

GAO

Report to the Chairmen, Senate and
House Select Committees Investigating
Iran Arms Sales

March 1987

IRAN ARMS SALES

DOD's Transfer of
Arms to the Central
Intelligence Agency



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Comptroller General
of the United States

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March 13, 1987

The Honorable Daniel K. Inouye
Chairman, Select Committee on
Secret Military Assistance to
Iran and the Nicaraguan Opposition
United States Senate

The Honorable Lee H. Hamilton
Chairman, Select Committee to
Investigate Covert Arms
Transactions with Iran
House of Representatives

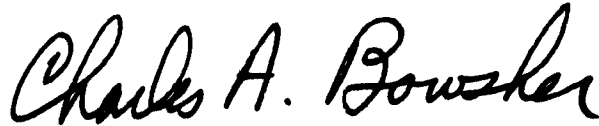
This report provides information relevant to your inquiries into the facts surrounding the U.S. arms sales to Iran. It specifically addresses the Department of Defense's (DOD) transfer of 2,008 TOW missiles and 3,976 Hawk spare parts to the Central Intelligence Agency (CIA) pursuant to the January 17, 1986, presidential finding. The appendix presents the detailed results of our review. Our basic conclusions are:

- DOD acted properly in treating the transfer of arms to the CIA as an inter-agency transfer governed by the Economy Act.
- The pricing and congressional reporting requirements of the Arms Export Control Act—the legislation which normally governs DOD arms sales to foreign governments—do not apply to these transactions.
- In managing these arms transfers, DOD bypassed its normal review and approval channels.
- In pricing the TOW missiles, DOD undercharged the CIA by \$2.1 million.
- Although DOD covert arms transfers may ordinarily be subject to congressional notification requirements, in this case the President's finding ensured that the responsibility for meeting any such requirement remained with him.

We recommend that DOD adjust its billing to the CIA to reflect the conclusions in this report. In addition to adjusting the prices for items already transferred, we also recommend that DOD obtain reimbursement from the CIA for any costs to reconvert missiles which had been modified for shipment but not sent.

Because of the problems we encountered in determining the correct price for these items, we plan to pursue with DOD the need for clear procedures to establish actual costs.

At your request, we plan no further distribution of this report at this time. We are continuing our work on other aspects of the arms sales and related activities and will be reporting the results to you as our work is completed.

A handwritten signature in black ink that reads "Charles A. Bowsher". The signature is written in a cursive style with a large, prominent initial "C".

Charles A. Bowsher
Comptroller General
of the United States

Transfer of Arms to the Central Intelligence Agency

On January 18, 1986, the Secretary of Defense, acting in response to the prior day's presidential finding, instructed his senior military assistant, Major General Colin L. Powell, to arrange for transfer of certain weapons under the Economy Act to the Central Intelligence Agency (CIA). The Secretary told General Powell that the matter was to be closely held at the direction of the President.

General Powell said that it was his decision not to use normal Department of Defense (DOD) and Army procedures for handling this CIA transaction. Normally, several DOD and military service offices perform extensive policy and legal reviews on sensitive support requests received from non-DOD federal agencies. However, General Powell decided that these reviews were not necessary because the transaction was initiated as a presidential order, not as a CIA request for support. Also, General Powell decided that dealing directly with the Army was the most expeditious method for delivering the equipment.

General Powell verbally conveyed the Secretary's order to General M. R. Thurman, Vice Chief of Staff of the Army, to provide about 4,000 Basic tow (BGM-71A) missiles in ready-to-go condition to the CIA. On January 25, 1986, the CIA increased the initial requirement to 4,508 missiles. According to General Powell, no information on the ultimate destination of the equipment was provided to the Army.

General Thurman told us that he verbally tasked Lieutenant General Benjamin Register, Army Deputy Chief of Staff for Logistics (DCSLOG), to provide tow missiles to the CIA. General Register informed us that he (1) instructed Major Chris Simpson, DCSLOG, to carry out the tasking and (2) told his deputy, Major General Vincent Russo, to oversee the project and to keep General Powell advised. Major Simpson communicated the requirement to Colonel James Lincoln, tow Project Office of the U.S. Army Missile Command (MICOM).

Several months after the tow request was received, DOD was tasked to provide 234 line items of Hawk spare parts to the CIA. In April 1986, Deputy Secretary of Defense William H. Taft, IV informed General J. A. Wickham, Jr., Army Chief of Staff, of this requirement. General Wickham passed the instructions on to General Russo, who ordered Major Simpson to coordinate the project. Subsequently, the CIA expanded its request to include two pre-phase II Hawk radars.

Major Simpson asked officials at the U.S. Army Materiel Command (AMC), the Defense Logistics Agency (DLA), and Oklahoma City Air Logistics Center at Tinker Air Force Base to ascertain availability of parts and to prepare pricing data. According to Major Simpson, the CIA did not reveal to him at any time the ultimate destination of the Hawk spare parts and radars despite his efforts to obtain this information.

According to DOD officials, only a few individuals in the Office of the Secretary knew that the TOW missiles and Hawk spare parts were destined for Iran, including: the Secretary of Defense; the Deputy Secretary of Defense; Richard L. Armitage, Assistant Secretary of Defense (International Security Affairs); Noel C. Koch, former Principal Deputy Assistant Secretary of Defense (International Security Affairs); and Major General Powell and his successor Vice Admiral Donald Jones, Senior Military Assistants to the Secretary.

Transfer of Items

A TOW is a tube-launched, optically-tracked, wire-command link guided missile system with a range of 3,000 to 3,750 meters that is used against heavily armored vehicles. It can be fired from a ground or helicopter launcher.

The TOW missile requested by the CIA was the Army's oldest model—the Basic TOW. This model was last procured in 1975. MICOM, in which the TOW Project Office is located, reviewed inventory stocks and determined that the Army had enough Basic TOWs to meet the CIA request, but most of these were not in the required ready-to-go condition due to a faulty battery. Since 1983, the Army had been modifying the defective TOWs by installing a Missile Ordnance Inhibitor Circuit (MOIC) to correct the battery problem. The CIA agreed to accept the modified TOW, but the Army had only about 2,000 modified missiles available—about 2,500 missiles fewer than requested.

To fulfill the CIA request, MICOM reviewed the possibility of adding MOICs to 2,500 more Basic TOWs. The review showed that sufficient MOICs would not be available to meet the CIA's 45-day delivery requirement. As an alternative, the Army offered to provide 2,500 of its Improved TOW (ITOW) model, which has an improved warhead and a longer range than the Basic TOW. However, the CIA insisted on TOWs with less capable warheads. Consequently, the Army downgraded 2,500 ITOWs by replacing the ITOW warheads with the Basic TOW warheads. This downgrading, coupled with the 2,000 modified Basic TOWs, would enable the Army to basically meet the total requirement.

Between February and November 1986, the Army shipped a total of 2,008 TOWs from the Anniston Army Depot to the Redstone Arsenal in Alabama. The first transfer of 1,000 MOIC-modified Basic TOWs was made on February 13, 1986; the second transfer of 508 MOIC-modified Basic TOWs was made on May 19, 1986; and the third transfer of 500 downgraded ITOWs was made on November 3, 1986. Although about 500 additional MOIC-modified Basic TOWs were available at the time of the third transfer, the CIA specifically requested that the newer downgraded ITOWs be provided.

For the most part, MICOM used its normal procedures in making these transfers. According to TOW Project Office officials, the major differences were that fewer individuals were involved in preparing and shipping the missiles and that shipments were scheduled at night, which was not usual. MICOM documents showed these transactions to be Army-to-Army transfers from Anniston Depot to Redstone Arsenal. Title was transferred from the Army to the CIA at Redstone Arsenal.

In each case, the CIA shipped the TOWs from Redstone to Texas via a commercial trucking firm. Subsequently, the TOWs were flown out of Kelly Air Force Base (AFB). According to Air Force records maintained at Kelly, the first 1,000 TOWs were shipped from Kelly on two Southern Air Transport (SAT) Boeing 707 cargo jets on February 15, 1986. On May 22 and 23, 1986, the same two SAT aircraft transported 508 boxes of rocket ammunition with explosive projectiles (presumably 508 TOWs) and inert cargo (presumably Hawk spare parts).

The last shipment is somewhat different from the others in that an Air Force aircraft was used. On November 6, 1986, a Military Airlift Command (MAC) C-141 cargo jet transported 12 aircraft pallets of rocket ammunition with explosive projectiles (presumably 500 TOWs) from Kelly to Ramstein Air Base in the Federal Republic of Germany. According to Air Force officials, about 5 hours later a commercial Boeing 707 cargo jet picked up the cargo and flew it to Ben Gurion International Airport, Israel. MAC billed the CIA \$63,857 for the C-141 flight.

On November 28, 1986, the Army embargoed at Anniston Army Depot the 2,500 TOW missiles (2,000 downgraded ITOWs and 500 MOIC-modified Basic TOWs) that had been requested but never transferred. On February 9, 1987, the Army lifted the embargo and the missiles were available for Army use. The Army Materiel Command has ordered MICOM to plan the reconversion of the downgraded ITOWs back to regular ITOWs. MICOM is studying the cost to restore the more advanced ITOW warheads.

Hawk Spare Parts

The Hawk missile system provides defense against air attacks and uses a radar homing guidance system to intercept low flying aircraft. The system is mobile, helicopter transportable, and designed for use in rugged environments.

In April 1986 the Army was tasked to provide 234 line items of Hawk spare parts (or 4,342 individual items). AMC, DLA, and the Oklahoma City Air Logistics Center at Tinker Air Force Base were involved in supplying these items.

A preliminary review by DOD showed that some of the spare parts could not be identified by the national stock number that the CIA provided DOD, some parts were obsolete, provision of some of the parts to the CIA would reduce DOD stocks to zero, and stock levels for some of the parts were already at zero. DOD officials met most of the requirements by substituting items, using reserved assets, and by supplying more advanced assemblies—which in some cases would eliminate the need for one or more of the old parts. In the end, DOD transferred 218 line items, or 3,976 spare parts, to the CIA.

AMC repositioned 146 line items of parts at Red River Army Depot, Texarkana, Texas. DLA supplied the parts for 71 line items that were segregated at various supply depots, and Tinker supplied one other item. In all, 13 depots were involved in the transfer. The items were then shipped to Kelly AFB.

The only known stocks of the two pre-phase II radars requested by the CIA were part of the Iranian frozen assets, which the Defense Security Assistance Agency advised could not be released as the title had been transferred to Iran. Because of this problem, the CIA changed its request to two post-phase II radars. The Army located two such radars, which had been designated for the Marine Corps. However, before a transfer could take place, all action on the radars was put on hold.

How the Army Priced the Transferred Arms

Although the arms were ultimately destined for Iran, from the Army perspective these transfers were being made to another U.S. agency, the CIA. Accordingly, the Army computed the price of the arms under terms of the Economy Act (31 U.S.C. 1535), the legislation governing inter-agency transfers. According to DOD officials, the use of the Economy Act to support other non-DOD federal agencies is standard practice.

Based on our review of applicable laws and regulations related to these transfers, we believe the Army was correct in determining that this transaction should be priced under the Economy Act. The Economy Act may be used by any agency, including the CIA, as the legal authority to procure services or supplies from any other agency in the course of its own operations. Since Congress has explicitly recognized that intelligence activities may include the secret transfer of arms (Intelligence Authorization Act for fiscal year 1986, section 403), the CIA is authorized by the Economy Act to turn to other agencies for this equipment. Therefore, we believe that the decision to use the Economy Act to provide support for this covert transaction was proper.

Transfers of the equipment by the CIA to others, including foreign governments, are governed by applicable laws relating to intelligence and special activities, rather than the Arms Export Control Act, which ordinarily governs overt arms transfers overseas. Consequently, we consider those transfers to be subject to the requirements pertaining to the conduct of intelligence and special activities. As a general rule, those transfers would not be subject to the pricing or reporting restrictions applicable to overt arms transfers conducted under the Arms Export Control Act.

Under the Economy Act, the price of goods and services transferred between agencies must be based on actual costs incurred, plus all indirect costs that are significantly related to supplying the goods or services. The purpose is to ensure that the transferring agency is fully reimbursed for its costs and that neither the transferring nor receiving agency is permitted to augment its appropriations.

The Army's interpretation of the pricing methodology for Economy Act transfers is prescribed in chapter 2 of Army Regulation 37-60 (Pricing for Materiel and Services, July 1986). This regulation provides that Economy Act transfers may be made on the basis of "standard costs," which is defined as the contract price at the time of the last acquisition.

We believe that Army Regulation 37-60 is reasonable (that is, using standard costs or the price at the last acquisition as the basis for estimating actual costs conforms to the requirements of the Economy Act). Although we concur in the Army's use of standard costs as the basis of pricing these transactions, we nevertheless found that the Army erred in establishing these costs. In pricing the missiles, the Army undercharged the CIA by \$2.1 million and overestimated prices for Hawk spare parts by a relatively small amount.

Army Pricing of the TOWs

The CIA and the Army agreed to use the standard price for the Basic TOWs as shown in the Army Master Data File (AMDF). The AMDF lists contract prices at the time of last acquisition. The unit price shown for the Basic TOW as of January 1986 was \$3,169. To this price, the Army added the MOIC modification cost (estimated by MICOM at \$300 per missile), thus deriving a unit price of \$3,469 for the modified Basic TOW. For the downgraded TOWs, the Army charged the CIA the modified Basic TOW price of \$3,469, plus costs to replace the warheads on 2,500 TOWs with the less capable Basic TOW warheads (\$377,720). In addition, for both the modified Basic TOW and the TOW, the Army added costs for packing, crating, and handling (PCH); transportation; and security. Table I.1 shows the Army's breakdown of these charges for each of the three transfers.

Table I.1: Total Charges of the Transfers Based on Standard Price of \$3,469 Per Missile

	Transfer 1 1,000 modified Basic TOWs	Transfer 2 508 modified Basic TOWs	Transfer 3 500 downgraded TOWs
Hardware	\$3,469,000	\$1,762,252	\$1,734,500
Transport	2,100	3,383	3,383
PCH	5,941	3,960	3,960
Security	7,650	157	157
TOW modification	377,720	0	0
Total	\$3,862,411	\$1,769,752	\$1,742,000

Prior to the transfers, the CIA provided the Army with certification of funding availability. On June 10, 1986, the Army billed and the CIA subsequently paid \$5,632,163 for the first and second transfers, which included costs for modifying all 2,500 TOWs. On January 16, 1987, the Army billed the CIA \$1,742,000 for the third shipment, which the CIA paid on February 13, 1987.

Army Pricing of Hawk
 Spare Parts

The cost of the Hawk spare parts was based on an estimate initially prepared by DCSLOG, using AMDF standard prices and current contract prices. Based on DCSLOG's estimate, the CIA certified funding availability of \$4.3 million. This amount included a standard 3-1/2 percent for packing, crating, and handling, and \$8,000 for transporting the items. The actual cost of the spares is now being developed by using the bills submitted from the depots to DCSLOG. A bill for about half the line items was sent in January 1987 but has not yet been paid.

TOW Missile Prices Were Too Low

Our analysis of the Army's estimated costs for the TOW missiles indicated that the Army underestimated the price to the CIA by about \$2.1 million. Table I.2 summarizes the differences between the amount the Army originally estimated (\$7.4 million) and the costs as adjusted by us to reflect the latest acquisition price data (\$9.5 million).

Table I.2: Comparison of Army's Cost Estimate With GAO's Adjusted Estimate

	Army's original estimate	GAO's adjustment	Difference
Hardware	\$6,965,752	\$9,052,244	\$2,086,492
Transportation	8,866	18,896	10,030
PCH	13,861	17,784	3,923
Security	7,964	7,964	0
ITOW modification	377,720	377,720	0
Total	\$7,374,163	\$9,474,608	\$2,100,445

The primary difference between the Army's and our price for the TOWs involves the cost of the hardware, or the missile itself. The reasons for the \$2.1 million difference is basically attributable to three factors:

- The Army used the wrong price in computing the costs for the downgraded TOWs.
- The price for the Basic TOW (\$3,169) listed in the AMDF was incorrect.
- The Army underestimated costs for packing, crating, handling, and transportation.

The bulk of the \$2.1 million difference in hardware costs centers on the ITOW. As discussed earlier, the Army used the Basic TOW standard cost (\$3,169) plus the MOIC modification charge of \$300 in computing a baseline cost of \$3,469 per missile for both the modified Basic TOW and the downgraded ITOW. According to MICOM records, the last Army acquisition of the TOWs occurred in 1981 at a price of \$6,710. We believe that the Army should have used this higher standard price for TOWs and then added downgrading costs. From the \$6,710 standard price, the Army should have deducted \$593 for the ITOW warhead and then added \$397 for the Basic TOW warhead. This would have resulted in a standard price of \$6,514, which is \$3,045 more than the cost estimate provided to the CIA (or a difference of about \$1.5 million for the 500 downgraded ITOW missiles actually transferred).

Also contributing to the difference between the Army's and our hardware cost estimate was the fact that the standard price listed in the

AMDF for the Basic TOW was incorrect. As previously discussed, the file listed the standard price of the Basic TOW at \$3,169. Our analysis of records at the MICOM showed that the last Army acquisition of the Basic TOW was in 1975 at a price of \$3,491. We discussed this discrepancy with MICOM officials responsible for updating the AMDF, and they agreed that the standard price should have been updated to the higher price. They said that due to an oversight on its part, the documents required to update the AMDF were not processed. Had the correct price of \$3,491 been applied to the 1,508 modified Basic TOWs that were transferred to the CIA, the cost to the CIA would have been increased by \$485,576.

Furthermore, according to MICOM records, the cost for the MOIC modification was \$352, not \$300 as MICOM had originally estimated. Using this cost would increase the price by \$52, or a total of \$78,416 for the 1,508 Basic TOWs that were transferred.

In addition to hardware costs, we believe that the Army underestimated charges for transportation and for packing, crating, and handling. The Army estimate provided to the CIA for these items and security totaled \$30,691. Current MICOM estimates of actual costs show a total of \$44,644.

Army Inspector General's Findings

In January 1987, the Army Inspector General (IG) completed a review of the arms shipments and concluded that the Army had undercharged the CIA by about \$2.6 million—about \$500,000 more than our audit shows. Such differences can occur because the pricing regulations are not precise and are thus subject to some interpretation. Nevertheless, after discussing our discrepancies with Army IG officials and reexamining our audit, we believe that our interpretation is more in line with the intent of the Economy Act and that our finding of a \$2.1 million undercharge is correct. The following accounts for the major discrepancies between our and the Army IG's figures:

- The Army IG accepted the AMDF price for the basic TOW (\$3,169). As discussed above, we believe that the AMDF price for this model is wrong and should have been \$3,491.
- In computing the ITOW price, the Army IG used as a basis the last procurement price (\$8,069). This price was based on a 1986 contract for ITOW missiles being procured for foreign military sales (FMS) customers. In our opinion, FMS contracts do not reflect actual costs to the Army, and should not have been used in determining actual costs for the missiles transferred to the CIA. The Army last purchased ITOW missiles for its

own stocks in 1981 at a price of \$6,710. As discussed on page 10, we used this amount in computing the downgraded row price.

- The Army IG used a rate of 3-1/2 percent in computing the accessorial charge for packing, crating, handling, security, and transportation costs, for a total of \$325,634. We, on the other hand, used actual costs that were available at MICOM, totaling about \$45,000. We believe that the use of actual costs when available captures the intent of the Economy Act.

Hawk Spare Parts Price Estimates Were Reasonably Close

The Army generally uses AMDF prices to estimate spare parts costs and subsequently audits these prices to ensure that these prices reflect actual costs. This procedure was followed in connection with the Hawk spares. However, the Army originally overestimated the prices of some spares, in part because of the difficulty in identifying the parts and estimating replacement costs as opposed to the actual initial procurement cost. As of February 1987, we reviewed actual bills representing about 86 percent of the items. Our analysis showed that the Army's original price estimate was high by about 6 percent, or about \$250,000. The Army is billing the CIA based on the actual bills.

Congressional Notification

The covert transfer of arms by DOD may, under ordinary circumstances, be subject to the congressional notification requirements of section 501 of the National Security Act of 1947. Under that section, the Director of Central Intelligence and the heads of all departments, agencies, and other entities of the United States involved in intelligence activities shall keep the committees "fully and currently" informed of all intelligence activities "which are the responsibility of, are engaged in by, or are carried out for or on behalf of, any department, agency, or entity of the United States." Transfers exceeding \$1 million per item are automatically subject to such notification requirements, under section 403 of the Intelligence Authorization Act for Fiscal Year 1986.

In the present case, the terms of the President's January 17, 1986, finding ensured that, as a practical matter, any responsibility for complying with congressional notification requirements regarding covert arms transfers remained with the President. In this January 1986 finding, the President directed the Director of Central Intelligence to refrain from reporting the finding to the Congress unless otherwise directed by the President. Although the directive was issued to the Director of Central Intelligence and not to the Secretary of Defense, we do not consider it unreasonable for the Secretary of Defense to consider it to apply to all transactions incidental to the Iranian initiative. Thus,

the President's finding shifted any responsibility for congressional notification from the agencies to the President.

Objectives, Scope, and Methodology

We conducted this review to determine DOD's role in transferring TOW missiles and Hawk spare parts to the CIA and to determine the appropriateness of the prices for the transferred items. We performed our review at the Departments of Defense and Army in Washington, D.C.; the Army Missile Command in Huntsville, Alabama; and Anniston Army Depot in Anniston, Alabama. We examined DOD memorandums, vouchers, checks, shipping documents, contracts, and certificates of funding, and interviewed numerous DOD and Army officials involved in the transactions.

Additionally, we discussed the transportation of the items with Department of Air Force officials and reviewed available Air Force flight records regarding the transfer.

Our review was performed from December 1986 to February 1987 in accordance with generally accepted government auditing standards.

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