United States Government Accountability Office

Report to Congressional Requesters

April 2018

DEFENSE BUDGET

Actions Needed to Improve the Management of Foreign Currency Funds

GAO-18-221

GAO Highlights

Highlights of GAO-18-221, a report to congressional requesters

April 2018

DEFENSE BUDGET

Actions Needed to Improve the Management of Foreign Currency Funds

Why GAO Did This Study

DOD requested about $60 billion for fiscal years 2009 - 2017 to purchase goods and services overseas and reimburse service-members for costs incurred while stationed abroad. DOD uses foreign currency exchange rates to budget and pay (that is, disburse amounts) for these expenses. It also manages the FCFD account to mitigate a loss in buying power that results from foreign currency rate changes.

GAO was asked to examine DOD's processes to budget for and manage foreign currency fluctuations. This report (1) describes DOD's revision of its foreign currency budget rates since 2009 and the relationship between the revised rates and projected O&M and MILPERS funding needs; (2) evaluates the extent to which DOD has taken steps to reduce costs in selecting foreign currency rates to disburse funds to liquidate O&M obligations, and determined whether opportunities exist to gain additional savings; and (3) assesses the extent to which DOD has effectively managed the FCFD account balance. GAO analyzed data on foreign currency rates, DOD financial management regulations, a non-generalizable sample of foreign currency disbursement data, and FCFD account balances.

What GAO Recommends

GAO is making four recommendations, including that DOD review opportunities to achieve cost savings by more consistently selecting the most cost-effective foreign currency rates used for the payment of goods and services, and analyze projected losses to manage the FCFD account balance. DOD generally concurred with the recommendations.

View GAO-18-221. For more information, contact Cary Russell at (202) 512-5431 or RussellC@gao.gov

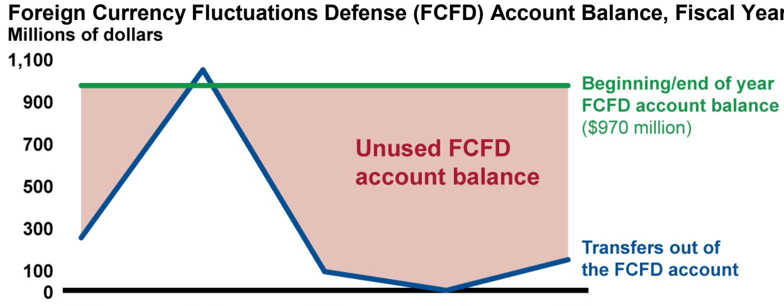
What GAO Found

The Department of Defense (DOD) revised its foreign currency exchange rates ("budget rates") during fiscal years 2014 through 2016 for each of the nine foreign currencies it uses to develop its Operation and Maintenance (O&M) and Military Personnel (MILPERS) budget request. These revisions decreased DOD's projected O&M and MILPERS funding needs. DOD's revision of the budget rates during these years also decreased the expected gains (that is, buying power) that would have resulted from an increase in the strength of the U.S. Dollar relative to other foreign currencies. DOD did not revise its budget rates in fiscal years 2009 through 2013. For fiscal year 2017, DOD changed its methodology for producing budget rates, resulting in rates that were more closely aligned with market rates. According to officials, that change made it unnecessary to revise the budget rates during the fiscal year.

DOD has taken some steps to reduce costs in selecting foreign currency rates used to pay (that is, disburse amounts) for goods and services, but DOD has not fully determined whether opportunities exist to achieve additional savings. The Army has estimated potential savings of up to $10 million annually by using a foreign currency rate available 3 days in advance of paying for goods or services rather than a more costly rate available up to 5 days in advance. The Army has converted to the use of a 3-day advanced rate. GAO's analysis suggests that DOD could achieve cost savings if the services reviewed and consistently selected the most cost-effective foreign currency rates when paying for their goods and services. Absent a review, DOD is at risk for paying more than it would otherwise be required to conduct its transactions.

DOD used the Foreign Currency Fluctuations, Defense (FCFD) account to cover losses (that is, less buying power) due to unfavorable foreign currency fluctuations in 6 of the 8 years GAO reviewed. Since 2012, DOD has maintained the FCFD account balance at the statutory limit of $970 million, largely by transferring unobligated balances before they are cancelled from certain DOD accounts into the FCFD. However, DOD has not identified the appropriate FCFD account balance needed to maintain program operations by routinely analyzing projected losses and basing any transfers into the account on those expected losses. Thus, DOD may be maintaining balances that are hundreds of millions of dollars higher than needed, and that could have been used for other purposes or returned to the Treasury Department (see figure).

Foreign Currency Fluctuations Defense (FCFD) Account Balance, Fiscal Years 2012-2016



Source: GAO analysis of Department of Defense data. | GAO-18-221

Contents

Abbreviations

DOD	Department of Defense
FCFD	Foreign Currency Fluctuations, Defense
ITS.gov	International Treasury Services
MILPERS	Military Personnel
OUSD(C)	Office of the Under Secretary of Defense (Comptroller)
O&M	Operation and Maintenance

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

April 3, 2018

The Honorable Madeleine Bordallo
Ranking Member
Subcommittee on Readiness
Committee on Armed Services
House of Representatives

The Honorable Rob Wittman
House of Representatives

The Department of Defense (DOD) requested about $60 billion for fiscal years 2009 through 2017 in Operation and Maintenance (O&M) and Military Personnel (MILPERS) appropriations to purchase foreign goods and services overseas and to reimburse service-members for certain costs incurred while stationed abroad.[1] As part of the annual budget formulation process, DOD selects exchange rates for each of the nine foreign currencies it uses to develop its O&M and MILPERS funding requirements.[2] Budget formulation for a particular fiscal year starts approximately 18 months prior to the beginning of that fiscal year.[3] DOD

[1]In this report, we focus on O&M and MILPERS amounts requested and appropriated for operation and maintenance and personnel costs incurred overseas. DOD also includes in its annual budget request foreign currency funds for its Military Construction (MILCON) appropriation and those funds are not discussed in this report.

[2]DOD develops budget rates for the following foreign currencies: Iceland Krona, Denmark Krone, Japan Yen, Norway Krone, Singapore Dollar, South Korea Won, Turkey Lira, United Kingdom (U.K.) Pound, and European Union Euro. Four of DOD's nine foreign currencies—the European Union Euro, Japan Yen, South Korea Won, and United Kingdom (U.K.) Pound—comprised 96.9 percent of DOD's foreign currency exchange budget requested for the fiscal years 2009 through 2017 period—a total of about $58 billion.

[3]The budget process occurs in three main phases: formulation, congressional and execution. During the formulation phase executive branch departments such as DOD prepare the President's budget. Once the President has sent the budget to Congress for the upcoming fiscal year, the Office of Management and Budget and federal agencies begin preparing the budget for the following fiscal year. The President's budget is submitted to Congress each spring. During the congressional phase, Congress considers the President's budget proposals for the upcoming fiscal year, passes an overall spending plan and enacts regular appropriations acts. The execution phase begins on October 1, when the fiscal year for which funds were appropriated begins, and continues through the appropriation's period of availability for new obligations (1 year in the case of O&M and MILPERS) and the period of expiration (5 additional years), when amounts are available only for limited purposes. Remaining amounts are canceled at the end of the 5- year period of expiration.

refers to foreign currency exchange rates established during the budget formulation process as the budget rates.

During each fiscal year, DOD's O&M and MILPERS appropriations incur new obligations for overseas expenditures at the budget rate for a particular foreign currency.[4] The fiscal year during which an appropriation may incur new obligations is known as the period of availability. DOD liquidates those obligations through disbursements at the foreign currency market rates available at the time the disbursements are made.[5] DOD typically disburses funds to liquidate its MILPERS obligations during the fiscal year of availability because MILPERS appropriations fund service-member salaries, which are paid on a regular basis throughout the fiscal year. However, O&M appropriations are generally obligated for the provision of goods and services, and the liquidation of those obligations may not always occur within the fiscal year of availability. Disbursements to liquidate O&M obligations also commonly occur during an appropriation's 5-year period of expiration, particularly during the first year of expiration, during which amounts are available only for limited purposes, such as disbursement (see figure 1). Differences between the foreign currency budget rate applied when an obligation is incurred and the foreign currency market rate applied at the time of disbursement will result in either a gain or a loss in the amount of appropriations available to DOD for its planned overseas expenditures.[6]

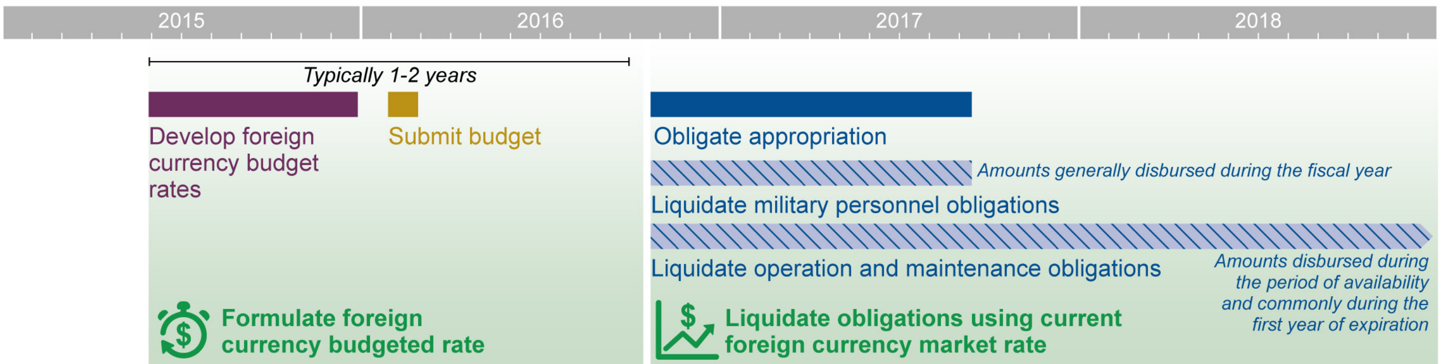
---

[4]An obligation is a definite commitment that creates a legal liability for the government to pay for goods or services received. A disbursement is an amount paid by federal agencies to liquidate government obligations.

[5]A disbursement is an amount paid by cash or cash equivalent during the fiscal year to liquidate a federal obligation.

[6]As discussed later in this report, DOD uses various methods for selecting foreign currency rates to disburse funds to liquidate O&M obligations, which may vary from the budget rates. This includes the option of selecting and then locking in a rate in advance of disbursement. Some rates are more cost-effective than others, based on how far in advance of disbursement the rate is locked in.

Figure 1: Example of the Timeline for Developing the Department of Defense's (DOD) Fiscal Year 2017 Foreign Currency Budget Rates and Obligation and Disbursement of Appropriated Amounts



Source: GAO analysis of DOD information. | GAO-18-221

Note: Time-limited appropriations, such as Military Personnel and Operation and Maintenance amounts, are available for new obligations during the fiscal year for which they are appropriated. Amounts not obligated during the period of availability expire at the end of the fiscal year for which they were appropriated. Expired unobligated balances remain available for limited purposes, such as adjusting contract amounts and liquidating, or disbursing, obligations for 5 fiscal years after expiration, at which time funds are canceled and returned to the Treasury.

In fiscal year 1979, Congress appropriated $500 million to establish the Foreign Currency Fluctuations, Defense (FCFD) account for purposes of maintaining the budgeted level of operations in the MILPERS and O&M accounts by eliminating substantial gains or losses to the appropriations caused by foreign currency rate fluctuations that vary from rates used in preparing budget submissions.[7] DOD may replenish FCFD amounts by transferring MILPERS and O&M appropriations, under certain

[7] *Department of Defense Appropriation Act, 1979*, Pub. L. No. 95-457 (1978). In addition to DOD's FCFD account, Congress also established in fiscal year 1987 a Foreign Currency Fluctuation, Construction, Defense account to protect military construction and family housing programs from foreign currency fluctuations. The focus of this report is on DOD's use of the FCFD account and does not address the Foreign Currency Fluctuation, Construction, Defense account.

circumstances.[8] Congress has not provided the FCFD account with annual appropriations since the account's inception. Unobligated FCFD account balances are available until expended, carrying over from one fiscal year to the next.[9] We have previously reported that an examination of balances in federal accounts carried forward into future fiscal years (carryover balances) provides an opportunity to identify areas where the federal government can improve and maximize the use of its resources.[10]

You asked us to examine DOD's processes and methodologies to budget for and manage foreign currency fluctuations. Specifically, this report (1) describes DOD's revision of its foreign currency budget rates since 2009 and the relationship between the revised budget rates and DOD's projected O&M and MILPERS funding needs; (2) evaluates the extent to which DOD has taken steps to reduce costs in selecting foreign currency rates to disburse funds to liquidate O&M obligations, and has determined whether opportunities exist to gain additional savings; and (3) assesses the extent to which DOD has effectively managed the FCFD account balance to cover losses due to foreign currency fluctuations and maintained quality information to manage these funds.

[8]The FCFD account may be replenished in several ways. Amounts transferred from the FCFD to O&M and MILPERS appropriations may be returned when not needed to liquidate obligations because of subsequent favorable foreign currency rates in relation to the budget rate, or other amounts have become available to cover obligations. A transfer back to the FCFD of unneeded amounts must be made before the end of the second fiscal year of expiration following the fiscal year of availability of the O&M or MILPERS appropriation to which the funds were originally transferred. DOD may also transfer to the FCFD account any unobligated O&M and MILPERS amounts unrelated to foreign currency exchange fluctuations as long as the transfers are made not later than the end of the second fiscal year of expiration of the appropriation. Any transfer of expired unobligated amounts is limited so that the amount in the FCFD account does not exceed the statutory maximum of $970 million at the time of transfer.

[9]While FCFD amounts residing in the FCFD account are available until expended, once FCFD amounts are transferred into a MILPERS or O&M account, the FCFD amounts merge with and become available for the same purpose, and for the same time period, as the appropriation to which transferred. MILPERS and O&M amounts are only available for a single fiscal year.

[10]GAO, *Budget Issues: Key Questions to Consider When Evaluating Balances in Federal Accounts*, GAO-13-798 (Washington, D.C.: Sept. 30, 2013). Although federal funding may be available to obligate for one year, multiple years, or until expended (that is, no year), only accounts with multi-year or no-year funds may carry over amounts that remain legally available for new obligations from one fiscal year to the next. Unobligated FCFD account balances are carryover amounts.

To address our first objective, we reviewed DOD's foreign currency budget rates for the period of fiscal years 2009 through 2017, and we identified any years during which DOD revised the initial budget rates. We discussed with DOD officials the process for reviewing the rates and the factors considered in determining whether to revise the rates. Additionally, to understand the effects that revising the budget rates had on DOD's O&M and MILPERS funding estimates, and the potential for gains or losses due to foreign currency fluctuations, we compared DOD's initial foreign currency budget rates and revised foreign currency budget rates against rates published by the U.S. Treasury Department (Treasury) for fiscal years 2009 through 2017. This period corresponded with the data available to us on DOD's initial and revised rates, and it allowed for use of the most current data available, because while we were conducting our audit work DOD had not yet decided whether or not to revise the fiscal year 2018 budget rates. We chose rates published by Treasury for this comparison because Treasury has the sole authority to establish for all foreign currencies or credits the exchange rates at which such currencies are to be reported by all agencies of the government.

For our second objective, we reviewed accounting standards and disbursement guidelines such as DOD's *Financial Management Regulation*, which mirrors the FCFD account's statutory authority by directing that MILPERS and O&M obligations be liquidated and amounts be disbursed at the foreign currency market rate that is current at the time.[11] We discussed with DOD officials the foreign currency rates used to liquidate DOD's obligations; any analysis and ongoing efforts to identify options for selecting more cost-effective disbursement rates; and whether there is guidance that may be considered in selecting a disbursement rate. We also analyzed a non-generalizable selection of data from Treasury for disbursements made during the months of June and July 2017 to determine what foreign currency rates were used and what savings may have been possible using alternate rates. We chose these two months because they were the most recent data available on disbursements at the time Treasury provided the data for our review.

For our third objective, we analyzed DOD data for fiscal years 2009 through 2016 on foreign currency gains and losses reported by each of the services that resulted from differences between the foreign currency budget rate applied when incurring obligations and the rates applied when

[11] DOD 7000.14-R *Financial Management Regulation*, vol. 6A, chap. 7 (Feb. 2016).

those obligations were liquidated; transfers of amounts between the FCFD account and the services' O&M and MILPERS appropriations accounts; and the end-of-year FCFD account balances. We chose this time period in order to capture years in which both gains and losses were experienced, and for which DOD had complete data on gains and losses, fund transfers, and end-of-year balances for the FCFD account. We compared the end-of-year FCFD account balances and the use of the FCFD account against guidelines on the importance of examining unobligated carryover balances established in our prior work.[12] Additionally, we reviewed and analyzed DOD financial reports on foreign currency gains or losses and compared the reports, including any identified discrepancies, against standards for accurate reporting and maintaining quality information, such as those identified in GAO's Standards for Internal Control in the Federal Government and the Federal Accounting Standards Advisory Board's *Handbook of Federal Accounting Standards and Other Pronouncements.*[13]

To determine the reliability of the data used in addressing these objectives, we analyzed DOD and Treasury foreign currency rates, data on DOD foreign currency disbursements, and DOD financial reporting data on foreign currency gains and losses to identify any missing or inaccurate information; and we discussed with agency officials any identified data abnormalities and how the data were extracted from systems, when appropriate. We found the data to be sufficiently reliable for the purposes of our reporting objectives, with the exception of the financial reporting on financial gains and losses. Specifically, based on problems with the completeness and accuracy of DOD's financial reporting on foreign currency gains and losses, we found that these data were not sufficiently reliable for the purpose of computing exact totals for the gains and losses DOD experienced. However, because DOD uses these data as the basis for decisions related to management of the FCFD account, we included the data in our analysis to provide insight into the general scope of gains and losses experienced. We also spoke with

[12]GAO-13-798. This report includes guidelines or key questions to consider in evaluating carryover balances, such as how the agency estimates and manages its carryover balances. These questions were developed after analysis of government-wide guidance on budget preparation and execution and discussions with officials, including federal budget specialists and officials from the Office of Management and Budget.

[13]GAO-14-704G and Federal Accounting Standards Advisory Board (FASAB), *Handbook of Federal Accounting Standards and Other Pronouncements, as Amended* (June 30, 2015).

Office of the Under Secretary of Defense (Comptroller) (OUSD(C)), military service, and Treasury officials regarding the process and systems used to input the data and generate the foreign currency reports we reviewed. More details on our objectives, scope, and methodology can be found in appendix I.

We conducted this performance audit from February 2017 to April 2018 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Establishing Foreign Currency Budget Rates

As part of the annual budget formulation process for each fiscal year, DOD establishes for each of nine foreign currencies, a foreign currency budget rate (units of foreign currency per one United States (U.S.) Dollar) to use when developing O&M and MILPERS funding requirements for overseas expenditures. Foreign currency budget rates for a particular fiscal year are established approximately 18 months prior to the fiscal year when overseas obligations will be incurred and disbursements made. For example, in June 2015, OUSD(C) issued guidance to, in part, instruct the services on the foreign currency rates to use in building their fiscal year 2017 budgets. In February 2016, as part of the President's budget, DOD submitted its proposed fiscal year 2017 budget to Congress, and it began incurring obligations against subsequently appropriated amounts on October 1, 2016.

DOD has used various methodologies for establishing the foreign currency budget rates. In 2005, we reviewed DOD's methodology for developing its foreign currency budget rates and reported that DOD's approach for estimating its foreign currency requirements for the fiscal year 2006 budget was a reasonable approach for forecasting foreign currency rates that could produce a more realistic estimate than its historical approach.[14] In its fiscal year 2006 through 2016 budget requests, DOD used a centered weighted average model that combined both a 5-year average of exchange rates and an average of the most recently observed 12 months of exchange rates.

For its fiscal year 2017 request, DOD adjusted its methodology to establish the foreign currency budget rates. Specifically, DOD established its foreign currency rates by calculating a 6-month average of *Wall Street Journal* rates published every Monday from May 25, 2015, to November 16, 2015. According to an OUSD(C) official, the 6-month average more closely represented foreign currency exchange rates experienced by the department during budget formulation, and it accounted for the strength of the U.S. Dollar, which had increased as compared with its historical 5-year average. DOD's analysis found that the use of the 5-year historical average would have resulted in substantial gains when compared with gains expected from application of the 6-month average. More specifically, DOD projected gains of about $1 billion using the 5-year average of rates.

Obligating and Disbursing Amounts Using Foreign Currency Rates

During the fiscal year for which a budget is developed, DOD incurs obligations for its overseas O&M and MILPERS activities. Those obligations are recorded using the foreign currency budget rates. DOD uses various methods for selecting foreign currency rates to liquidate those obligations through disbursements, which may differ from the budget rates. DOD's preferred payment method for foreign currency transactions is the Department of Treasury's (Treasury) comprehensive international payment and collection system—the International Treasury Services (ITS.gov) system—which serves federal agencies making payments in nearly 200 countries.[15] ITS.gov offers a number of rates, including advanced rates available up to 5 days in advance of disbursement, and the spot rate. The spot rate is the price for foreign currencies for delivery in 2 business days. While advanced rates, like spot

[14]GAO, *Review of DOD's Report on Budgeting for Exchange Rates for Foreign Currency Fluctuations,* GAO-05-800R, (Washington, D.C.: June 16, 2005). As discussed in the report, DOD used market rates published by the *Wall Street Journal* as a guide in developing its foreign currency budget rates.

[15]If ITS.gov cannot support mission requirements, then DOD disbursing officers may maintain official limited depositary checking accounts for check or electronic transfer payments in foreign currencies with banks designated by Treasury as "Depositaries of Public Moneys of the United States."

rates, are based on the current market rate, advanced rates at the time they are selected are generally higher than the spot rate, with the 5-day advanced rate being the highest, because the rates are locked in ahead of the actual value date.[16] While the spot rate can be more cost-effective, it requires immediate transaction processing, which may not be feasible for all disbursements.

Differences between obligations incurred at the foreign currency budget rates and the amounts that DOD actually disburses drive gains or losses in the appropriated amounts DOD has available for its planned overseas expenditures. For example, if DOD budgeted for the U.K. Pound at a rate of .6289 (that is, 1 U.S. Dollar buys .6289 U.K. Pounds) as it did in fiscal year 2016, and the rate experienced at the time of disbursement was .6845, then DOD would have requested more funds than were actually needed for transactions involving the U.K. Pound. That would have resulted in a gain from the transaction—meaning that DOD would need less funds than were budgeted for the transaction. Conversely, a current rate that is lower than what was budgeted will result in a loss—and DOD would require more funds than were budgeted for the transaction.

Foreign Currency Accounts

Within each of the services' O&M and MILPERS appropriations accounts, amounts are available for overseas activities. Amounts obligated for overseas activities, along with associated foreign currency gains and losses, are managed by the services as part of the overall management of their O&M and MILPERS appropriations accounts.[17] Service components use foreign currency fluctuation accounts within their O&M and MILPERs appropriations to manage realized gains and losses in direct programs due to fluctuations in foreign exchange rates. The service-level foreign currency fluctuation accounts are maintained at various budgetary levels within the service components.

In fiscal year 1979, Congress appropriated $500 million to establish the FCFD account for purposes of maintaining the budgeted level of operations in the MILPERS and O&M appropriation accounts by

[16]As discussed later in this report, a number of factors, including mission requirements and the time necessary to process the transaction drive DOD's selection of a disbursement rate.

[17]The services include the U.S. Army, Air Force, Navy, and Marine Corps.

mitigating substantial gains or losses to those appropriations caused by foreign currency rate fluctuations.[18]

FCFD appropriations are different from the O&M and MILPERS appropriations in two ways. First, FCFD account amounts are no-year amounts, meaning that they are available until expended, while in general, O&M and MILPERS appropriations are 1-year amounts and expire at the end of the fiscal year for which they were appropriated.[19] Expired O&M and MILPERS amounts remain available only for limited purposes for 5 additional fiscal years.[20] At the end of the 5-year expired period, any remaining O&M or MILPERS amounts, obligated or unobligated, are canceled and returned to Treasury. Second, FCFD account amounts may be used only to pay obligations incurred because of fluctuations in currency exchange rates of foreign countries, while O&M amounts are available for diverse expenses necessary for the operation and maintenance of the services and MILPERS amounts are available for service personnel-related expenses, such as pay, permanent changes of station travel, and expenses of temporary duty travel, among other purposes.

Amounts from the FCFD account may be transferred to service-level foreign currency fluctuation accounts within O&M and MILPERS appropriation accounts to offset losses in buying power due to unfavorable differences between the budget rate and the foreign currency exchange rate prevailing at the time of disbursement. The FCFD account may be replenished in several ways. Amounts transferred from the FCFD to O&M and MILPERS appropriations may be returned when not needed to liquidate obligations because of subsequent favorable foreign currency rates in relation to the budget rate, or because other amounts have become available to cover obligations. A transfer back to the FCFD of unneeded amounts must be made before the end of the second fiscal year of expiration following the fiscal year of availability of the O&M or MILPERS appropriation to which the funds were originally transferred.

---

[18]*Department of Defense Appropriation Act, 1979*, Pub. L. No. 95-457 (1978).

[19]Congress, at its discretion, may appropriate O&M and MILPERS amounts that are available for more than one fiscal year.

[20]Expired amounts are no longer available to incur new obligations, but they are available for liquidation of obligations incurred during the period of availability. Unobligated expired amounts may be used to adjust the amount of obligations properly made during the period of availability, or to cover obligations properly made during availability that the agency failed to record.

Amounts may also be transferred to the FCFD account even if they did not originate there. Specifically, DOD may transfer to the FCFD account any unobligated O&M and MILPERS amounts unrelated to foreign currency exchange fluctuations so long as the transfers are made not later than the end of the second fiscal year of expiration of the appropriation. While multiple transfers of these unobligated amounts may be made during a fiscal year, any such transfer is limited so that the amount in the FCFD account does not exceed the statutory maximum of $970 million at the time of transfer.[21] When the FCFD account balance is at the maximum balance, the services normally retain in their service-level O&M and MILPERs foreign currency fluctuation accounts any gains resulting from favorable foreign currency rates. Finally, any amounts transferred, whether from the FCFD account to an O&M or MILPERS account, or from an O&M or MILPERS account to the FCFD, are merged with the account and assume the characteristics of that account, including the period of availability of the funds contained in the account.

Visibility of service-level foreign currency fluctuation account and FCFD transactions is maintained through the services' accounting systems and execution reports. DOD uses the following reports to track its foreign currency funds:

- Foreign Currency Fluctuations, Defense Report (O&M): provides data on O&M foreign currency gains and losses for each service, by currency, including data on projected gains or losses for any remaining obligations that have not yet been liquidated and disbursed at the time of the report.
- Foreign Currency Fluctuation, Defense Report (MILPERS): provides data on MILPERS foreign currency gains and losses for each service, by currency, including data on projected gains or losses for any remaining obligations that have not yet been disbursed at the time of the report.

GAO's Prior Work on Management of Federal Funds

In 2013 we analyzed and reported on carryover balances in federal accounts, which amounted to $2.2 trillion in fiscal year 2012, and we found that greater examination of carryover balances by an agency provides opportunities for enhanced oversight of their management of federal funds and may help identify opportunities for potential budgetary

[21] 10 U.S.C. § 2779(d)(3).

savings.[22] Carryover balances are composed of both obligated and unobligated amounts. Only accounts with multi-year or no-year amounts, such as the FCFD, may carry over amounts that remain legally available for new obligations from one fiscal year to the next. DOD's carryover balances would include FCFD account balances carried from one year to the next. DOD's FCFD account is composed of unobligated carryover amounts that accumulate when unneeded for transfer to O&M and MILPERS accounts to cover foreign currency fluctuations. FCFD unobligated carryover balances include any expired, unobligated balances from the military services' O&M and MILPERS accounts, which can include any gains due to favorable foreign currency fluctuations that are not used to cover other losses and that are transferred into the FCFD.

DOD Revised Its Foreign Currency Budget Rates in Fiscal Years 2014 through 2016, Decreasing Its Projected Funding Needs and Potential Foreign Currency Gains and Losses

DOD revised its foreign currency budget rates in fiscal years 2014 through 2016, which resulted in budget rates in these years that were more closely aligned with rates published by Treasury. Furthermore, the revised budget rates in fiscal years 2014 through 2016 decreased DOD's projected O&M and MILPERS funding needs. The revised budget rates also decreased potential gains and losses in the amount of funds that DOD had available for its planned overseas expenditures.

DOD Revised Its Foreign Currency Budget Rates in Fiscal Years 2014 through 2016, Resulting in Rates More Closely Aligned with Treasury Rates

DOD revised its foreign currency budget rates in fiscal year 2014 and continued to do so in fiscal years 2015 and 2016 before making adjustments to its methodology in fiscal year 2017. According to an OUSD(C) official, the methodology developed in 2017 resulted in budget rates that were more closely aligned with market rates than in previous years, making revision of the 2017 budget rates unnecessary. DOD's revisions to its foreign currency budget rates in fiscal years 2014 through 2016 resulted in rates that more closely aligned with those published by

[22] GAO-13-798.

Treasury. Further, they decreased the expected gains that would have otherwise resulted from a substantial increase in the strength of the U.S. Dollar, in fiscal years 2014 through 2016, relative to other foreign currencies from the time the budget rates were set as compared with the rates available once the fiscal year began.[23] Prior to fiscal year 2014, DOD did not revise its foreign currency budget rates. DOD officials did not provide an explanation for why the budget rates for fiscal years 2009 through 2013 were not revised.

DOD developed, in November 2015, a set of standard operating procedures that describe the methodology it used for formulating budget rates for the nine foreign currencies included in its budget submission. These procedures also state that DOD is required to update the budget rates once an appropriation is enacted for the fiscal year. For example, if Congress reduces DOD's appropriations due to favorable foreign currency rates, such as the $1.5 billion reduction in DOD's total fiscal year 2016 appropriations, OUSD(C) then revises the budget rates to absorb the reduced funding levels.

OUSD(C) officials stated that other factors are also considered when determining whether to revise the foreign currency budget rates, and that the department communicates the revised budget rates to the DOD components and Congress. For example, OUSD(C) assesses the value of each of the nine foreign currencies used to develop the budget request relative to the strength of the U.S. Dollar during the fiscal year.[24] An OUSD(C) official also noted that the effects that the rate changes would have across these foreign currencies are also considered prior to submitting recommended rate revisions to the OUSD(C) leadership for approval. The official stated that one currency may be experiencing a loss, while another is experiencing a gain, which can affect whether to revise the rates and what those revisions should be.

Additionally, the OUSD(C) official stated that "significant" projected gains or losses could drive a revision to the foreign currency budget rates, and

[23]DOD uses rates published in the *Wall Street Journal* to determine its foreign currency budget rates. However, because Treasury has the sole authority to establish for all foreign currencies or credits the exchange rates at which such currencies are to be reported by all agencies of the government, we used Treasury rates as our point of comparison with DOD's budget rates. 22 U.S.C. § 2363(b).

[24]DOD uses market rates published by the *Wall Street Journal* to determine the strength of the U.S. Dollar relative to each of its nine foreign currencies.

that an informal $10 million threshold for projected gains and losses is used to determine when the foreign currency budget rates are revised. According to OUSD(C) officials, DOD components and Congress were notified when the budget rates were revised during fiscal years 2014 through 2016, including an explanation for why the rates were revised.[25] OUSD(C) also includes the budget rates for each of the nine foreign currencies on its website and identifies any instances in which the budget rates were revised with the effective date of any rate revisions.

Our analysis of DOD's use of revised budget rates during fiscal years 2014 through 2016 found that the revised budget rates for those years were more closely aligned with rates published by Treasury. More specifically, for the nine foreign currencies included in DOD's budget, our analysis comparing DOD's initial and revised budget rates for fiscal years 2009 through 2017 with average Treasury rates for these years found that DOD's budget rates differed from Treasury rates by less than 10 percent in about 64 percent of the total 162 occurrences we examined.[26] While we are unaware of any criteria that suggest how closely DOD's foreign currency budget rates should align with market rates, we used 10 percent as a basis for our analysis because Treasury's guidance states that amendments to its published exchange rates are required if rates differ from current rates by 10 percent or more.[27]

We further examined these occurrences to determine what the differences were between the DOD and Treasury rates before and after

[25]DOD officials stated that, in each fiscal year, DOD includes in the President's Budget submission the foreign currency budget rates for that year. If DOD revised the previous fiscal year's rates after the budget request was submitted, then the revised rates for the previous year would also be included in DOD's budget request. Although DOD's budget overview documents show the revised budget year rates for a prior fiscal year, if applicable, they do not include details on the factors that led to the revisions.

[26]We performed our analysis for fiscal years 2009 through 2017 on a bi-annual basis to account for the fact that Treasury rates are published quarterly and the DOD budget rates were revised in fiscal years 2014 through 2016. For the nine fiscal years included in our review, we examined the differences between DOD's rates for each of its nine foreign currencies and an average of Treasury's quarterly rates. We averaged the Treasury's first and second quarter rates for each currency and compared the Treasury average with DOD's initial budget rates. Similarly, we computed an average of the third and fourth quarter Treasury rates for each currency and compared that average with the DOD revised budget rates, where applicable. This resulted in a total of 18 occurrences for comparison for each fiscal year, which is a total of 162 occurrences over the 9-year period.

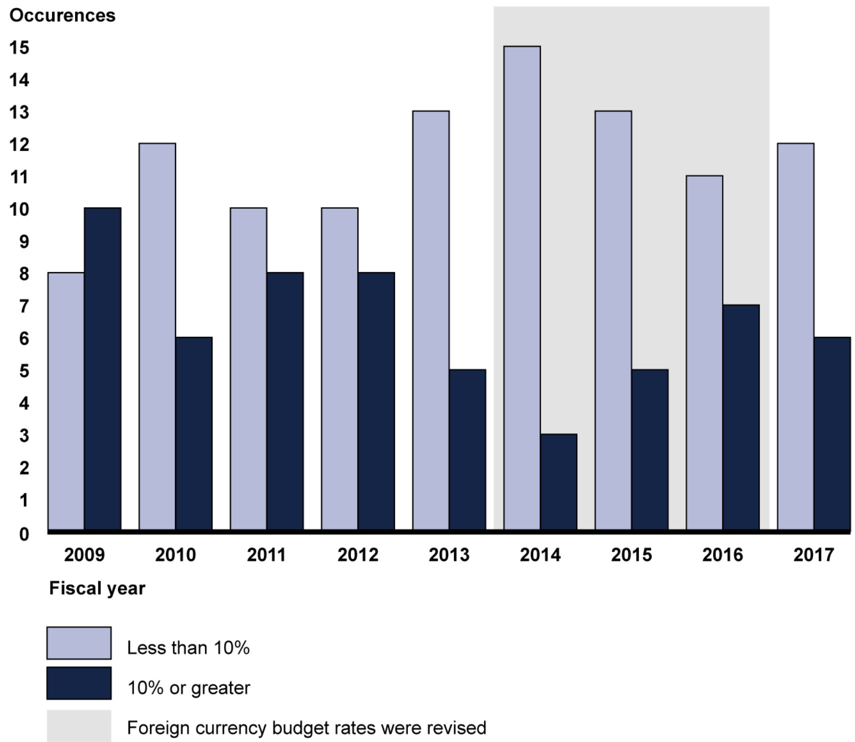
[27]Department of Treasury, *Treasury Financial Manual,* vol. 1, part 2, § 3230.20(d)) (2017).

DOD began revising its budget rates in fiscal year 2014. Of the 162 occurrences we reviewed, there were 90 occurrences included in our comparison for fiscal years 2009 through 2013, and 72 occurrences were included in our comparison for fiscal years 2014 through 2017. Our analysis shows the following:

- For fiscal years 2014 through 2017, DOD's budget rates for its nine foreign currencies differed from Treasury rates by less than 10 percent in about 71 percent of the occurrences. This increased from about 59 percent of the occurrences for the period of fiscal years 2009 through 2013, before DOD began revising its rates after the fiscal year began.
- For fiscal years 2014 through 2017, DOD's budget rates differed from Treasury's rates by 10 percent or more after DOD began revising its rates in fiscal year 2014 in about 29 percent of the occurrences, which is a decrease from about 41 percent of the occurrences prior to fiscal year 2014.

Figure 2 below shows the number of occurrences in which DOD's initial and revised rates differed from Treasury rates by less than 10 percent, and the occurrences in which DOD's rates differed from Treasury rates by 10 percent or more. The occurrences that are less than 10 percent of Treasury rates are most closely aligned with Treasury rates.

Figure 2: Number of Occurrences in Which the Department of Defense's (DOD) Budget Rates Differed from Treasury Rates by Less Than 10 Percent, or by 10 Percent or More, for Fiscal Years 2009 - 2017



Source: GAO analysis of Department of Defense (DOD) and Department of Treasury foreign currency budget rates. | GAO-18-221

Note: Data shown reflect the results of our analysis of DOD and Treasury foreign currency rates for fiscal years 2009 through 2017. We used "less than 10 percent" or "10 percent or greater" as the benchmark for assessing the nine foreign currencies included in DOD's budget. We computed two 6-month averages using Treasury's quarterly rates and compared them with the DOD initial and revised budget rates. This resulted in a total of 18 occurrences for comparison for each fiscal year, which is a total of 162 occurrences over the 9-year period.

According to DOD officials, the differences between DOD's foreign currency budget rates and Treasury rates are driven primarily by market volatility (that is, the differences in the foreign currency rates from when DOD formulates its budget rates, prior to the fiscal year, and the foreign currency rates determined by Treasury when obligated amounts are liquidated through disbursements during the fiscal year). According to the OUSD(C) official responsible for formulating and revising the foreign currency budget rates, the delay that occurs between the time when a budget rate is set (approximately 18 months prior to the beginning of a particular fiscal year) and the actual fiscal year is a major factor for why the budget rate may be revised. According to the official, the market rates experienced during fiscal years 2014 through 2016 were substantially different from those expected when the budget rates for those years were developed. Therefore, DOD revised its budget rates during these years to more closely align with market rates experienced.

Specifically, this official stated that DOD revised its budget rates during fiscal years 2014 through 2016 to decrease the expected gains that would have otherwise resulted during these fiscal years from a substantial increase in the strength of the U.S. Dollar relative to other foreign currencies from the time the budget rates were set as compared with more favorable rates available once the fiscal year began. In order to more closely align its budget rates with market rates, DOD introduced a new methodology to establish the foreign currency budget rates for fiscal year 2017 because DOD anticipated approximately $1 billion in projected gains if it used the prior methodology.[28] As a result of this change in the methodology, according to the OUSD(C) official, DOD did not experience substantial gains or losses in fiscal year 2017. Therefore, DOD did not revise its foreign currency budget rates during fiscal year 2017. However, as previously stated, the official did not provide an explanation as to why the budget rates for fiscal years 2009 through 2013 were not revised.

Revised Foreign Currency Budget Rates Decreased the Estimate of DOD's O&M and MILPERS Funding Needs and Potential Gains and Losses That Would Have Occurred Due to Foreign Currency Fluctuations

DOD's use of revised foreign currency budget rates decreased DOD's projected O&M and MILPERS funding needs and any potential gains and losses that would have occurred due to foreign currency fluctuations during fiscal years 2014 through 2016. Because DOD uses its budget rates to establish its projected annual O&M and MILPERS funding requirements for planned overseas expenditures, any revisions to the budget rates affect DOD's estimate of its funding needs. For example, our analysis shows that as a result of revising its budget rates during fiscal years 2014 through 2016, DOD's projected funding needs for the period of fiscal years 2009 through 2017 decreased from about $60.2 billion to about $57.5 billion—a decrease of about $2.7 billion.

To further show the effect that changing foreign currency rates could have on DOD's projected funding for planned overseas expenditures for fiscal years 2009 through 2017, we also compared DOD's projected O&M and MILPERS funding needs, based on its initial and revised foreign currency

[28]As discussed earlier in this report, DOD calculated a 6-month average of *Wall Street Journal* rates published every Monday from May 25, 2015, to November 16, 2015, for use in establishing its fiscal year 2017 foreign currency budget rates.

budget rates, against projected funding needs based on the use of foreign currency rates published by Treasury during the fiscal year.[29] Our analysis shows that DOD's projected O&M and MILPERS foreign currency funding needs using Treasury rates would have been about $58.4 billion, or about $885 million more than the $57.5 billion that DOD had projected using its initial and revised budget rates.

DOD also uses foreign currency budget rates to calculate gains or losses attributable to foreign currency fluctuations. Specifically, DOD determines gains and losses due to foreign currency fluctuations by comparing the budget rate (that is, initial or revised budget rate) used to incur obligations against a more current market rate at the time it liquidates its obligations through disbursements. Therefore, revisions to the budget rates not only change DOD's projected O&M and MILPERS funding requirements for the fiscal year in which the revisions occur, but also change the baseline from which the potential gains or losses would result when DOD liquidates its overseas O&M and MILPERS obligations through disbursements. For example, in fiscal year 2016, Congress reduced DOD's total appropriations by $1.5 billion. As a result of this reduction and favorable foreign currency rates, DOD revised its fiscal year 2016 budget rates in February 2016 and applied the revised foreign currency budget rates in its calculations of gains and losses due to foreign currency fluctuations since the beginning of the fiscal year to absorb the reduced funding level. In applying the revised budget rates, a $30 million gain DOD had previously projected became a projected loss of about $186.2 million. The use of revised budget rates also affects the movement of funds from the FCFD account. For example, if the use of the revised budget rate creates a loss and DOD is unable to cover the increased costs to its O&M or MILPERS appropriations, funds from the FCFD account may be used to cover its planned overseas expenditures.

[29]Although DOD uses market rates published by the *Wall Street Journal* as a guide in developing its foreign currency budget rates, OUSD(C) officials stated that they had never compared the *Wall Street Journal* and Treasury rates to determine whether one rate performs better than the other. According to the official, the *Wall Street Journal* rates are based on the daily closing of the New York Stock Exchange and are considered to be more timely than Treasury rates, which are published quarterly.

DOD Has Taken Some Steps to Reduce Costs, but Has Not Fully Explored Additional Opportunities to Achieve Savings When Selecting Foreign Currency Rates

DOD has taken some steps to reduce costs in selecting foreign currency rates to liquidate its obligations through disbursements. However, DOD organizations are not always selecting the most cost-effective rates to convert U.S. Dollars, and DOD has not determined whether opportunities exist to achieve additional efficiencies when making disbursements. DOD liquidates its obligations through disbursements for overseas expenditures using Treasury's ITS.gov system, which provides DOD organizations with a choice of foreign currency rates to apply when making disbursements in a foreign currency. The foreign currency rate chosen determines how many U.S. Dollars must be paid for the transaction. Treasury officials explained that customers may choose either the spot rate or an advanced rate. The spot rate is the price for foreign currencies for delivery in 2 business days. Treasury officials explained that advanced rates are exchange rates that are "locked in" and guaranteed by the bank processing the disbursement 5, 4, or 3 days in advance of payment processing, which is known as the "value date" of a disbursement. Normally, the cost of the rate increases the further from the date of disbursement that it is locked in.

While DOD often uses a 5-day advanced rate to make its disbursements, the other rate options available, such as a 3-day advanced and a spot rate, can be more cost-effective. We analyzed data provided by Treasury from its ITS.gov system and found that for disbursements made during the period of June and July 2017, the 5-day advanced rate was more costly than the 3-day advanced rate. In instances where the spot rate was available, we found that it was also more cost-effective than either the 3-day or 5-day advanced rates. For example, for those transactions processed through ITS.gov on June 13, 2017, DOD would have paid 1 U.S. Dollar for .881 European Euros if using the 5-day advanced rate; .883 European Euros if using the 3-day advanced rate; and .889 European Euros if using the spot rate.

In the case of the Army, an Army Financial Management Command official provided us information indicating that the service has estimated potential cost savings that would result from more consistently selecting 3-day advanced rates through the ITS.gov system to make overseas disbursements of amounts, rather than the 5-day advanced rate. More specifically, the Army estimated between $8 million and $10 million in annual savings by transitioning from a 5-day to a 3-day advanced rate when selecting foreign currency rates. According to officials, the Army has transitioned all paying locations to the 3-day advanced rate. The Army estimates that these locations have produced $6.04 million in savings through February 2018.[30] Although the Army indicated that it also planned to analyze whether use of the spot rate was feasible, it had not conducted this review at the time of our review.

Data provided to us by Treasury from its ITS.gov system indicate that in June and July of 2017, the Air Force used the 5-day advanced rate exclusively for its disbursements, while the Navy and Marine Corps relied on both the 5-day and the 3-day advanced rates. Our analysis of these data show the Air Force would have achieved total savings for those 2 months of about $258,000 if it had made its disbursements using the 3-day versus the 5-day advanced rate. The savings resulting from each transaction varied based on the amount of the transaction. For example, on June 13, 2017, the Air Force disbursed a payment exceeding $3.7 million and would have saved more than $9,000 for that transaction if the 3-day advanced rate had been used. For the same single transaction, if the spot rate had been used instead of the 5-day advanced rate, the Air Force would have saved more than $31,000. The savings associated with the Navy's and Marine Corps' disbursements for the same 2-month period showed the potential for less dramatic savings of less than $100 because the Navy and Marine Corps used the 3-day advanced rate as opposed to the 5-day advanced rate for most of its disbursements. Where information on the spot rate was available, its use, as opposed to either the 5-day or 3-day advanced rate, would have resulted in additional savings opportunities for those 2 months. While these examples are illustrative of cost savings opportunities in June and July 2017, Treasury data show that in fiscal year 2016, DOD disbursed more than $11.8 billion through ITS.gov and, as of July 2017, had disbursed more than $9.6 billion through ITS.gov.

Our analysis suggests that DOD could achieve further cost savings by more consistently selecting cost-effective foreign currency rates, such as the 3-day advanced or spot rates, with which to make disbursements. In selecting foreign currency rates, DOD's *Financial Management Regulation* states that disbursements should be computed to avoid gains or deficiencies (losses) due to fluctuations in rates of exchange to the greatest extent possible. If there is no rate of exchange established by agreement between the U.S. government and the foreign country, then foreign currency transactions are to be conducted at the prevailing rate.

[30]We did not independently review or determine the accuracy or completeness of the Army's estimate of potential savings.

The prevailing rate of exchange is the most favorable rate legally available for acquisition of foreign currency for official disbursement and other exchange transactions. Additionally, GAO's *Standards for Internal Control in the Federal Government* calls for management to periodically review policies, procedures, and related control activities for continued relevance and effectiveness in achieving the entity's objectives or addressing related risks.[31]

DOD disbursement organizations have flexibility in selecting foreign currency rates to use when making disbursements using ITS.gov. There is no DOD-wide requirement for the services to review the rates used to make disbursements and, except for the Army, the services have not conducted such a review.[32] This step is necessary to determine whether there are opportunities for savings by more consistently selecting cost-effective foreign currency rates. We discussed disbursement processes with DOD and Air Force, Navy, and Marine Corps financial management officials, including the factors considered when selecting foreign currency rates. In addition, a Defense Finance and Accounting Service official noted that currencies can have criteria specifying when a payment is made and provided us the ITS.gov user's guide, which addresses "special currency requirements," such as those that would drive advanced payment for a currency. For example, the user's guide indicates that payment for transactions involving the Afghanistan Afghani must be made 2 days in advance of the value date, and cannot be made on a Friday. However, information that is contained in the ITS.gov user's guide and that we received from a Treasury official indicate that none of the nine foreign currencies for which DOD budgets place restrictions on when payment must be made; and therefore, this consideration should not drive the use of a specific rate at disbursement.

Marine Corps financial management officials told us that the foreign currency rate selected at disbursement is at the discretion of the disbursing officer based on operational requirements, with the understanding that the most favorable rate for the government is the preference, while balancing mission requirements and the time necessary to process the transaction. These officials acknowledged that the 3-day

[31] GAO-14-704G.

[32] While the Army has reviewed the rates it uses at disbursement and has converted from the 5-day to the 3-day advanced rate, according to Army officials, it has not conducted a similar review to determine whether use of the spot rate is feasible and would result in additional cost savings.

advanced rate can be more cost-effective to the government but indicated that there are occasions when the 5-day advanced rate should be used because it provides more time to process the payments from deployed locations operating in different time zones or with limited communication capabilities.

However, we found that OUSD (C) officials and financial management officials with the headquarters of the Air Force, Navy, and Marine Corps were not involved in disbursement, were unaware of what rates were being used at disbursement, and had not reviewed the rationale for selecting one rate over another. For example, Air Force and Navy headquarters officials we spoke with were unable to provide insight as to what drives the decision to use one rate over another. One Navy financial management official told us that he was unaware of any Navy policy that directs a specific rate to be used when disbursing funds, and suggested that the absence of such a policy provides the flexibility for officials to determine which approach is best. Headquarters, Marine Corps officials also stated that they did not monitor foreign currency rates used for disbursements or the reasons why one rate was selected over another. Based on our inquiry, officials indicated that they would analyze the foreign currency rates used for disbursements in 2017 and whether opportunities existed to achieve savings by using other rates available through ITS.gov. A Marine Corps official subsequently provided us with information that showed that two of three disbursing offices that currently utilize ITS.gov for disbursements use the 3-day advanced rate exclusively and one uses the 5-day advanced rate. The official noted that a technical issue within ITS.gov has restricted the disbursing office currently using the 5-day advanced rate from choosing any other rate, but that the service was further assessing options to correct the issue.

In our conversations with an official in OUSD(C) about why the other services had not reviewed the foreign currency rates used for disbursements to determine what was being paid through ITS.gov and whether there was an opportunity for savings, the official commented that OUSD(C) had not directed the services to conduct any reviews in this area. This official was unaware that different foreign currency rates were used to make disbursements, and assumed that the military services all make disbursements in the same way. However, as discussed above, the services are using different rates resulting in inconsistency across the department. The official further indicated that DOD could perform a review to determine the cost differences of using one disbursement rate over another. Absent a review of the rates the services are using in making disbursements and whether cost savings could be achieved by more consistently selecting the most cost-effective foreign currency rates available for use at disbursement, DOD is at risk for paying more to convert U.S. Dollars for overseas expenditures than would otherwise be required.

DOD Has Used the FCFD Account to Cover Losses Due to Foreign Currency Fluctuations, but Does Not Manage the Account Balance Based on Projected Losses or Quality Data

In fiscal years 2009 through 2016, DOD used the FCFD account to cover losses that the services experienced due to foreign currency fluctuations in 6 of the 8 years we reviewed. However, DOD does not effectively manage the FCFD account balance based on projected gains or losses. Transfers of expired unobligated balances from MILPERS and O&M accounts into the FCFD account have been made to replenish the account balance to the statutory limit of $970 million, without consideration of projected losses due to foreign currency fluctuations. Furthermore, DOD's financial reporting on foreign currency fluctuations for fiscal years 2009 through 2016 contains incomplete and inaccurate information.

DOD Has Used the FCFD Account to Cover Losses and Has Maintained the Account at the Maximum Level since Fiscal Year 2012

In fiscal years 2009 through 2016, DOD transferred approximately $1.92 billion out of the FCFD account to cover losses that the services experienced due to foreign currency fluctuations in 6 of the 8 years we reviewed. For these years, DOD transferred funds from the FCFD account to the services' MILPERS and O&M accounts during the fiscal year in which the funds were obligated for overseas expenses. The transfer amounts were based on both losses realized from actual disbursements and projected losses for any remaining obligations to be liquidated. The projected losses were calculated based on the current foreign currency market rates as of the time of the calculation. Based on the service-level data we reviewed, all of the services reported that they experienced losses in at least 5 of the fiscal years we reviewed.[33] For example, the Army reported that it experienced losses in its MILPERS

[33] We found problems with the completeness and accuracy of the data that we used to calculate the gains and losses experienced by the services, which we discuss later in this report. However, because DOD uses that data as its primary source for FCFD account management decisions, we included that data in our analysis to provide insight into the general scope of the gains and losses experienced.

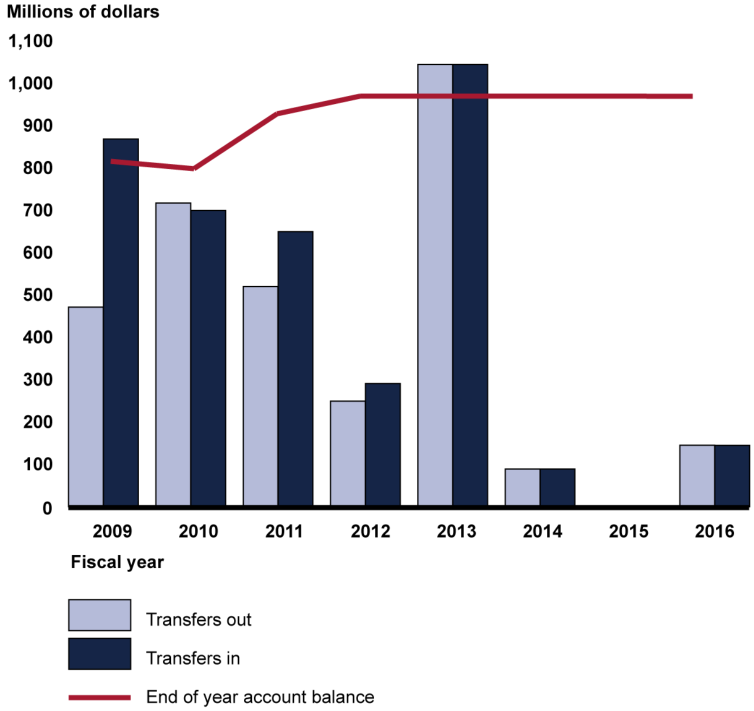
account for 5 of 8 years, while the Marine Corps reported that it experienced losses in its O&M and MILPERS accounts in each of the 8 years. In addition to the transfers to cover losses within the services' MILPERS and O&M accounts, in fiscal year 2013 DOD transferred an additional $969 million to the Defense Working Capital Fund to offset fuel cost losses.[34]

Since fiscal year 2012, DOD has maintained the FCFD end-of-year account balance at $970 million—the maximum allowed by statute.[35] To replenish the funds that were transferred out of the FCFD account, DOD transferred unobligated balances to the FCFD account from the services' O&M and MILPERS accounts. While DOD can also replenish the FCFD account or absorb foreign currency losses in certain currencies by transferring to the FCFD account any gains experienced by the services, our analysis found that DOD did not transfer any gains into the FCFD account for fiscal years 2009 through 2016. Figure 3 shows the transfers into and out of the FCFD account and the end-of-year FCFD account balance for fiscal years 2009 through 2016.

[34]The Department of Defense Appropriations Act for fiscal year 2013 included a provision to allow transfer between the FCFD account and the Defenses Working Capital Fund, and in May 2013 the OUSD(C) approved the FCFD transfer to the working capital fund in accordance with that provision. *Consolidated and Further Continuing Appropriations Act of 2013,* Pub. L. No. 113-6 (2013).

[35]10 U.S.C. § 2779(d)(3).

Figure 3: Transfers into and out of the Foreign Currency Fluctuations, Defense (FCFD) Account and End-of-Year Account Balance, Fiscal Years 2009 - 2016



Source: GAO analysis of Department of Defense foreign currency fluctuation, defense account transfers and balances data. | GAO-18-221

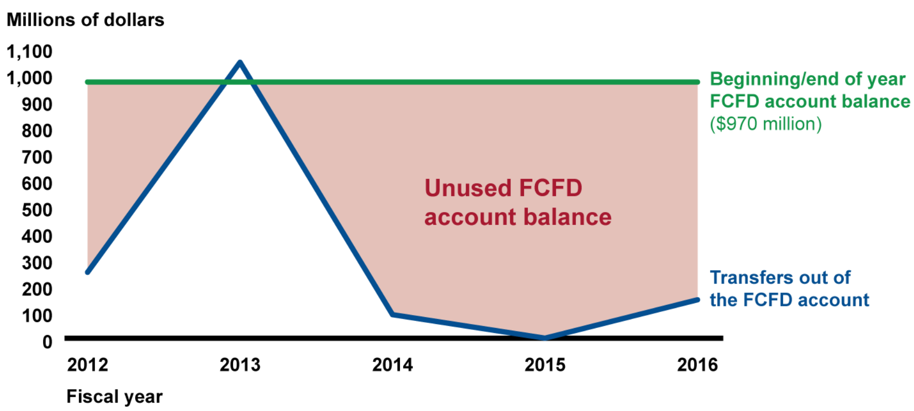
Note: The services did not receive any FCFD transfers to cover foreign currency fluctuation losses in fiscal year 2013. The Department of Defense transferred $969 million to the Defense Working Capital Fund and the account was reduced by $76 million due to across-the-board spending reductions, known as sequestration, which reduced DOD's discretionary resources. In fiscal year 2015 there were no transfers out of or into the FCFD account.

Our analysis also shows that DOD transferred funds to maintain the FCFD account at its maximum balance since 2012, despite experiencing fewer losses due to foreign currency fluctuations than it had experienced in fiscal years 2009 to 2011. Of the $1.92 billion transferred from the FCFD account to the services' MILPERS and O&M accounts to cover losses, $464.5 million was transferred since fiscal year 2012, when DOD began maintaining its FCFD account at the maximum level. During that time, some of the services experienced foreign currency gains, while others experienced losses. For example, at the end of fiscal year 2013 the Navy reported a total realized and projected cumulative gain for its O&M and MILPERS accounts of about $98.6 million. In that same year, the Marine Corps reported a cumulative realized and projected loss for its O&M and MILPERS accounts of approximately $12.7 million. Had DOD not transferred unobligated funds back into the FCFD account, it would have retained a positive balance of approximately $505.5 million. However, DOD maintained the account balance at $970 million by transferring approximately $495.3 million in unobligated balances into the account.

DOD Analyzes Projected Losses to Inform Transfers out of the FCFD Account, but Does Not Consider Similar Information When Making Transfers into the FCFD Account

As part of its management of the FCFD account balance, DOD analyzes data on realized and projected losses as the basis for transferring funds from the FCFD account to the services' MILPERS and O&M accounts to cover losses. However, DOD does not consider projected losses when making transfers of unobligated O&M and MILPERS balances into the FCFD account. Figure 4 below shows the FCFD account balance that DOD has maintained in relation to the transfers out of the account to cover losses.

Figure 4: Transfers out of the Foreign Currency Fluctuations, Defense (FCFD) Account and Beginning and End-of-Year Account Balance, Fiscal Years 2012 - 2016



Source: GAO analysis of Department of Defense data. | GAO-18-221

Specifically, according to the OUSD(C) official responsible for managing the FCFD account, DOD maintains the FCFD account balance at $970 million to maximize unobligated balances within the military services' O&M and MILPERS accounts before they are canceled and are no longer available to DOD.[36] In addition, this official stated that DOD prefers to maintain the maximum balance in case it is needed due to sudden, unfavorable swings in foreign currency exchange rates.

Our review of the documentation used to make transfers into and out of the FCFD account corroborates that DOD maintains the FCFD account balance to maximize the retention of unobligated balances. Specifically, we found instances in which the documentation states that the transfers of unobligated balances into the FCFD account were made for the purpose of replenishing the account balance to the statutory limit. For example, DOD transferred $89 million from the FCFD account to the Army for losses it had realized and projected in fiscal year 2014, and later transferred unobligated balances of the same amount back into the account. DOD's documentation states that this transfer of unobligated balances was made for the purpose of replenishing the account to $970 million in order to finance estimated foreign currency losses resulting from the decline in value of the U.S. Dollar. However, the transfer to the Army already covered the realized losses and projected losses for any remaining disbursements. In other words, estimated foreign currency losses had already been accounted for at the time of the transfer to the Army.

In addition, based on data reported by the Air Force, Marine Corps, and Navy, DOD had an estimated cumulative gain of about $30 million for fiscal year 2014 based on the other services' gains and losses, which could have been transferred to the FCFD account to absorb any additional foreign currency losses elsewhere.[37] However, DOD did not transfer those gains to the FCFD account. Similarly, based on data reported by these services, DOD experienced cumulative realized and projected gains of more than $200 million in fiscal year 2013 and about $92.6 million in fiscal year 2015, but it did not transfer any gains to the

[36]Time-limited appropriations, such as Military Personnel and Operation and Maintenance amounts, are available for new obligations during the fiscal year for which they are appropriated. Amounts not obligated during the period of availability expire at the end of the fiscal year for which they were appropriated. Expired unobligated balances remain available for limited purposes, such as adjusting contract amounts and liquidating, or disbursing, obligations for 5 fiscal years after expiration, at which time funds are canceled and returned to Treasury.

[37]Due to the issues with the accuracy of the Army data on O&M gains and losses that we discuss later in this report, we excluded the Army data from our analysis in which we used data on O&M gains and losses to calculate cumulative losses and determine what percentage of those losses were covered by FCFD account transfers to the services.

FCFD account because the account balance had already reached its maximum using transferred unobligated balances.

Despite replenishing the account balance to the maximum amount for the purpose of covering additional losses, the FCFD transfers have not been made to fully offset losses in some years, further raising questions about the need to maintain the balance at the statutory cap of $970 million annually. Specifically, in 3 of the 6 years in which DOD transferred funds from the FCFD account to the services' MILPERS and O&M accounts, DOD did not use the FCFD account to fully cover the losses that the Air Force, Marine Corps, and Navy experienced. In fiscal year 2011, for example, DOD's transfers out of the FCFD account to these services covered about 88 percent of the reported MILPERS and O&M losses that these services had realized and projected to lose by the end of the fiscal year. In fiscal year 2012, FCFD transfers covered almost 72 percent of the MILPERS and O&M realized and projected losses reported by the Air Force, Marine Corps, and Navy, as of the end of the fiscal year. In fiscal year 2016, DOD FCFD transfers to these services covered approximately 55 percent of their reported MILPERS and O&M realized and projected losses by the end of the fiscal year.

The OUSD(C) official we spoke with stated that FCFD transfers to cover losses begin with a request from the services, and the OUSD(C) office and the services then coordinate on the final transfer amount. In addition, some service officials told us that they try to cover their losses using each service's available funding before reaching out for assistance from the FCFD account. Therefore, based on a service's ability to cover the loss, it may not always request an FCFD transfer to cover the full amount of realized and projected losses. Further, according to an OUSD(C) official, the timing of a service's request for an FCFD transfer may also affect any differences between the amount transferred and the actual losses experienced. Specifically, if a service requests a transfer early in the fiscal year based on realized and projected losses, actual losses experienced as of the end of the fiscal year may be greater than or less than the transfer amount due to foreign currency fluctuations.

Using transfers of unobligated balances, DOD has maintained its FCFD account balance at the maximum level allowed by statute because it has not analyzed realized and projected losses to determine what size account balance is necessary to meet the intended purpose of the account. In our prior work, we have developed key questions for evaluating federal account balances that agencies may use to identify the amount of the balance necessary to maintain agency or program operations.[38] Through examination of carryover balances, oversight of agencies' management of federal funds may be enhanced. Specifically, we reported that understanding an agency's processes for estimating and managing carryover balances provides information to assess how effectively agencies anticipate program needs, and ensure the most efficient use of resources. To estimate and manage carryover balances, agencies may consider such factors as future needs of the account, economic indicators, and historical data. If an agency does not have a robust strategy in place to manage carryover balances or is unable to adequately explain or support the reported carryover balance, then a more in-depth review is warranted. In those cases, balances may either fall too low to efficiently manage operations or rise to unnecessarily high levels, producing potential opportunities for those funds to be used more efficiently elsewhere.

When asked about maintaining the balance at a level necessary to cover losses, rather than at the maximum level allowed by statute, the OUSD(C) official indicated that the OUSD(C) takes a cautious approach and prefers to have the additional flexibility allowed by the higher balance. Further, the official stated that it would be difficult for DOD to attempt to base its unobligated balance transfers and the FCFD account balance on analysis and evaluation, given the unpredictable nature and constant volatility of foreign currency rates. Our guidelines on evaluating carryover balances acknowledge that external events beyond an agency's control can dramatically affect carryover balances. However, the challenges that are inherent in predicting foreign currency rates do not preclude DOD from conducting analysis to glean insight as to the appropriate size for the balance of the account and what potential opportunities for savings might exist. Specifically, our guidelines suggest that agencies would benefit from considering the sources and fiscal characteristics of an account with carryover balances. In this case, the FCFD account can receive funds from transfers of unobligated balances and realized foreign currency gains. In addition, DOD can make multiple transfers throughout a fiscal year and can transfer funds from the FCFD to and from the services' O&M and MILPERS accounts simultaneously, if necessary.

These characteristics of the FCFD account already provide the department with flexibility, indicating that DOD may be positioned to manage the FCFD balance in a more analytical manner based on any

[38] GAO-13-798.

projected losses. Without analyzing any realized or projected losses to determine what balance may be needed to meet the FCFD account's intended purpose, the account balance may be kept at a higher level than is necessary. As a result, although an exact amount is unknown, DOD may be maintaining balances in the FCFD account that are hundreds of millions of dollars higher than needed to cover any losses it has experienced, and these funds may have been more efficiently used in supporting other defense activities or returned to Treasury after the account is canceled by law.[39]

DOD Lacks Quality Data to Support Management of the FCFD Account

DOD prepares financial reports to monitor the status of its foreign currency funds, but some of DOD's financial reporting on foreign currency fluctuations for fiscal years 2009 through 2016 is incomplete and inaccurate. DOD's *Financial Management Regulation* establishes reporting requirements specifically for tracking all transactions that increase or decrease the FCFD.[40] In accordance with that guidance, the services provide data from their accounting systems to the Defense Finance and Accounting Service to generate reports that are used as a tool with which the services and OUSD(C) can monitor how they are expending funds appropriated for overseas expenditures. For O&M appropriations, the Foreign Currency Fluctuations, Defense (O&M) report provides data on foreign currency gains and losses for each service, by currency, including data on projected gains or losses for any remaining obligations that have not yet been disbursed at the time of the report. The Foreign Currency Fluctuations, Defense Report (MILPERS) provides similar information for the MILPERS appropriation.

We reviewed end-of-year Foreign Currency Fluctuations, Defense (O&M) and (MILPERS) reports for fiscal years 2009 through 2016 and found that some of the reporting for O&M was incomplete and inaccurate, which hampers the quality of information available to manage the FCFD account.[41] For instance, we found the following:

[39] Expired unobligated balances are canceled and returned to Treasury 5 fiscal years after expiration.

[40] DOD 7000.14-R, *Financial Management Regulation*, vol. 6A, chap. 7 (Feb. 2016).

[41] DOD's Appropriation Status by Fiscal Year Program and Subaccounts report (1002 report) presents budget execution data with respect to obligational authority in terms of the fiscal year programs executed at the budgetary subaccount and program level.

- **Incomplete data in the Foreign Currency Fluctuations Defense (O&M) reports:** In our review of the end-of-year Foreign Currency Fluctuations Defense (O&M) and (MILPERS) reports we observed several instances of incomplete data in the O&M reports, and these affect managers' ability to make sound decisions to manage foreign currency gains and losses. First, for the Navy, we found that the report data showed, for multiple currencies across fiscal years 2011 through 2016, values in the realized variance column, indicating that the service had experienced a gain or loss in a particular currency; however, the reports showed values of zero in other columns that are necessary for calculating the gain or loss. Second, the Air Force data for the Turkey Lira, in fiscal year 2012, showed a gain or loss without any data indicating what would have driven the gain or loss. Third, in one instance, Marine Corps data on obligations for fiscal year 2011 were missing from the end-of-year reports until 2014. Missing obligation data for these end-of-year reports indicate a limitation in using these reports for tracking actual gains and losses.
- **Inaccurate data in the Army's Foreign Currency Fluctuations Defense (O&M) reports:** The Army's Foreign Currency Fluctuation Defense (O&M) reports are inaccurate and cannot be used to reliably track gains or losses, and this hinders managers from making sound decisions regarding the Army's foreign currency gains and losses. The reports are inaccurate in that the Army's accounting system charges disbursements to the current fiscal year appropriation rather than to the fiscal year appropriation that incurred the obligation, as required by the *Financial Management Regulation.* According to officials from the Army Budget Office, the Army designed its General Fund Enterprise Business System (GFEBS) to record disbursements to the current fiscal year based on differing interpretations of a previous version of the Regulation. Because the Army is not recording its disbursements to the fiscal year appropriation as the other services are, Army data are inaccurate and cannot be used by the OUSD(C) official responsible for overseeing DOD's foreign currency program to track the Army's foreign currency transactions and maintain full visibility of DOD's overall gains and losses in a given fiscal year. Army Budget Office officials acknowledged that the Army will need to modify its system to record disbursements consistent with *Financial Management Regulation* guidance, but it has not developed a plan or timeline for doing so. Without accurate reporting of the Army's foreign currency transactions, DOD lacks information for tracking and helping to manage the Army's foreign currency gain and losses.

DOD's *Financial Management Regulation* specifies the data that must be included in the Foreign Currency Fluctuations Defense (O&M) and

(MILPERS) reports and the roles and responsibilities of the services as well as the Defense Finance and Accounting Service for ensuring the quality of those data. However, we identified data issues in our analysis that indicate that quality is inconsistent. For example, officials from the Navy stated that they had observed the incomplete data for some currencies and speculated that the incompleteness was attributable to data entry errors. Similarly, according to an OUSD(C) official, the Defense Finance and Accounting Service is notified when discrepancies are found in the reports and the Defense Finance and Accounting Service officials coordinate with the services to correct the data. However, neither Navy nor the Defense Finance and Accounting Service officials have corrected the data. Although DOD's *Financial Management Regulation* specifies the data that are to be included, as well as roles and responsibilities of the services and the Defense Finance and Accounting Service, it does not identify who is responsible for correcting erroneous or missing data. According to an OUSD(C) official, correcting reporting issues is an area that OUSD(C), the Defense Finance and Accounting Service, and the services can improve on, and they would benefit from guidance in the *Financial Management Regulation* that establishes the steps that should be taken for making such corrections.

Further, GAO's *Standards for Internal Control in the Federal Government* and the Federal Accounting Standards Advisory Board's *Handbook of Federal Accounting Standards and Other Pronouncements, as Amended,* both establish the importance of using reliable and complete information for making decisions. In addition, DOD's *Financial Management Regulation* establishes responsibilities for both the DOD components and the Defense Finance and Accounting Service to establish appropriate internal controls to ensure that financial reporting data are complete, accurate, and supportable, in order for managers to make sound decisions and exercise proper stewardship over these resources.

Effectively managing foreign currency gains and losses as well as any projected gains or losses for any remaining obligations that have not yet been liquidated through disbursement requires complete and accurate data. OUSD(C) and service officials recognize the importance of reliable data, as well as the need to take steps to improve the quality of the foreign currency gains and losses data. Without OUSD(C) establishing guidance to ensure that the Foreign Currency Fluctuation Defense (O&M) report data that tracks foreign currency gains and losses are complete, DOD and Congress do not have information to make sound decisions and exercise proper stewardship over resources due to foreign currency fluctuations. Furthermore, until the Army establishes a plan and timeline for modifying its system to record foreign currency disbursements in an accurate manner, the Army and DOD will lack quality information for tracking and helping to manage the Army's and DOD's foreign currency gain and losses.

Conclusions

Congress provides DOD with a significant amount of funding each year to purchase goods and services overseas and to pay service-members stationed abroad. DOD develops and can revise foreign currency budget rates to determine its funding needs and calculate any gains or losses that result from DOD's overseas expenditures. The Army has estimated potential cost savings that would result from more consistently selecting a more cost-effective foreign currency rate for making disbursements to liquidate its overseas O&M obligations. However, DOD has not fully determined whether additional cost-saving opportunities exist because the services have not reviewed the rates used for foreign currency disbursements. Absent a review of the foreign currency rates the services are using at disbursement, including whether cost-saving opportunities exist, by more consistently selecting cost-effective foreign currency rates, DOD risks paying more than would be required otherwise. Further, while DOD has used the FCFD account to cover losses that resulted from foreign currency fluctuations, it has not managed the FCFD account balance by basing the transfers of unobligated balances into the FCFD account on an analysis of realized and projected losses. Without basing its FCFD account balance on such analyses, DOD may be maintaining balances in the FCFD account that are hundreds of millions of dollars higher than needed to cover any losses it has experienced, and these amounts may have been more efficiently used supporting other defense activities or ultimately returned to Treasury, once expired. Moreover, DOD has not established guidance and other procedures to ensure that complete and accurate data are included in financial reporting on foreign currency funds, and this limits the quality of information available to effectively manage the FCFD account.

Recommendations for Executive Action

We are making the following four recommendations to DOD. The Secretary of Defense ensures that:

The Under Secretary of Defense (Comptroller), in coordination with the U.S. Army, Air Force, Navy, and Marine Corps, should conduct a review of the foreign currency rates used at disbursement to determine whether cost-saving opportunities exist by more consistently selecting cost-effective rates at disbursement. (Recommendation 1)

The Under Secretary of Defense (Comptroller) should analyze realized and projected losses to determine the necessary size of the FCFD account balance and use the results of this analysis as the basis for transfers of unobligated balances to the account. (Recommendation 2)

The Under Secretary of Defense (Comptroller) should revise the *Financial Management Regulation* to include guidance on ensuring that data are complete and accurate, including assignment of responsibility for correcting erroneous data in its Foreign Currency Fluctuations Defense (O&M) reports. (Recommendation 3)

The Secretary of the Army should develop a plan with timelines for implementing changes to its General Fund Enterprise Business System to accurately record its disbursements, consistent with DOD *Financial Management Regulation* guidance. (Recommendation 4)

Agency Comments and Our Evaluation

We provided a draft of this report to DOD for review and comment. In its written comments, reproduced in appendix II, DOD concurred with our first, third, and fourth recommendations and outlined its plan to address them. DOD partially concurred with our second recommendation that the Under Secretary of Defense (Comptroller) analyze realized and projected losses to determine the necessary size of the FCFD account balance and use the results of the analysis as the basis for transfers of unobligated balances to the account. DOD also provided technical comments, which we incorporated in the report, where appropriate.

In partially concurring with our second recommendation, DOD stated that projecting foreign currency gains or losses can be difficult given that foreign currency rates can be volatile due to various factors, such as trade balances, money supply, and national income, as well as arbitrary disturbances that affect foreign currency rates that cannot be predicted or forecasted, such as the departure of the United Kingdom from the European Union. DOD noted that because of the risk and volatility associated with foreign currency rates, the Congress established the FCFD account.

We agree that forecasting foreign currency rates is challenging due to market volatility and include examples in our report of the effect of foreign currency rate fluctuations on DOD's planned foreign currency obligations. Our report also describes the relationship between gains and losses and foreign currency fluctuations, and the movement of funds from the FCFD account to offset any losses. As our report also discusses, DOD calculates actual and projected losses due to foreign currency fluctuations and uses those projections as the basis, at least in part, for any transfers out of the FCFD account to cover losses experienced in the military services' O&M and MILPERS appropriations. However, our report also notes that DOD does not consider its calculations of actual and future projected losses when making transfers of unobligated O&M and MILPERS balances to replenish the FCFD account. Instead, since fiscal year 2012, DOD has kept the FCFD account balance at the maximum level allowed by statute by using unobligated balances before they are canceled and are no longer available to DOD, regardless of whether the funds were needed in the account to offset any projected losses.

DOD's comments also stated that projecting gains or losses for foreign currency to determine the size of the FCFD account opens the door to greater uncertainty and risk at a time when the department is working to rebuild readiness and implement the National Defense Strategy. Our report describes the characteristics of the FCFD account that provide DOD with flexibility to manage market volatility, thereby helping to address uncertainty and reduce risk. For example, DOD can make multiple transfers of funds to the FCFD account throughout a fiscal year in response to unforeseen foreign currency fluctuations. The FCFD account can also receive funds from transfers of actual foreign currency gains and/or unobligated balances. As we also noted, DOD made use of its authority to transfer expired unobligated MILPERS and O&M amounts into the FCFD account in the event that actual losses exceeded the projected amounts and additional transfers were deemed necessary.

We continue to believe that by analyzing actual and projected losses and basing the transfer of any unobligated balances on these losses, DOD would be better positioned to determine the size of the FCFD account balance that is necessary to meet its intended purpose. Further, such analyses would provide opportunities to more efficiently use unobligated balances for other defense activities or return the balances to Treasury.

We are sending copies of this report to the Secretary of Defense, the Under Secretary of Defense (Comptroller), the Secretary of the Army, the Secretary of the Navy, the Secretary of the Air Force, the Commandant of the Marine Corps, and appropriate congressional committees. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-5431 or russellc@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix III.

Cary B. Russell
Director
Defense Capabilities and Management

Appendix I: Scope and Methodology

To describe the Department of Defense's (DOD) revised foreign currency budget rates since 2009 and the relationship between the revised budget rates and DOD's projected Operation and Maintenance (O&M) and Military Personnel (MILPERS) funding needs, we reviewed DOD's foreign currency budget rates for the period of fiscal years 2009 through 2017, and we identified any years during which DOD revised the initial budget rates. We compared DOD's initial foreign currency budget rates and revised foreign currency budget rates with rates published by the U.S. Treasury Department (Treasury) for fiscal years 2009 through 2017. This period corresponded with data available to us on DOD's initial and revised rates and allowed for use of the most current data available, since DOD had not yet decided whether or not to revise the fiscal year 2018 budget rates, while we were conducting our audit work. We chose rates published by Treasury for this comparison because Treasury has the sole authority to establish for all foreign currencies or credits the exchange rates at which such currencies are to be reported by all agencies of the government.[1]

Because Treasury rates are issued quarterly, we averaged Treasury's first and second quarter rates for each currency and compared the Treasury average with DOD's initial budget rates. Similarly, we computed an average of the third and fourth quarter Treasury rates for each currency and compared them with the DOD initial or revised budget rates, where applicable. These comparisons are meant to show the difference between DOD's budget rates and Treasury rates for the first 6 months of the fiscal year, and the difference between DOD's revised exchange rates and Treasury rates for the last 6 months of the fiscal year. Further, we analyzed the extent to which DOD's budget rates were within 10 percent of Treasury rates during these same years. We chose 10 percent as the basis for our analysis because Treasury's guidance states that amendments to the quarterly rates will be published during the quarter to reflect significant changes in the quarterly data, such as rate changes of 10 percent or more.[2]

Additionally, to understand the effect that revising the budget rates had on DOD's O&M and MILPERS funding estimates and on potential gains or losses due to foreign currency fluctuations, we used a three-step approach. First, we identified the amount of O&M and MILPERS funds

[1] 22 U.S.C. § 2363(b).

[2] Department of Treasury, *Treasury Financial Manual*, vol. 1, part 2, § 3230.20(d) (2017).

DOD requested for each currency. We converted the U.S. Dollars requested to the total amount of foreign currency needed by multiplying the U.S. Dollars requested by DOD's initial budget rate. Second, we determined the total amount of U.S. Dollars required using the revised rates by dividing the total amount of foreign currency needed using DOD's initial budget rate by DOD's revised budget rate. We used this same approach to determine the total amount of U.S. Dollars required using the average Treasury rates. Third, we computed the differences in DOD's O&M and MILPERS foreign currency funding needs by subtracting the U.S. Dollars required to meet its foreign currency needs based on the average Treasury rates from the amounts required based on DOD's initial budget rates and DOD's revised budget rates, respectively. We discussed further with officials from the Office of the Under Secretary of Defense, Comptroller (OUSD(C)) the factors considered in revising the rates and whether those factors are communicated within and outside of the department.

To evaluate the extent to which DOD has taken steps to reduce costs in selecting foreign currency rates at which to make disbursements and determine whether opportunities exist to gain additional savings, we reviewed accounting standards and any guidelines that exist regarding disbursements and calculations of foreign currency gains and losses, such as DOD's *Financial Management Regulation 7000.14-R*, which calls for the use of prevailing foreign currency rates to make disbursements. We also discussed with agency officials how those guidelines are being carried out, and whether DOD or the services have developed guidance that instructs the services in selecting rates used for disbursements in foreign currencies. Additionally, we examined a non-generalizable selection of data for DOD disbursements made during the months June and July 2017 from Treasury's International Treasury Service (ITS.gov) system to determine which rates DOD used during this period and what savings might be achievable from using alternate rates. We chose data from those 2 months because it was the most recent data available on disbursements at the time Treasury provided the data for our review. Additionally, we discussed with officials from OUSD(C) and the services any analysis and ongoing efforts to transition to more cost-effective rates, including savings that may result.

To assess the extent to which DOD has effectively managed the Foreign Currency Fluctuations, Defense (FCFD) account to cover losses, and maintained quality information to manage these funds, we analyzed DOD data for fiscal years 2009 through 2016 on foreign currency gains and losses reported by each of the services as reported in their Foreign

Currency Fluctuation, Defense (O&M) and (MILPERS) reports; movements of funds between the FCFD account and the services' O&M and MILPERS accounts; and the end-of-year FCFD account balances. We chose this time period in order to capture years in which both gains and losses were experienced, and for which DOD had complete data on gains and losses, fund transfers, and end-of-year balances for the FCFD account. Because the Army charges disbursements to the current fiscal year appropriation instead of the fiscal year appropriation that incurred the obligation, we requested that the Army adjust its reported data on foreign currency gains and losses and provide information consistent with how the other services report them, and with DOD's *Financial Management Regulation*. However, the Army was unable to provide us with data that were consistent with what was provided by the other services at the time of our review. We, therefore, were unable to use Army data for purposes of comparison with data provided by the other services. We compared the end-of-year FCFD account balances and the use of the account with guidelines established in our prior work on the importance of examining unobligated balances.[3] Additionally, we reviewed and analyzed DOD financial reports on foreign currency gains or losses and compared the reports, including any identified discrepancies, against best practices and standards on accurate reporting and maintaining quality information, such as those in GAO's *Standards for Internal Control in the Federal Government,* and the Federal Accounting Standards Advisory Board's *Handbook of Federal Accounting Standards and Other Pronouncements, as Amended.*[4]

To determine the reliability of the data used in addressing these objectives, we analyzed DOD and Treasury foreign currency rates, data on DOD foreign currency disbursements, and DOD financial reporting data on foreign currency gains and losses to identify any missing or inaccurate information, and we discussed with agency officials any identified abnormalities and how the information was extracted from systems, when appropriate. We found the data to be sufficiently reliable for the purposes of our reporting objectives, with the exception of the financial reporting on financial gains and losses. Specifically, based on problems with the completeness and accuracy of DOD's financial

[3] GAO-13-798.

[4] GAO-14-704G and Federal Accounting Standards Advisory Board (FASAB), *FASAB Handbook of Federal Accounting Standards and Other Pronouncements, as Amended* (June 30, 2017).

reporting on foreign currency gains and losses, we found that these data were not sufficiently reliable for the purpose of computing exact totals for the gains and losses DOD experienced. However, because DOD uses these data as the basis for decisions related to management of the FCFD account, we included the data in our analysis to provide insight into the scope of gains and losses experienced. We also spoke with OUSD(C), military service, and Treasury officials regarding the process and systems used to input the reviewed data and generate the foreign currency reports we reviewed.

We conducted this performance audit from February 2017 to April 2018 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

MAR 2 2018

Mr. Matt Ullengren
Assistant Director, Defense Capabilities and Management
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Ullengren:

This is the Department of Defense (DoD) response to the GAO Draft Report GAO-18-221, "DEFENSE BUDGET: Actions Needed to Improve the Management of Foreign Currency Funds," dated February 16, 2018 (GAO Code 101680).

The Department is providing official written comments for inclusion in the report.

Sincerely,

Monique L. Dilworth
Director for Operations

Attachments

GAO DRAFT REPORT DATED FEBRUARY 16, 2018
GAO-18-221 (GAO CODE 101680)

"DEFENSE BUDGET: Actions Needed to Improve the Management of Foreign Currency Funds"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION

RECOMMENDATION 1: The GAO recommends that the Under Secretary of Defense (Comptroller), in coordination with the U.S. Army, Air Force, Navy, and Marine Corps, should conduct a review of the foreign currency rates used at disbursement to determine whether cost savings opportunities exist by more consistently selecting cost-effective rates at disbursement.

DoD RESPONSE: Concur. The Under Secretary of Defense (Comptroller) will work with the U.S. Army, Navy, Marine Corps, and Air Force and the Defense Finance and Accounting Service (DFAS) to determine a consistent rate for disbursement and ensure all Components are utilizing the most cost-effective rates while balancing mission requirements and time required to process transactions. It should be noted, as included in the technical comments, that using one disbursement rate over another does not guarantee cost savings due to foreign currency fluctuations.

RECOMMENDATION 2: The GAO recommends that the Under Secretary of Defense (Comptroller) should analyze realized and projected losses to determine the necessary size of the FCFD account balance and use the results of the analysis as the basis for transfers of unobligated balances to the account.

DoD RESPONSE: Partially concur. If foreign currency rates were not volatile, projecting foreign currency gains or losses to determine the size of the Foreign Currency Fluctuation, Defense account would be possible. However, as history proves, projecting rates is not always a sound business practice not only for the Department of Defense, but for commercial industry. Foreign currency rates are very difficult, if not impossible, to predict over time due to several factors, e.g., trade balances, money supply, national income, etc. Also, arbitrary disturbances that affect foreign currency rates cannot be predicted or forecasted, e.g., Greek Financial Crisis or the departure of the United Kingdom from the European Union. Because of the risk and volatility associated with foreign currency rates, the Congress established the Foreign Currency Fluctuation, Defense account. Forecasting projected gains or losses to determine the size of this account may not be very effective. Using history as a predictor for foreign currency rates may present challenges as displayed in the example below.

As an example, in FY 2017, the average Euro exchange rates as published in the Wall Street Journal were 0.9069 as compared to the U.S. dollar while the Department's FY 2018 budgeted Euro exchange rate is 0.9329 as compared to the U.S. dollar. As of the beginning of FY 2018, the difference between the FY 2017 average rate and the FY 2018 budgeted rate was a potential loss of -2.8 percent or $-81 million of the Department's planned foreign currency obligations in FY 2018. However, as of early March 2018, the average Euro exchange rates as published in the

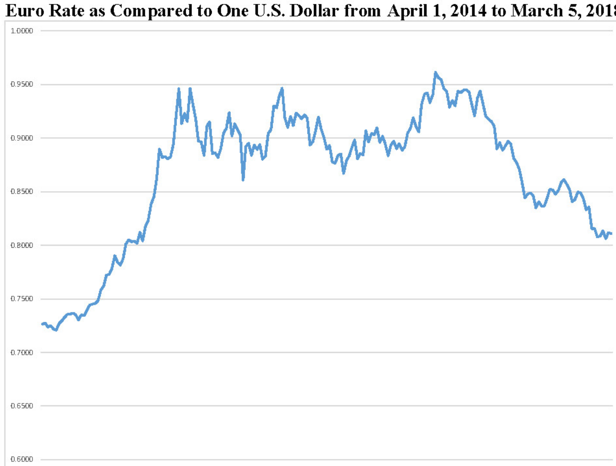
Wall Street Journal are 0.8354 as compared to the U.S. dollar while the Department's FY 2018 budgeted Euro exchange rate is 0.9329 as compared to the U.S. dollar. As of the beginning of March 2018, the difference between the FY 2018 average rate and the FY 2018 budgeted rates represents a potential loss of -10.5 percent or $-328 million of the Department's planned foreign currency obligations in FY 2018. Over the course of 5 months, the Euro exchange rate has improved as compared to the U.S. dollar resulting in additional U.S. dollars required if converting to Euros for disbursement.

Euro Rate as Compared to One U.S. Dollar

FY 2017 Average Euro Rate	PB 2018 Euro Rate	% Delta	FY 2018 Average Euro Rate as of March 5, 2018	PB 2018 Euro Rate	% Delta
0.9069	0.9329	-2.8%	0.8354	0.9329	-10.5%

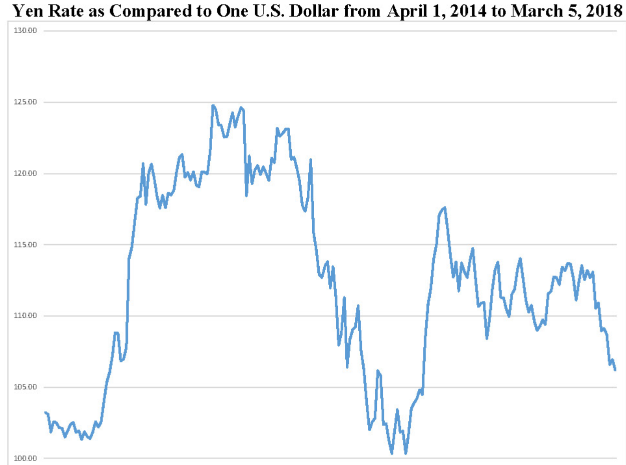
Projecting gains or losses for foreign currency to determine the size of the Foreign Currency Fluctuations, Defense account opens the door to greater uncertainty and risk at a time when the Department is working to rebuild readiness and implement the National Defense Strategy. The tables below provide the foreign currency fluctuations from April 1, 2014 to March 5, 2018 for the Euro and Yen as compared to the U.S. dollar.

Euro Rate as Compared to One U.S. Dollar from April 1, 2014 to March 5, 2018



2

Yen Rate as Compared to One U.S. Dollar from April 1, 2014 to March 5, 2018



RECOMMENDATION 3: The GAO recommends that the Under Secretary of Defense (Comptroller) should revise the *Financial Management Regulation* to include guidance on ensuring data is complete and accurate, including assignment of responsibility for correcting erroneous data in its Foreign Currency Fluctuation Defense (O&M) reports.

DoD RESPONSE: Concur. The Under Secretary of Defense (Comptroller) will work with the U.S. Army, Navy, Marine Corps, and Air Force, the Defense Travel Management Office (DTMO), and the Defense Finance and Accounting Service (DFAS) to revise Volume 6A, Chapter 7 of the DoD Financial Management Regulation to ensure reporting is complete and accurate and to assign responsibilities to the Components for data correction.

RECOMMENDATION 4: The GAO recommends that the Secretary of the Army should develop a plan with timelines for implementing changes to its General Fund Enterprise Business System to accurately record its disbursements, consistent with DoD *Financial Management Regulation* guidance.

DoD RESPONSE: Concur. The Secretary of the Army is poised to develop a Systems Change Request (SCR) to accurately record disbursements in the General Fund Enterprise Business System (GFEBS) consistent with the Defense Financial Management Regulation. This SCR is pending the revision of Volume 6A, Chapter 7 of the DoD Financial Management Regulation as it applies to foreign currency fluctuations. Upon submission and prioritization of the final SCR to GFEBS, it is estimated that the updated functionality will become available in approximately nine to twelve months.

3

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Cary B. Russell, (202)512-5431 or russellc@gao.gov

Staff Acknowledgments:

In addition to the contact named above, Matt Ullengren, Assistant Director; and Tulsi Bhojwani, Justin Bolivar, Carol Bray, Amie Lesser, Kelly Liptan, Felicia Lopez, Leah Nash, Randy Neice, Jacqueline McColl, Mike Silver, Roger Stoltz, Susan Tindall, John Trubey, Elaine Vaurio, and Cheryl Weissman made key contributions to this report.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's website (https://www.gao.gov). Each weekday afternoon, GAO posts on its website newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to https://www.gao.gov and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's website, https://www.gao.gov/ordering.htm.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

Connect with GAO

Connect with GAO on Facebook, Flickr, Twitter, and YouTube.
Subscribe to our RSS Feeds or E-mail Updates. Listen to our Podcasts.
Visit GAO on the web at https://www.gao.gov.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Website: https://www.gao.gov/fraudnet/fraudnet.htm

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Orice Williams Brown, Managing Director, WilliamsO@gao.gov, (202) 512-4400, U.S. Government Accountability Office, 441 G Street NW, Room 7125, Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

Strategic Planning and External Liaison

James-Christian Blockwood, Managing Director, spel@gao.gov, (202) 512-4707
U.S. Government Accountability Office, 441 G Street NW, Room 7814, Washington, DC 20548