, the Navy's country manager will submit a transaction into the system in order to change the part number to a national stock number, and allow the system to continue processing the requisition. The requisition for the newly substituted spare part then bypasses the system's control-edit function, designed to determine the foreign country's eligibility to receive the part.
 - The Navy's system lacked control edits over controlled cryptographic¹⁵ spare parts, and allowed foreign countries to obtain these controlled parts under blanket orders without determining whether the countries were eligible to receive them. Navy policy requires that physical security measures be used to protect controlled cryptographic spare parts. According to DOD policy, parts containing controlled cryptographic and telecommunication parts are considered unclassified but must be controlled, and the loss of these parts could adversely affect U.S. national security. DOD materials that contain controlled cryptographic parts and secure telecommunications equipment are used to deny unauthorized persons information derived from telecommunications of the U.S. government related to national security. In our review, we identified 5 out of 38 blanket order requisitions for which the Navy's system erroneously approved and released 32 controlled circuit card assemblies' cryptographic spare parts to foreign countries. According to DOD and Navy officials, the system was not programmed to review controlled cryptographic item

¹⁴ A corresponding government spare part (national stock number) identifies a specific item of supply.

¹⁵ Cryptography equipment provides security to telecommunication by converting information to a form unintelligible to an unauthorized interception.

codes; consequently, the system automatically approved these requisitions and allowed the release of these parts to foreign countries. On the basis of our review, which identified the Navy system's lack of internal controls over controlled spare parts, the Navy has modified the Management Information System for International Logistics to review foreign countries' requisitions for controlled cryptographic parts and identify them for manual review to determine whether the foreign countries requisitioning the parts are eligible to receive them. According to Navy officials, they do not plan to recover these particular controlled cryptographic parts because the foreign countries requisitioning the parts were entitled to receive them.

- The Navy has not conducted periodic tests, as required by federal internal control standards to ensure that its system is accurately reviewing and approving blanket order requisitions for compliance with restrictions and operating in accordance with the Navy's foreign military sales policies. GAO's and the Office of Management and Budget's internal control standards require that a system such as the Navy's be periodically tested to ensure that it is working as intended and that the ability to accurately review and approve requisitions is not compromised. According to DOD and Navy officials, the last major systemwide testing was conducted in 2000, but this test did not determine whether the system was accurately reviewing and approving blanket order requisitions. According to Defense Security Assistance Development Center officials, who are responsible for managing the Navy's foreign military sales automated system, periodic tests of the Navy's system have not been conducted recently because, in October 1998, the Defense Security Cooperation Agency directed that no additional funds be used to expand the current system. However, Defense Security Cooperation Agency officials stated that this directive does not preclude the Navy from periodically testing the system and reviewing the procedures to assess compliance.

Since the Navy's system has already been modified to review controlled cryptographic spare parts requisitioned under blanket orders prior to shipping them to foreign countries, we are not making a recommendation in this area. We are recommending, however, that the Secretary of Defense instruct the Secretary of the Navy to resolve the conflict between the DOD and Navy policies on the use of waivers; require that the Navy's country managers manually submit into the Navy's system correct blanket order requisitions; and establish policies and procedures to follow when documenting system overrides and processing blanket orders using manufacturer or vendor part numbers. Also, we are recommending that

the Navy establish policies to recover spare parts shipped to foreign countries not entitled to receive them.

We are also recommending that the Secretary of Defense instruct the Under Secretary of Defense for Policy to modify the Navy's Management Information System for International Logistics so that it validates blanket order requisitions on the basis of stock numbers' security classifications when items are requested by manufacturer or vendor part numbers and to periodically test the Navy's system to ensure that it is accurately reviewing and approving blanket order requisitions.

In written comments on a draft of this report, DOD concurred with five of our recommendations and partially concurred with three of our recommendations. DOD's comments and our evaluation of them are discussed on page 19.

Background

The sale or transfer of U.S. defense items to friendly nations and allies is an integral component of both U.S. national security and foreign policy. The U.S. government authorizes the sale or transfer of military equipment, including spare parts, to foreign countries either through government-to-government agreements or through direct sales from U.S. manufacturers. The Arms Export Control Act¹⁶ and the Foreign Assistance Act of 1961,¹⁷ as amended, authorize the DOD foreign military sales program.

The Department of State sets overall policy concerning which countries are eligible to participate in the DOD foreign military sales program. DOD identifies military technology that requires control when its transfer to potential adversaries could significantly enhance a foreign country's military or war-making capability. Various agencies such as the Department of State and DOD are responsible for controlling, in part, the transfer or release of military technology to foreign countries.

The Defense Security Cooperation Agency, under the direction of the Under Secretary of Defense for Policy, has overall responsibility for administering the foreign military sales program, and the military services generally execute the sales agreements with the individual countries. A foreign country representative initiates a request by sending a letter to

¹⁶ Pub. L. No. 90-629.

¹⁷ Pub. L. No. 87-195.

DOD asking for such information as the price and availability of goods and services, training, technical assistance, and follow-on support. Once the foreign customer decides to proceed with the purchase, DOD prepares a Letter of Offer and Acceptance stating the terms of the sale for the items and services to be provided. After this letter has been accepted, the foreign customer is generally required to pay, in advance, the amounts necessary to cover the costs associated with the services or items to be purchased from DOD and then is allowed to request spare parts through DOD's supply system.

For the Department of the Navy, foreign military sales policy and oversight are the responsibility of the Navy International Programs Office, under the direction of the Deputy Assistant Secretary of the Navy for Research Development, and Acquisition. The Navy International Programs Office is primarily responsible for directing, guiding, and implementing the U.S. Navy's foreign military sales program. The Naval Inventory Control Point, International Programs Directorate is responsible for recording, managing, and reporting the material and service order transactions associated with the Department of the Navy Security Assistance Program.

The Navy International Programs Office's responsibilities begin with the initial negotiation of a foreign military sale and end with the transfer of items and completion of all financial aspects of the sales agreement. Also, the Navy International Programs Office uses an automated system called the "Management Information System for International Logistics" to support the U.S. Navy's management of the foreign military sales program. The Navy originally developed the system in 1978, and in October 1997, the Defense Security Cooperation Agency transferred the Navy's system to the Defense Security Assistance Development Center. The Navy retained responsibility for defining system-user requirements, designing new processes, and directing programming modifications to the system's applications. However, the overall responsibility for providing system information technology maintenance support, such as writing and testing the programs and coordinating infrastructure support, was transferred to the Defense Security Assistance Development Center.

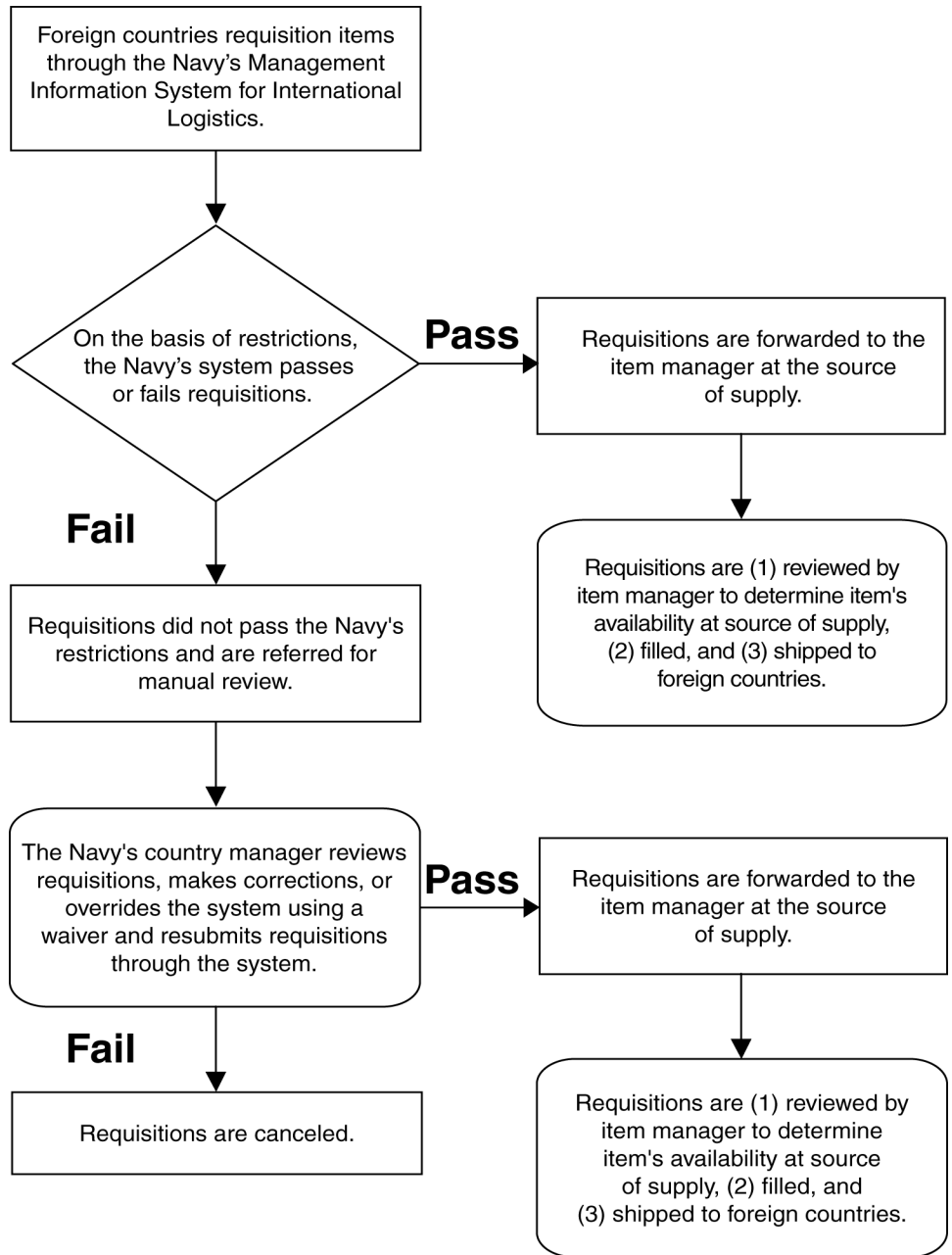
Foreign military sales requisitions for Navy spare parts and other items are initially processed through the automated system. For blanket orders, the system uses the security classification code,¹⁸ the cognizance code,¹⁹ the Federal Supply Group, federal supply class, and the National Stock Number²⁰ to restrict the spare parts available to foreign military sales customers. Once the system validates a requisition, the requisition is sent to a supply center to be filled and shipped. The Navy's requisition process for foreign military sales of classified and controlled spare parts is shown in figure 1.

¹⁸ It is called the "controlled inventory item code," and it indicates the security classification and security risk or controls for storage and transportation of DOD assets.

¹⁹ A cognizance code is a two-character alphanumeric code providing supply management information, identifying the type of items referred to, and identifying the item manager who has control over it.

²⁰ The Federal Supply Group identifies, by title, the commodity area covered by classes within a group and their physical or performance characteristics. The Federal Supply Group makes up 2 of the 13 digits combined to create the National Stock Number, which identifies a specific item of supply.

Figure 1: The Navy's Requisition Process for Foreign Military Sales of Spare Parts



Sources: DOD (data); GAO (analysis) .

Note: This flowchart provides only a brief overview of the complex processes in the Navy's foreign military sales process.

Internal Controls over the Navy's Foreign Military Sales Are Not Adequate

The Navy's internal controls over foreign military sales pursuant to blanket orders are not adequate, placing classified and controlled spare parts at risk of being inappropriately shipped to foreign countries. We found that the Navy (1) might not have followed DOD policy when it approved requisitions under blanket orders leading to the release of classified spare parts to foreign countries and that a written policy does not exist to recover parts shipped to foreign countries that may not be eligible to receive them, (2) lacks adequate documentation for overriding the system to release classified spare parts, (3) lacks written procedures to guide the processing of blanket order requisitions from foreign countries that request parts by manufacturer or vendor part numbers, (4) lacked system control edits to review blanket order requisitions for controlled cryptographic spare parts, and (5) has not conducted periodic tests to ensure that its system is performing as intended. As a result of these inadequate internal controls, classified and controlled spare parts could be shipped to foreign countries that may not be entitled to receive them under blanket orders.

Navy Might Not Have Followed DOD Policy When It Approved Requisitions Leading to the Release of Classified Spare Parts under Blanket Orders

The Navy might not have followed DOD policy when it approved 27 of 38 blanket order requisitions leading to the release of classified spare parts to foreign countries. According to Navy policy, classified material can be requisitioned under a blanket order when a foreign country obtains a waiver from the Navy. However, according to the Defense Security Cooperation Agency, this Navy policy contradicts DOD policy, which prohibits the services from using waivers to allow foreign countries to obtain classified material under blanket orders. From these 27 blanket order requisitions, we identified 26 for which the foreign country obtained waivers from the Navy to release 108 classified spare parts such as circuit card assemblies and radar receivers. For these 26 blanket order requisitions, there is a conflict in the interpretation of DOD and Navy policy on the use of waivers to grant foreign countries access to classified material under blanket orders. According to Navy officials, the system identified the 26 requisitions for review, requiring the Navy's country managers to manually review them. The country managers contacted item managers and obtained waivers, which allowed them to override the system and release the classified materials to foreign countries. In one case, we found that the Navy shipped 30 classified towed body²¹ spare parts to a foreign country under a blanket order. Navy International

²¹ A towed body is a torpedo countermeasure transmitting set for ships.

Programs Directorate officials stated that the Navy uses waivers to grant a foreign country a one-time exception, enabling the country to obtain a classified spare part in support of a major end item that the country acquired through the foreign military sales program. Also, Navy officials stated that the Defense Security Cooperation Agency approves the Navy's blanket order agreements, which contain notes authorizing the Navy to release restricted items on a case-by-case basis. However, according to the DOD policy, the agency is not required to approve all blanket order cases and their corresponding notes. Nonetheless, the Navy provided examples of blanket order cases that were approved by the Defense Security Cooperation Agency and contained notes allowing foreign countries to obtain classified material under blanket orders.

Also, we identified 1 out of the 38 requisitions for classified spare parts that the system erroneously approved. According to Navy officials, the system is programmed to identify for manual review classified spare parts that are requested under blanket orders. However, the Navy system's history records did not show that the country manager manually reviewed or overrode the system to approve the release of one blanket order requisition for classified parts. According to the Defense Security Assistance Development Center officials who are responsible for this part of the Navy's system, the records contain information such as the spare parts' security classification and federal supply group. Also, the officials stated that the system records the security classification code only for those codes that have been identified as classified. The item record is updated every month and the previous month's data are overwritten in the system. At the time of our review, DOD officials could not confirm the security classification for the classified parts because the item's records had been overwritten. The spare parts' classifications were not recorded in the system's history files at the time when the foreign country requested the spare parts. According to Navy officials, the hard copy for this foreign military sales case file was retired and sent to the Federal Records Center. Also, the Navy officials stated that either there was no stock item record in the system when the foreign country requested the parts or if there were an item record, it did not reflect a security classification for the spare part. Nonetheless, DOD officials stated that if the same requisition were submitted today, the system would identify it for manual review because the current item records show that these spare parts are classified. Also, DOD officials stated the new DOD Security Assistance system, entitled the "Case Execution Management Information System," may preclude this type of error in the future. According to the Defense Security Cooperation Agency, the initial deployment of the new system is expected to begin in the Fiscal Year 2007-8 time frame.

According to Navy policy, the Navy International Programs Directorate may advise foreign countries to return parts that the Navy shipped in error. However, Navy officials stated that they have no plans to recover the classified parts we identified in our review because the countries justified the need for the classified parts and obtained written waivers. Also, the Navy officials stated that the foreign countries could obtain the classified spare parts under a different process such as a defined order.²² We agree with the Navy officials' decision. However, according to Navy officials, there are no written policies or procedures that address the return of materials that foreign countries should not have requisitioned and received under blanket orders. If this situation were to occur, Navy officials said that they would work with the Security Assistance Office located in the country involved to recover the material. However, without written policies or procedures, the Navy cannot be assured that appropriate steps will be taken to recover materials shipped to foreign countries that may not be eligible to receive them.

Navy Lacks Adequate Documentation for Overriding System to Release Classified Spare Parts

The Navy did not always document its reasons for overriding the system to release classified spare parts to foreign countries. According to the *Standards for Internal Control in the Federal Government*, all transactions and other significant events need to be clearly documented. The standards state that such documentation should be properly managed and maintained and should be readily available for examination. We identified 4 of the 38 requisitions for which Navy's country managers overrode the system and shipped classified antennas, radar receivers, and circuit card assemblies, but the case files did not contain any documentation for the transactions explaining the reasons for the release of the classified spare parts. According to Navy records, the Navy's country managers manually entered these four blanket order requisitions into the system. Navy policy indicates that foreign countries may submit requests for spare parts by mail or by fax, requiring Navy country managers to manually enter the requests into the system so they can be processed, controlled, tracked, and recorded. Navy records indicate that if the Navy country managers manually submit the requisitions as if the foreign country had initiated the requests called "pull requisitions," the system will validate them in order to determine whether the foreign country is eligible to receive the classified spare parts. However, if the

²² Defined orders are foreign military sales cases used to specify defense articles and services that are identified and approved in the letter of agreement.

blanket order requisitions are referred for review because the spare parts are classified, the country manager will use a waiver to override the system and allow the system to continue processing the requisitions. Nonetheless, if the Navy's country managers submit the requisitions as if the U.S. government had initiated the requests—called “pushed requisitions,”—the system will cause the requisitions to bypass the control-edit function designed to determine whether the foreign countries are eligible to receive the parts. According to records from the Navy International Programs Directorate, the Navy's country managers incorrectly submitted these blanket order requisitions as “pushed requisitions,” causing the requisitions to bypass the control-edit function in the system. A “push” type requisition is not subjected to the same level of processing checks as a “pull” type requisition. Also, the Navy International Programs Directorate officials did not locate any documentation in the case files to indicate if there was a waiver obtained for these requisitions. However, remarks in the system's history files for one requisition indicated that the system command was contacted but no further information was available. According to Navy officials, country managers are aware that they need to maintain documentation of blanket order waiver approvals and denials. However, we found that the supporting documentation was not in the case files to justify the country managers' decisions to override the system to approve and release the classified spare parts.

Navy Lacks Written Policies and Procedures to Guide the Processing of Blanket Order Requisitions by Manufacturer or Vendor Part Numbers

The Navy lacks written policies and procedures to guide the processing of blanket order requisitions from foreign countries that request classified spare parts by manufacturer or vendor part numbers. Consequently, and in violation of DOD and Navy policy, the Navy allowed the release of classified spare parts under blanket orders to foreign countries that requested parts by manufacturer or vendor part numbers. We identified 2 out of 38 requisitions in our review for which the Navy released four classified spare parts (servo amplifiers and network bias) under blanket orders.

The Navy attempts to prevent countries from obtaining classified spare parts by restricting countries from receiving spare parts associated with a unique security classification code and its designated national stock number. When a country submits a blanket order requisition by manufacturer or vendor part numbers, the Navy's system will identify the requisition for manual review because the system does not recognize orders entered by manufacturer's or vendor's part numbers. A Navy country manager will review the blanket order requisition to identify the

corresponding government spare part that matches the one requested. If a corresponding government spare part is identified, the country manager will submit a change in the system and add the correct national stock number to allow the requisition to continue processing through the system. However, when the system continues to process these requisitions, its control-edit function does not check the spare part's security classification to determine whether the foreign country is eligible to receive the part. According to Navy officials, there are no written policies or procedures on processing blanket order requisitions when foreign countries request classified spare parts by the manufacturer's or vendor's part numbers.

Navy's System Lacked Control Edits for Controlled Cryptographic Spare Parts under Blanket Orders

The Navy's system lacked control edits over controlled cryptographic spare parts and allowed foreign countries to obtain them under blanket orders without determining whether they were eligible to receive them. According to DOD policy, these controlled cryptographic and telecommunication parts, known as "Communications Security items," are considered unclassified but must be controlled. The loss of these items could adversely affect U.S. national security interests. DOD materials that contain controlled cryptographic and secure telecommunications parts are used to deny unauthorized persons information derived from telecommunications of the U.S. government related to national security. We identified 5 out of 38 blanket order requisitions for which the Navy's system approved and released 32 circuit card assemblies' controlled cryptographic spare parts to foreign countries. According to DOD policy, if placed in the wrong hands, controlled cryptographic parts could adversely affect U.S. national security. According to the Defense Security Assistance Development Center officials, who are responsible for this part of the Navy's system, the system was not programmed to review the controlled cryptographic item codes, and as a result, the system automatically approved and released the parts requested by the foreign countries. Navy International Programs Directorate and DOD officials were unaware that the system was not reviewing controlled cryptographic parts prior to their release to foreign countries until we identified the problem. On the basis of our review, which identified the Navy's lack of internal controls over controlled spare parts, the Navy requested that the system be modified, and the Defense Security Assistance Development Center modified the system to review foreign countries' requisitions for controlled cryptographic parts and identify them for manual review to determine the foreign countries' eligibility to receive the parts. Also, according to controlled cryptographic item managers, they are required by the National Security Agency to verify that the foreign country can purchase the spare

parts before they are shipped. In addition, Navy officials stated that the foreign countries were approved to purchase the controlled cryptographic parts and the countries have the weapon systems that these parts support. Therefore, according to the officials, there is no need to recover the parts. We agree with the Navy officials' decision. However, according to Navy officials, there are no written policies or procedures addressing the return of spare parts that foreign countries should not have requisitioned and received under blanket orders.

Navy Has Not Conducted Periodic Tests to Ensure That Its System Is Performing As Intended

The Navy has not conducted periodic tests, as required by federal internal control standards, to ensure that its system is accurately reviewing and approving blanket order requisitions for compliance with restrictions and operating in accordance with the Navy's foreign military sales policies. GAO's and the Office of Management and Budget's internal control standards require that a system such as the Navy's be periodically tested to ensure that it is working as intended and that the ability to accurately review and approve requisitions is not compromised. In the *Federal Information Systems Controls Audit Manual*,²³ one of the internal control activities listed is the testing of new and revised software to ensure that it is working correctly. Furthermore, the *Management of Federal Information Resources* manual²⁴ requires that each agency establish an information system/management oversight mechanism to provide for periodic reviews, enabling the agency to determine how mission requirements might have changed and whether the information system continues to fulfill ongoing and anticipated mission requirements. A third guide, the *Internal Control Management and Evaluation Tool*²⁵ assists managers and evaluators in determining how well an agency's internal control is designed and functioning. It lists monitoring as one of five standards of internal controls. Internal control monitoring should assess the quality of performance over time and ensure that findings from reviews are promptly resolved. Ongoing monitoring occurs during normal operations and includes regular management and supervisory activities,

²³ U.S. General Accounting Office, *Federal Information System Controls Audit Manual*, [GAO/AMD-12.19.6](#) (Washington, D.C.: January 1999).

²⁴ Office of Management and Budget, *Management of Federal Information Resources* (Washington, D.C.: November 2000).

²⁵ U.S. General Accounting Office, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001).

comparisons, reconciliations, and other actions people take in performing their duties.

We found that the Navy's system was not programmed to review foreign countries' blanket order requisitions for controlled cryptographic spare parts. Navy International Programs Directorate and DOD officials were unaware of this deficiency until we identified it. On the basis of our review, the Navy has modified its system to review foreign countries' requisitions for controlled cryptographic spare parts and identify them for manual review, to determine the foreign countries' eligibility to receive the parts.

Defense Security Assistance Development Center officials indicated that periodic tests of the Navy's system have not been conducted because, in October 1998, the Defense Security Cooperation Agency directed that no additional funds were to be used to expand the current system. However, Defense Security Cooperation Agency officials stated that this directive does not preclude the Navy from periodically testing the system. According to DOD officials, the last major systemwide testing was conducted in 2000, but this test did not determine whether the system was accurately reviewing and approving blanket order requisitions.

DOD officials pointed out that when minor changes are made to the system, full regression testing is conducted to verify that the program continues to work. As part of our review, we tested the system by reviewing the Navy's restrictions applied to historical requisitions for classified and controlled spare parts. We found that the system did not always perform as intended.

Conclusions

The Navy has not maintained effective internal controls over foreign military sales conducted under blanket orders. Specifically, since the Navy may not have followed DOD policy, which prohibits the release of classified spare parts, the Navy might have released classified spare parts to foreign countries not eligible to receive them. Also, since the Navy has no written policies or procedures on the return of materials that foreign countries should not have requested and received under blanket orders, the Navy's ability to recover the shipped classified or controlled spare parts is lessened. In addition, because the Navy lacks adequate documentation for system overrides, the Navy will not know the basis for approval of classified spare parts when manually processing blanket order requisitions. Furthermore, because the Navy has no written procedures to guide the processing of blanket orders when foreign countries request

spare parts by manufacturer or vendor part numbers and because the system does not validate these orders, there is no assurance that the Navy will be aware that classified spare parts may be shipped to foreign countries not eligible to receive them. Also, since the Navy has periodically failed to test the Management Information System for International Logistics, the Navy may not be able to determine whether its system is in compliance with requisitioning policies and procedures. Without adequate internal controls, classified and controlled spare parts may be released under blanket orders to foreign countries that may not be eligible to receive them, thereby providing military technology to countries that might use it against U.S. interests.

Recommendations for Executive Action

To improve internal controls over the Navy's foreign military sales program and to prevent foreign countries from obtaining classified and controlled spare parts under blanket orders, we are recommending that the Secretary of Defense instruct the Secretary of the Navy to take the following six actions:

- Consult with the appropriate officials to resolve the conflict between the DOD and Navy policies on the Navy's use of waivers allowing foreign countries to obtain classified spare parts under blanket orders.
- Determine and implement the necessary changes required to prevent the current system from erroneously approving blanket order requisitions for classified spare parts until the new system is deployed.
- Establish policies and procedures for the Navy's country managers to follow when documenting their decisions to override the system when manually processing blanket order requisitions.
- Require that the Navy's country managers manually enter blanket order requisitions into the Navy's system to correctly represent foreign-country-initiated orders versus U.S. government-initiated orders so the Navy's system will validate whether the foreign countries are eligible to receive the requested spare parts.
- Establish policies and procedures to follow for blanket orders when the Navy's country managers replace spare parts requested by manufacturer or vendor part numbers with corresponding government national stock numbers.

-
- Establish interim policies and procedures, after consulting with appropriate government officials, for recovering classified or controlled spare parts shipped to foreign countries that might not have been eligible to receive them under blanket orders until the Defense Security Cooperation Agency develops guidance on this issue.

To improve the Navy system's internal controls aimed at preventing foreign countries from obtaining classified and controlled spare parts under blanket orders, we are recommending that the Secretary of Defense direct the Under Secretary of Defense for Policy to require the appropriate officials to take the following two actions:

- Modify the Navy's system to revalidate blanket order requisitions when the Navy's country manager replaces spare parts that are requested by manufacturer or vendor part numbers.
- Periodically test the system to ensure that it is accurately reviewing blanket order requisitions before approving them.

Agency Comments and Our Evaluation

The Director of the Defense Security Cooperation Agency commented on a draft of this report for DOD and concurred with five of our recommendations and partially concurred with three of our recommendations.

DOD partially concurred with our proposed recommendation to determine why the system erroneously approved a blanket order requisition for classified spare parts and make the necessary changes to prevent such a problem in the future. The department believes that the blanket order requisition in question was processed automatically by the system either because the item was not coded as classified at the time the requisition was processed or because the Navy's system did not contain an item record for the national stock number. However, the department stated that historical information was unavailable to determine the coding at the time the requisition was originally processed in 1995. Moreover, the department believes that preventing this problem in the future would require utilizing a comprehensive feed from the Defense Logistics Information System of all DOD catalogued items, not just the Navy interest items the system currently screens. The department stated that the Navy's current system database structure cannot accommodate such a comprehensive feed but that its future system would. The department emphasized that it would be an inefficient use of resources to modify the current Navy's system, particularly given the age of the event. According to the department, the new DOD Security Assistance system, entitled the "Case Execution

Management Information System,” will accommodate the comprehensive feed of all DOD-catalogued items and, therefore, preclude this type of error in the future. According to the Defense Security Cooperation Agency, the initial deployment of the new system is expected to begin in the Fiscal Year 2007-8 time frame. The intent of our recommendation is to ensure that the Navy’s system would not erroneously approve blanket order requisitions for classified spare parts. However, in its comments the department has focused on preventing the problem in the future without considering the existing problem in the current system. Since the Navy will not consider modifying the current system, it cannot be assured that current controls will prevent the system from erroneously approving future blanket order requisitions for classified spare parts. We continue to believe that resources should be utilized to prevent the current system from erroneously approving blanket order requisitions for classified spare parts until the new proposed system is deployed. Therefore, we have modified our recommendation accordingly.

DOD also partially concurred with our recommendation to request Navy country managers to manually enter blanket order requisitions into the Navy’s system to correctly represent foreign-country-initiated orders versus U.S. government-initiated orders. The department stated that a great majority of these electronically submitted orders are not reviewed by the country manager but instead are recognized as foreign customer-submitted “pull” requisitions. DOD also suggested that our recommendation should be limited to those orders that are manually reviewed by a country manager who validates the customer’s eligibility to receive requested parts. The intent of our recommendation is to ensure that Navy country managers manually enter blanket order requisitions into the Navy’s system correctly so that the system will validate whether the foreign countries are eligible to receive the requested parts. We continue to believe that “pull” requisitions in this instance should be covered under this recommendation because among other things, there is no assurance that manually entered blanket order requisitions will undergo stringent reviews by Navy country managers to validate a customer’s eligibility to receive requested parts. In addition, allowing the Navy’s system to thoroughly validate blanket order requisitions will ensure that foreign countries are eligible to receive requested parts. Thus, we continue to believe that when the Navy country managers manually enter blanket order requisitions for foreign-country-initiated orders, they should correctly enter them into the Navy’s system so the system will validate whether the foreign countries are eligible to receive the requested spare parts. Otherwise, these types of requisitions would continue to be

approved through the system without validating the foreign countries' eligibility to receive the requested parts.

In addition, DOD partially concurred with our recommendation to recover classified and controlled spare parts shipped to foreign countries that might not have been eligible to receive them under blanket orders. The department noted that this particular issue has been cited in previous GAO reports on DOD's foreign military sales programs. The department also suggested that the Defense Security Cooperation Agency provide standardized policies and procedures. The intent of our recommendation is for the Navy to have policies and procedures in place to recover classified or controlled spare parts shipped to foreign countries that might not have been eligible to receive them under blanket orders. We acknowledge the department's comments on recommending that the Defense Security Cooperation Agency provide standardized policies and procedures for recovering classified and controlled spare parts. However, as noted in our report, the Navy currently has no policies and procedures addressing this issue. If a foreign country requested and obtained classified and controlled spare parts for which it is not eligible, the country would not necessarily be likely to report this error to the Navy, particularly if the country in question had intended to order the parts. Therefore, we have modified our recommendation to establish interim policies and procedures, after consulting with appropriate government officials, for recovering classified or controlled spare parts shipped to foreign countries that might not have been eligible to receive them under blanket orders until the Defense Security Cooperation Agency develops guidance on this issue.

DOD also provided technical comments for our consideration in the final report and we incorporated changes as appropriate. DOD's formal comments appear in appendix I.

Scope and Methodology

To determine the adequacy of the Navy's internal controls for foreign military sales under blanket orders, we assessed and tested whether the Navy's key internal controls adequately restricted blanket orders for classified and controlled spare parts sold to foreign countries and obtained current DOD and Navy guidance on the foreign military sales programs. We also held discussions with key officials from the Naval Inventory Control Point, Navy International Programs Directorate, Philadelphia, Pennsylvania, to discuss the officials' roles and responsibilities, as well as the criteria and guidance they used in performing their duties to restrict foreign countries from requisitioning

under blanket orders classified and controlled spare parts. Also, we interviewed the officials regarding the requisitioning and approval processes applicable to classified and controlled spare parts. In addition, we obtained written responses from officials at the Defense Security Cooperation Agency, Washington, D.C., to identify the agency's roles and responsibilities regarding the policies and procedures relevant to the foreign military sales programs. We also interviewed officials from the Defense Security Assistance Development Center, Mechanicsburg, Pennsylvania, to discuss their roles and responsibilities, as well as the criteria and the guidance they used to maintain and oversee the Navy's Management Information System for International Logistics to restrict foreign countries from requisitioning under blanket orders classified and controlled spare parts. Furthermore, we interviewed officials to determine the functional and operational controls that are used to validate requisitions entered into the system. We also determined whether the Navy periodically conducted tests to validate the system to ensure that it accurately identified for review and approval blanket order requisitions to support foreign military sales. In addition, we obtained and reviewed documentation identifying the system tests to determine how often they were conducted. Also, we interviewed Navy and DOD officials to determine how periodic reviews and tests of the system were performed.

To support our analysis, we obtained records from the Navy International Programs Directorate on all classified and controlled spare parts that were purchased by using blanket orders and approved for shipment to foreign countries from October 1, 1997, through April 30, 2003. Also, we limited our review to blanket orders because defined orders and Cooperative Logistics Supply Support Agreements specified the parts that countries were entitled to requisition by the national stock number. We tested the system by identifying the 38 requisitions for classified and controlled spare parts that were shipped under blanket orders and reviewed the restrictions applied to determine if the system was operating as intended. We verified the Navy's system to determine whether it approved and released the selected blanket order requisitions in accordance with DOD foreign military sales policies. To conduct this work, we obtained from the Navy all blanket order shipments to foreign countries for the period mentioned above and matched the spare parts' stock numbers to a government database to identify the classified and controlled parts that were shipped to foreign countries. While we identified some issues concerning the appropriate procedures for such spare parts, in all the cases we reviewed, we found that the parts had been ordered and shipped from the Navy's system.

We conducted our review from May 2003 through April 2004 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this report. At that time, we will send copies of this report to the Secretary of Defense; the Secretary of the Navy; the Director, Office of Management and Budget; and interested congressional committees. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-8365 if you or your staff have any questions concerning this report. Key contributors to this report were Lawson (Rick) Gist, Jr.; Carleen Bennett; Latrealle Lee; Elisah Matvay; Arthur James, Jr.; Ann DuBois; and Cheryl Weissman.

Sincerely yours,

A handwritten signature in black ink, appearing to read "W. Solis". The signature is fluid and cursive, with a large loop at the end.

William M. Solis, Director
Defense Capabilities and Management

Appendix I: Comments from the Department of Defense

Note: Part of the enclosure to this letter provided technical comments, which we considered and incorporated in our report as appropriate. The technical comments are not attached.



DEFENSE SECURITY COOPERATION AGENCY

WASHINGTON, DC 20301-2800

28 MAY 2004

In reply refer to:
I-04/006540-P3

Mr. William M. Solis, Director
Defense Capabilities and Management
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Solis:

This is the Department of Defense (DoD) response to the GAO draft report, "FOREIGN MILITARY SALES: Improved Navy Controls Could Prevent Unauthorized Shipments of Classified and Controlled Spare Parts to Foreign Countries" dated April 16, 2004 (GAO Code 350440/GAO-04-507).

DoD acknowledges receipt of the draft report, and we concur with the report in principle. Our responses to the eight recommendations posed by the GAO, as well as a separate listing of technical/editorial comments for the GAO's consideration when preparing the final report are attached. We continue to pursue corrective measures to ensure that adequate controls are in place to prevent unauthorized shipments of classified and/or controlled spare parts to foreign countries.

The Department appreciates the opportunity to comment on the draft report. My point of contact on this matter is Ms. Kathy Robinson. She may be contacted by email: kathy.robinson@dscs.mil or by telephone at (703) 601-4368.

Sincerely,

A handwritten signature in black ink that reads "Tome H. Walters, Jr." in a cursive style.

TOME H. WALTERS, JR.
LIEUTENANT GENERAL, USAF
DIRECTOR

Attachments
As stated

GAO DRAFT REPORT - DATED APRIL 16, 2004
GAO CODE 350440/GAO-04-507

**“FOREIGN MILITARY SALES: IMPROVED NAVY CONTROLS COULD
PREVENT UNAUTHORIZED SHIPMENTS OF CLASSIFIED AND
CONTROLLED SPARE PARTS TO FOREIGN COUNTRIES”**

**DEPARTMENT OF DEFENSE COMMENTS
TO THE RECOMMENDATIONS**

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense instruct the Secretary of the Navy to consult with the appropriate officials to resolve the conflict between the DOD and the Navy policies on the Navy’s use of waivers allowing foreign countries to obtain classified spare parts under blanket orders. (p. 17/GAO Draft Report)

DOD RESPONSE: Concur

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense instruct the Secretary of the Navy to determine why the system erroneously approved a blanket order requisition for classified spare parts and make the necessary changes to prevent such a problem in the future. (p. 17/GAO Draft Report)

DOD RESPONSE: Partially Concur. The blanket order requisition in question was processed automatically by the system either because the item was not coded as classified at the time the requisition was processed or the Management Information System for International Logistics (MISIL) did not contain an “item record” for the national stock number (NSN). Historical information is unavailable to determine the coding at the time the requisition was originally processed in 1995. To prevent this problem in the future it would be necessary to utilize a comprehensive feed from the Defense Logistics Information System of all DOD catalogued items, not just the Navy interest items we currently screen, which is not an efficient use of resources, particularly given the age of the event. It is not possible to accommodate this in the current MISIL database structure. It will be accommodated in the future DOD Security Assistance system, entitled the Case Execution Management Information System (CEMIS).

RECOMMENDATION 3: The GAO recommended that the Secretary of Defense instruct the Secretary of the Navy to establish policies and procedures for the Navy’s country managers to follow when documenting their decisions to override the system when manually processing blanket order requisitions. (p. 17/GAO Draft Report)

DOD RESPONSE: Concur.

Note: Page numbers in the draft report may differ from those in this report.

RECOMMENDATION 4: The GAO recommended that the Secretary of Defense instruct the Secretary of the Navy to require that the Navy's country managers manually enter blanket order requisitions into the Navy's system to correctly represent foreign-country initiated orders versus U.S. government-initiated orders so the Navy's system will validate whether the foreign countries are eligible to receive the requested spare parts. (p. 17/GAO Draft Report)

DOD RESPONSE: Partially Concur. As the great majority of these orders (requisitions) are electronically submitted, not reviewed by the country managers, and recognized as foreign customer-submitted "pull" requisitions, the Recommendation should be limited to orders (requisitions) that are manually reviewed by the country managers. The rewrite of the Recommendation should be, "The GAO recommended that the Secretary of Defense instruct the Secretary of the Navy to require that, in situations when the Navy country managers manually enter blanket order requisitions into the Navy's system, the country managers will validate the customer's eligibility to receive the requested parts."

RECOMMENDATION 5: The Secretary of Defense instruct the Secretary of the Navy to establish policies and procedures to follow for blanket orders when the Navy's country managers replace spare parts requested by manufacturer or vendor part numbers with corresponding government national stock numbers. (p.17/GAO Draft Report)

DOD RESPONSE: Concur.

RECOMMENDATION 6: The GAO recommended that the Secretary of Defense instruct the Secretary of the Navy to establish policies and procedures, after consulting with appropriate government officials, for recovering classified or controlled spare parts shipped to foreign countries that may not have been eligible to receive them under blanket orders. (p. 17/GAO Draft Report)

DOD RESPONSE: Partially Concur. As this issue has been cited in the audit of all three military services' audits on FMS Spare Parts, recommend that DSCA provide standardized policies and procedures.

RECOMMENDATION 7: The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense for Policy to require the appropriate officials to modify the Navy's system to revalidate blanket order requisitions when the Navy's country manager replaces spare parts that are requested by manufacturer or vendor part numbers. (p. 18/GAO Draft Report)

DOD RESPONSE: Concur

RECOMMENDATION 8: The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense for Policy to require the appropriate officials to periodically test the system to ensure that it is accurately reviewing blanket order requisitions before approving them. (p. 18/GAO Draft Report)

DOD RESPONSE: Concur.

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