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RELEASED

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Report to Rep. Les Aspin; by Elmer B. Staats, Comptroller General.

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Congressional Relevance: House Committee on Armed Services;  
Senate Committee on Armed Services. Rep. Les Aspin.

Because of an international monetary crisis in 1973, major industrial countries changed from fixed to floating exchange rates for their currencies. The floating rates have caused problems for the Department of Defense (DOD) in managing programs financed with foreign currencies because the long leadtime between budget preparation and execution results in expenditures of foreign currencies at different exchange rates from those budgeted. Findings/Conclusions: If expenditures are made at less favorable exchange rates than those budgeted, DOD must either seek supplemental appropriations and reprogramming authority or absorb the increased costs. This causes delays and uncertainty in carrying out programs. If not enough funds are obtained in this way, reductions in approved programs must be made. Gains attained from favorable exchange rate fluctuations enable DOD to either offset unbudgeted costs or to finance unfunded requirements. An alternative funding method which would eliminate exchange rate gains and losses from the DOD budgetary process would insure that DOD does not supplement its appropriations through gains derived from favorable currency exchange rate fluctuations or suffer from losses.

Recommendations: The Secretary of Defense should seek legislative authority to initiate an alternative funding method to eliminate exchange rate gains and losses from the DOD budgetary process. Such legislation should require the Secretary of Defense to provide the Congress with an annual accounting of exchange rate transactions by country. (Author/SC)

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REPORT BY JLE

# Comptroller General

OF THE UNITED STATES

RELEASED 4/17/78

## Better Program Management Through Eliminating Exchange Rate Gains And Losses From DOD Budget Process

It would be desirable to provide for an alternative funding method to eliminate from the budgetary process exchange rate losses that are not predictable and that have adversely affected DOD programs. This would also ensure that DOD does not supplement its appropriations through gains derived from favorable currency exchange rate fluctuations.

Authorizing legislation would be needed to establish an appropriation available to fund net exchange rate losses. Gains would be deposited in miscellaneous receipts. Such legislation should require that the Secretary of Defense provide the Congress with an annual accounting of exchange rate transactions by country.





COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-133102

The Honorable Les Aspin  
House of Representatives

Dear Mr. Aspin:

In response to your letter of August 22, 1977, and subsequent agreement with your office, we reviewed the management of foreign currency conversions for Department of Defense programs, particularly Army and Air Force operations and maintenance and military family housing programs in West Germany and the United Kingdom. (See app. I.)

Because of an international monetary crisis in 1973, major industrial countries changed from fixed to floating exchange rates for their currencies. The floating rates have caused problems for the Department of Defense in managing programs financed with foreign currencies, because the long leadtime between budget preparation and execution results in expenditures of foreign currencies at different exchange rates from those budgeted.

If expenditures are made at less favorable rates than those budgeted, the Department must either seek supplemental appropriations and reprogramming authority or absorb the increased costs. This causes delays and uncertainty in carrying out programs. If not enough funds are obtained this way, reductions in approved programs must be made. Gains attained from favorable exchange rate fluctuations enable the Department of Defense to either offset unbudgeted costs or to finance unfunded requirements.

In January 1978 the Department of Defense requested a supplemental appropriation of \$187 million to meet increased operations and maintenance costs for fiscal year 1978 due to currency fluctuations. Of this amount, \$111 million was for increased Army costs in West Germany due to the decline in value of the dollar in relation to the German mark. In its fiscal year 1978 budget request to the Congress, the Army used an exchange rate of 2.50 marks to the dollar, whereas late in calendar year 1977 the exchange rate had dropped to 2.24 marks to the dollar. The dollar has continued to decline in value against the mark and, at March 22, 1978, had dropped to 2.04 marks to the dollar. No final action had been taken on the supplemental appropriation request as of March 31, 1978.

We believe it would be desirable to provide for an alternative funding method to eliminate from the budgetary process exchange rate losses that are not predictable and that have adversely affected Defense programs. (See apps. II and III.) This would also insure that the Department of Defense does not supplement its appropriations through gains derived from favorable currency exchange rate fluctuations. Authorizing legislation would be needed to establish a permanent indefinite appropriation available to fund the Department of Defense's net exchange rate loss. A gain would be deposited in miscellaneous receipts.

We recommend that the Secretary of Defense seek legislative authority to initiate an alternative funding method to eliminate exchange rate gains and losses from the Department of Defense budgetary process. Such legislation should require that the Secretary of Defense provide the Congress with an annual accounting of exchange rate transactions by country.

In informal discussions with Defense and Treasury officials no major problems regarding accounting for Defense gains and losses were indicated. Defense officials supported the concept of eliminating gains and losses from the budgetary process. Treasury and Office of Management and Budget officials were concerned about the departure from the usual supplemental appropriation process. We believe the primary issue is whether Defense's congressional oversight committees desire to provide for a budgetary procedure to avoid two effects of the floating exchange rates--gains permitting Defense to supplement its appropriations and losses which have adversely affected its overseas programs. From an international monetary standpoint the procedure we are recommending suggests neither that the dollar will rise nor that it will fall in relation to other currencies.

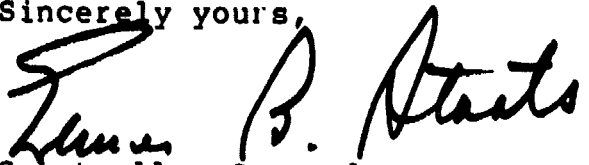
As requested by your office, we did not obtain formal comments from the Secretaries of Defense and the Treasury, but we did discuss the results of our work with agency officials and considered their comments.

As requested by your office, this report will not be released for 10 days from the date of publication.

B-133102

However, as agreed, we are providing copies today to the cognizant legislative and appropriation committees for their use.

Sincerely yours,



Thomas B. Stants  
Comptroller General  
of the United States

CONTROLS OVER  
FOREIGN CURRENCY CONVERSIONS

BACKGROUND

The Department of Defense uses foreign currencies to pay for salaries of foreign nationals, contractual services, rents, supplies and equipment, and travel. These expenditures are financed primarily from operations and maintenance and military family housing appropriations. These Army and Air Force appropriations for fiscal year 1977 are shown below.

<u>Appropriation</u>	<u>Army</u>	<u>Air Force</u>
	----- (millions) -----	
Operations and maintenance	\$8,115.7	\$8,284.3
Military family housing	<u>489.7</u>	<u>368.1</u>
Total	<u>\$8,605.4</u>	<u>\$8,652.4</u>

Although foreign currency expenditures represent only a small percentage of total operations and maintenance and military family housing costs, they involve a large portion of Defense's overseas expenditures.

The floating exchange rates have caused problems for junior enlisted soldiers and airmen assigned in West Germany. The decline in the value of the dollar against the German mark has resulted in higher living costs, especially for those enlistees and their families who are not quartered in military housing. According to Army and Air Force officials the morale and job performance of these enlisted personnel have been adversely affected by the dollar's loss of purchasing power in West Germany.

Purchase of German marks and British pounds

The Army and Air Force purchase German marks from the Bundesbank, the central bank of West Germany, through the American Express Company in Frankfurt. The Bundesbank determines its average buy/sell rate for the mark each day at 1 p.m., and the Army and Air Force have until 11 a.m.

the next day to buy at that rate. Generally, marks are purchased to meet the needs for 5 days or less.

British pounds are purchased for the Air Force by the State Department's Regional Finance Center in Paris. Each morning that pounds are to be purchased, the Finance Center usually telephones four to six banks in European cities, such as Frankfurt, Geneva, London, Zurich, and Paris, to determine the most favorable rate. The Reuters market information service, which provides current information on an electronic screen about exchange rates quoted by various banks is used as a guide in evaluating quotes. Two or three of the Finance Center's employees place the calls, so the entire procedure takes only a few minutes. A verbal agreement is made with the bank offering the best rate, and a confirming cable is sent by noon of the same day.

The Army purchases pounds through the Regional Finance Center in Paris or through direct solicitation of the market.

#### ARMY

The U.S. Army, Europe, has a large amount of foreign currency expenditures. In fiscal year 1977, its operations and maintenance program totaled \$1.3 billion; \$940 million (72.3 percent) of this was paid in foreign currencies, as shown below.

	(millions)
Foreign nationals' salaries	\$590.3
Contracts	171.1
Rents	82.7
Supplies and equipment	64.9
Temporary duty transportation	<u>31.0</u>
Total	<u>\$940.0</u>

About 95 percent of the European command's foreign currency expenditures were in German marks. Other foreign currencies in which expenditures were made include British pounds, Italian lira, Belgian and French francs, Dutch guilders, and Greek drachmas.

In fiscal year 1977, the command had a \$69.7 million net shortage in operations and maintenance funds due to unfavorable currency exchange rate fluctuations, primarily

because the dollar declined in value against the German mark. The Army had budgeted for mark expenditures at the rate of 2.56 marks to the dollar, but the average conversion rate was 2.37 marks to the dollar.

Of the \$69.7 million shortage, after considering all exchange gains and losses, \$49.8 million was offset by a \$23.7 million supplemental appropriation and \$26.1 million in reprogramming authority. The European Command was required to absorb the \$19.9 million difference by reducing approved programs.

There was an \$887,000 gain from favorable dollar exchange rate fluctuations with the British pound. Of this amount, \$852,000 was withdrawn from the United Kingdom to fund priority projects in West Germany, and \$35,000 was retained in the United Kingdom for application against the unfunded portion of the civilian pay raise.

The command said that during the second half of fiscal year 1977 uncertainty over the funding of currency exchange rate shortages caused it to cancel some training and to make adjustments in other training programs, thus slowing the improvement of combat readiness. It also delayed upgrading ammunition facilities, purchasing chemical defensive equipment, and completing maintenance and repair projects. Army officials said that these actions and numerous adjustments the Army was required to make in dealing with the funding shortage affected the orderly execution of the fiscal year 1977 operations and maintenance program.

The Army estimated that there would be a \$111.8 million shortage in operations and maintenance funds for Europe in fiscal year 1978--\$111.2 million due to a further decline in the value of the dollar against the German mark. In its fiscal year 1978 budget, the Army contemplated an exchange rate of 2.50 marks to the dollar; whereas, when the shortage was estimated late in calendar year 1977, the rate had dropped to 2.24 marks to the dollar. Army officials were concerned that the dollar would continue to decline in value against the mark, and if it averaged 2.10 marks to the dollar during the year, the shortfall in Europe would increase to an estimated \$156.9 million. As of March 22, 1978, the exchange rate was 2.04 marks to the dollar.

In fiscal year 1977, the U.S. Army, Europe, had an approved family housing program costing \$232.6 million,



\$186.1 million of which was spent in foreign currencies. In 1977, the command had a gain of \$1.2 million due to favorable exchange rate fluctuations. There was a gain primarily because the Army budgeted for family housing at the rate of 2.35 marks to the dollar rather than 2.56 marks to the dollar, as was budgeted for operations and maintenance expenditures. The average conversion rate was 2.37 marks to the dollar.

A \$25 million loss was projected for fiscal year 1978 for the family housing program if the exchange rate averaged during the year, 2.10 marks to the dollar.

### AIR FORCE

The U.S. Air Force, Europe (USAFE), also has a large amount of foreign currency costs. In fiscal year 1977, its approved operations and maintenance program totaled \$417.2 million; \$190.2 million of this was paid in foreign currencies.

As shown below, USAFE had a \$3.8 million net gain in operations and maintenance funds in fiscal year 1977 due to favorable exchange rates. Gains in the United Kingdom and four other countries more than offset losses experienced in Germany and the Netherlands.

<u>Country</u>	<u>Expenditures</u>	<u>Exchange rate gain or loss (-)</u>
----- (millions) -----		
Germany	\$101.3	\$-11.1
United Kingdom	48.9	7.5
Spain	19.3	4.3
Italy	7.4	1.7
Turkey	7.2	1.2
Greece	4.8	0.3
Netherlands	<u>1.3</u>	<u>-0.1</u>
Total	<u>\$190.2</u>	<u>\$ 3.8</u>

USAFE officials said that the net gain was used to absorb inflation and to finance unfunded requirements. They stated that USAFE had a backlog of needed projects costing \$60 million for which funds were not available.

USAFE officials said that, at the midyear review, \$4.9 million of the \$7.5 million gain in the United

Kingdom was transferred to bases in West Germany to meet critical requirements. The remaining \$2.6 million was spent in the United Kingdom on valid requirements, but there were still unfunded United Kingdom requirements at the yearend.

We were told by USAFE officials that \$1.2 million of the gain in Spain was transferred to Turkey to help pay for a wage increase for Turkish national employees.

As of December 30, 1977, USAFE estimated that in fiscal year 1978 it would have a shortage of \$12.9 million in operations and maintenance funds because of exchange rate fluctuations. Due to the British pound's recent increase in value against the dollar, \$5.2 million of this shortage is projected for the United Kingdom.

In fiscal year 1977, foreign currency expenditures for family housing in West Germany were \$26.3 million and in the United Kingdom were \$10.6 million, a total of \$36.9 million. There was a gain of \$1.6 million in the United Kingdom, and a loss of \$1.5 million in West Germany, due to fluctuating exchange rates, for a net gain of \$71,000.

In fiscal year 1977, the Air Force financed operations and maintenance and family housing programs in the United Kingdom and West Germany at more favorable currency exchange rates than rates used in the budget submitted to the Congress. Operations and maintenance expenditures were budgeted at the rate of \$2.32 to the British pound and \$0.406 to the German mark. However, the Air Force later financed USAFE programs in the United Kingdom and West Germany at rates of \$2.05 to the pound and \$0.385 to the mark. There were comparable differences in budgeted and financed rates for family housing programs.

The Air Force estimated that, as a result of financing these programs in the United Kingdom and West Germany at more favorable rates than those budgeted, an additional \$8.3 million was available to finance requirements outside of USAFE.

We estimated that an additional \$1.8 million was available to the Air Force in fiscal year 1977 due to differences between budgeted and financed rates for family housing programs.

1978 SUPPLEMENTAL APPROPRIATION

In January 1978, the Department of Defense requested a supplemental appropriation of \$187 million to meet increased operations and maintenance costs in fiscal year 1978 due to foreign currency fluctuations, including \$128 million for increased Army costs and \$22.6 million for increased Air Force costs. Below is a breakdown of these costs by country.

<u>Country</u>	<u>Army</u>	<u>Air Force</u>
	----- (000 omitted) -----	
West Germany	\$111,212	\$ 7,925
Japan	16,248	17,736
Netherlands	391	93
United Kingdom	369	1,424
France	359	-
Italy	-547	-163
Greece	-	353
Spain	-	-3,618
Philippines	-	132
Portugal	-	-814
Turkey	-	-492
	<u>\$128,032</u>	<u>\$22,576</u>
<b>Total</b>		

We estimated that the Air Force had a gain of \$2.4 million in operations and maintenance funds in fiscal year 1977 because the U.S. dollar increased in value against the Canadian dollar. A projected Canadian dollar gain or loss for fiscal year 1978 was not considered in Defense's request for the supplemental appropriation. The Air Force said that this was due to an oversight. We believe that Defense should consider gains and losses for all countries in support of its request for supplemental appropriations.

ALTERNATIVE FUNDING METHOD

We believe that the present method of seeking supplemental appropriations and reprogramming authority is not timely and that it affects the orderly implementation of approved programs. The fiscal year 1977 supplemental appropriation was submitted to the Congress in late January 1977 and was not approved until May 4; the 1977 reprogramming request was submitted on July 11, 1977, and was not approved until September 29.

It would be desirable to provide for an alternative funding method to eliminate from the budgetary process exchange rate losses that are not predictable and have adversely affected Defense programs. This would also insure that the Department of Defense does not supplement its appropriations through gains derived from floating currency exchange rates.

Under this approach Treasury would disburse funds from a permanent appropriation as needed to cover Defense's exchange rate losses and would collect exchange rate gains from Defense. The gains and losses for all foreign currency transactions would be measured on the basis of differences between exchange rates considered in the budgets submitted and those at which expenditures are made.

Authorizing legislation would be needed to establish a permanent indefinite appropriation available to fund Defense's net exchange rate losses. A gain would be deposited in miscellaneous receipts.

Under this method Defense should determine the currency exchange rates used by all its services in preparing their annual budgets. If the present procedure of each service determining its own exchange rates is continued, there could be an incentive for the services to use unrealistic rates knowing that funding shortages will be made up under the new funding method. Moreover, establishment of uniform exchange rates would eliminate inconsistencies in rates used for similar programs by the services and for different programs within the same service.

For example, in fiscal year 1977 the Army budgeted for English pound operations and maintenance and family housing costs at the rate of \$2 to the pound, whereas the Air Force budgeted for these costs at the rate of \$2.32 to the pound. Also, in fiscal year 1977 the Army budgeted for operations and maintenance costs at the rate of 2.56 German marks to the dollar and for family housing costs at the rate of 2.35 marks to the dollar.

### RECOMMENDATIONS

We recommend that the Secretary of Defense seek legislative authority to initiate an alternative funding method to eliminate exchange rate gains and losses from the Department of Defense's budgetary process. Such legislation should require that the Secretary of Defense provide the Congress with an annual accounting of exchange rate transactions

by country. The Department of Defense would continue to be responsible to its oversight committees for justifying program expenditures covered by the foreign currency transactions.

In informal discussions with Department of Defense and Treasury officials no major problems regarding accounting for Department of Defense gains and losses were indicated. Department of Defense officials supported the concept of eliminating gains and losses from the budgetary process. Treasury and Office of Management and Budget officials were concerned as to the departure from the usual supplemental appropriation process. We believe the primary issue is whether Department of Defense congressional oversight committees desire to provide for a budgetary procedure to avoid two effects of the floating exchange rates; gains permitting Department of Defense to supplement its appropriations and losses which have adversely affected its overseas programs. From an international monetary standpoint the procedure we are recommending suggests neither that the dollar will rise nor that it will fall in relation to other currencies.

PROPOSED APPROPRIATION FOR  
COST TO MILITARY SERVICES OF  
EXCHANGE RATE FLUCTUATIONS

There are appropriated, out of any monies in the Treasury not otherwise appropriated, such sums as hereafter may be necessary during any fiscal year to maintain foreign currency equivalency at levels equal to the rate of exchange used in preparing budget submissions, but this appropriation shall be available only to the extent that the inability to maintain foreign currency equivalency is a direct result of downward fluctuations in United States currency exchange rates. To the extent to which foreign currency equivalency is exceeded as the direct result of upward fluctuations in United States currency exchange rates over the rates used in preparing budget submissions, the excess shall be deposited in the Treasury as miscellaneous receipts. The Secretary of Defense shall report to the Committees on Appropriations, for each fiscal year, all expenditures from this appropriation and all deposits in the Treasury pursuant to this provision.

EXPLANATORY NOTES TO PROPOSED APPROPRIATION FOR COST  
TO MILITARY SERVICES OF EXCHANGE RATE FLUCTUATIONS

1. The language of this proposal is patterned generally on 31 U.S.C. §724a (permanent indefinite appropriation for payment of judgments and compromise settlements) and 31 U.S.C. §711 (permanent indefinite appropriations for a variety of purposes).
2. The language, "upward and downward fluctuations in foreign currency exchange rates," derives from 22 U.S.C. §2877, a provision which accomplishes a similar purpose for the Board for International Broadcasting.

COMPARISON OF U.S. DOLLARS WITH FOREIGN CURRENCIES  
SEPTEMBER 30, 1975 TO FEBRUARY 23, 1978

