



DEFENSE SECURITY COOPERATION AGENCY
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19 MAY 2011

MEMORANDUM FOR DEPUTY ASSISTANT SECRETARY OF THE ARMY
DEFENSE EXPORTS AND COOPERATION (DASA-DEC)
DEPUTY ASSISTANT SECRETARY OF THE NAVY
INTERNATIONAL PROGRAMS (NAVIPO)
DEPUTY UNDER SECRETARY OF THE AIR FORCE
INTERNATIONAL AFFAIRS (SAF/IA)

SUBJECT: "Pilot" of Foreign Military Sales (FMS) Tiered Administrative Surcharge
Rate, and Deferred Collection, DSCA Policy Memo 11-28

Reference: Department of Defense (DoD) Financial Management Regulation (FMR) 7000.14-R,
Volume 15, "Security Assistance Policy and Procedures," Chapter 3, Paragraph
030210.G, January 2010

The referenced regulation requires that activity in the FMS Administrative Surcharge Account be reviewed annually and that the results of that review serve as a basis for any recommendation on rate changes. The Defense Security Cooperation Agency (DSCA) conducted the FY10 annual review of this account, and results showed a suitable account balance at the end of the fiscal year. At this time, DSCA does not recommend a reduction or increase in the overall FMS Administrative Surcharge rate; however, as a result of our review of upcoming case activity and continued efforts to assess the health of the Surcharge Account, DSCA has determined an adjustment to our rate structure may be appropriate. As a result, we are evaluating an alternative rate structure that will apply to extremely large dollar value FMS cases. This evaluation is being accomplished as a "pilot" program in order to fully inform decisions on a possible permanent rate structure change for cases in this category.

Tiered Rate

Under the current rate structure, all cases are assessed the 3.8 percent FMS Administrative Surcharge against the articles/services amount of the case. This is regardless of the overall case dollar value. The collection of revenues and the ensuing account balance based on the existing rate have resulted in our continued ability to manage and execute FMS programs successfully at today's sales and workload levels. To date, the largest dollar value FMS case implemented/executed was a 1993 case written for \$9B. Our analysis shows that the case was successfully executed within the Administrative Surcharge collected, but in cases where a single platform/type is bought, economies of scale begin to kick-in above \$9B. As a result, DSCA is "piloting" a surcharge rate change that uses \$9B as the ceiling amount for applying the 3.8% surcharge. For cases over \$9B that are considered appropriate for the "pilot," a tiered FMS Administrative Surcharge rate structure will be used. Bundling of different types of platforms to achieve \$9B total case value is not appropriate for the "pilot." The following information is provided regarding this "pilot" program:

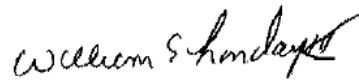
FMS cases up to \$9B will continue to be assessed the 3.8 percent FMS Administrative Surcharge. Under our “pilot” structure, cases that exceed \$9B are extraordinary and for such cases, a reduced FMS Administrative Surcharge rate is appropriate to ensure the customer is not overcharged while the United States still recovers the full estimated costs to administer FMS sales. For the exceptional cases over \$9B, the first \$9B of the case amount will be assessed the full 3.8 percent FMS Administrative Surcharge, and a reduced rate will be assessed against the portion of case value that exceeds \$9B.

DSCA will determine the reduced rate (for the portion of the case that is over \$9B) by using a formula to calculate the amount needed to recover the full estimated indirect costs of administrative services. This formula takes into account the Implementing Agency’s estimates for expenses over the life of the case, a fair share of infrastructure/community costs (historical experience shows that 67 percent of FMS Administrative Surcharge allocations go to the implementing agencies for their execution expenses for these cases and the remaining 33 percent of the funds are used for community costs), and a safety factor. DSCA will use the results of this calculation to determine the reduced percentage to be applied to the portion of the case value that exceeds \$9B. Should the “pilot” prove successful, this formula will be applied consistently to all new cases that exceed \$9B.

Deferred Collection of Administrative Surcharge Funds

In accordance with the DoD FMR, 50 percent of the FMS Administrative Surcharge collections are generally required up-front when a case is implemented. DSCA has made limited exceptions to this policy on a case-by-case basis in the past. Effective with this “pilot” structure, FMS Administrative Surcharge collections for cases over \$9B that are considered appropriate for the “pilot” will have a reduced up-front collection requirement of 25 percent. This reduced amount will be automatic for these exceptionally large cases and will not require the case-by-case exception. The remaining 75 percent will be collected as the case is executed in accordance with existing policy.

The “pilot” tiered structure and reduced up-front collection requirement will help ensure we do not achieve overly high balances in the FMS Administrative Surcharge Account based on any extremely large dollar value cases. Our analysis indicates these changes will not negatively affect the overall health of the account; however, to ensure we maintain a stable account balance, the Implementing Agency managing this type of case will be asked to provide periodic updates on execution cost to ensure this change does not negatively impact the FMS Administrative Surcharge Account. Based on our experience with this “pilot” case, DSCA will make appropriate adjustments to administrative rates and collection timing. If you have questions or would like additional information, please contact Beth Baker or Rita Chico, DBO/FPIO, (703) 601-3839 or (703) 602-3632.



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Director