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REPORT BY THE U.S.

General Accounting Office

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Weaknesses Persist In Defense Overseas Cash Management Program

Improvements continue to be needed in the way the Department of Defense operates its overseas cash management program. More economical and efficient means of providing dollars to overseas military installations and banks and better program monitoring and cash controls would reduce the excess cash which remains a problem despite recommendations made in two previous GAO reports on this subject.

Recommended program improvements would make sufficient funds available to enable the Treasury Department to reduce its borrowing costs by an estimated $1 million annually.

UNITED STATES GENERAL ACCOUNTING OFFICE

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FGMSD-79-6

JANUARY 10, 1979

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-159797

The Honorable Harold Brown
The Secretary of Defense

Dear Mr. Secretary:

The Department of Defense continues to experience problems in managing its cash overseas. In this report (our third on the subject 1/), we show the need for (1) improving cash controls and strengthening the monitoring of cash purchases in Europe, (2) refining the cash replenishment process in the Far East, and (3) reducing excess cash balances. The contents of this report were discussed with Defense and Treasury officials and, where appropriate, their comments were considered.

Our recommendations to you can be found on pages 8, 14, and 20. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving copies of these statements.

1/Two previous reports were dated March 21, 1974 (B-159797) and March 17, 1978, (FGMSD-78-20).

Since the President recently directed that a comprehensive review be made of Federal cash management policies and practices, we are sending copies of this report to the President's reorganization staff involved in reviewing Federal cash management. Copies are also being sent to the Director, Office of Management and Budget; the Chairmen, House Committee on Government Operations, Senate Committee on Governmental Affairs, and House and Senate Committees on Appropriations and Armed Services; the Secretary of the Treasury; and the Secretaries of the Army and Air Force.

Sincerely yours,

D L Scantlebury

D. L. Scantlebury
Director

REPORT TO THE
SECRETARY OF DEFENSE

WEAKNESSES PERSIST IN DEFENSE OVERSEAS CASH MANAGEMENT PROGRAM

D I G E S T

The Department of Defense is not effectively managing its cash holdings overseas, and as a result, the Federal Government is incurring unnecessary interest costs. Two previous GAO reports disclosed large excess cash balances held by Defense activities. (See p. 1.)

GAO recognizes that Defense organizations have little incentive to improve the management of cash since the Treasury bears the interest cost for public borrowings. Nonetheless, all Government employees have a responsibility to conserve Government funds. Defense employees should attempt to keep overseas cash holdings at minimum levels regardless of whether there are incentives to do so.

GAO's analysis revealed about $6 million in excess cash onhand in the Far East because cash replenishment techniques are cumbersome and inefficient. (See pp. 3 and 15.)

In Europe, the Army did not know daily the amount of dollars available to meet payday and other disbursement needs. Lacking this information, the Army could not determine whether its agent, the American Express International Banking Corporation, was buying the right amount of dollars at the right time from European banking institutions. (See p. 10.)

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Premature withdrawals from the Treasury and excess cash holdings, to the extent they involve additional borrowing by the Treasury, generate unnecessary interest costs. GAO estimated that Defense cash management program improvements could reduce Government interest costs by about $1 million annually.

The President has recognized that savings can be attained through improved cash management and has directed his reorganization staff to study Federal Government cash management policies, practices, and organization. The House Committee on Appropriations has instructed Defense to provide a detailed report of actions taken to reduce excess cash balances. And the Treasury recently issued guidelines for establishing effective cash management practices.

Defense has formulated a cash management review program, and a number of actions designed to improve the Department's cash management are being planned.

GAO is making several recommendations to the Secretary of Defense designed to

--reduce excess cash balances,

--improve cash replenishment procedures, and

--generally strengthen cash management at overseas activities.

GAO also is recommending that the Secretary of Defense assign responsibility to the Assistant Secretary of Defense (Comptroller) for devising a system of incentives to encourage effective and efficient cash management in his Department. (See pp. 8, 14, and 20.)

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CHAPTER 1

INTRODUCTION

At overseas installations the Department of Defense maintains cash (1) on hand at military central funding offices and at finance and accounting offices and (2) on deposit at military banking facilities operated by commercial concerns. The military banking facilities have cash custody accounts belonging to military central funding offices. These accounts are used to provide cash to military finance and accounting offices in the vicinity of each banking facility. As of June 30, 1978, overseas disbursing officers were accountable for about $282 million.

To provide the overseas banking program with sufficient U.S. currency to support troops and installations overseas, over $24 million a month is made available through either direct shipment from Federal Reserve Banks or recoupment of dollars from foreign banks.

The Air Force is in charge of overall direction and control of cash management in the Far East. The Army has this management responsibility in Europe. In the Far East, cash is primarily provided by shipment from the Federal Reserve DLG00573 Bank of San Francisco to the Central Funding Office, Okinawa, and from there to military banks and subfunding offices. In DLG00574 Europe, cash is primarily provided by recoupment, a process whereby a military banking organization purchases dollars from European money markets. The organization distributes the recouped dollars to military banks and finance offices.

PREVIOUS GAO REPORTS REGARDING CASH MANAGEMENT

Within the past 5 years we have issued two reports to the Secretary of Defense on Defense cash management--"Savings in Interest Costs Realized by Reducing Cash-on-Hand at Overseas Activities" (B-159797, Mar. 21, 1974) and "Cash Management Policy and Procedures Need Improvement" (FGMSD-78-20, Mar. 17, 1978). In both, we reported that Defense could save millions of dollars annually in interest costs by returning excess cash to the Department of the Treasury. Excess cash holdings, to the extent that they involve additional borrowings by the Treasury, generate unnecessary interest costs.

In reference to our report issued in March 1978, the House Committee on Appropriations informed Defense it

"* * * expects a full and complete report * * * on actions taken and procedures changed in conjunction with the fiscal year 1980 budget submission that will result in significant decreases in cash held by military service finance and accounting activities."

PRESIDENT RECOGNIZES NEED FOR IMPROVED CASH MANAGEMENT

The President has recognized the need for government-wide improvement in cash management. On November 14, 1977, he directed his reorganization staff and the Department of the Treasury "to conduct a comprehensive review of cash management policies, practices and organization throughout the Federal government." The Treasury, on March 31, 1978, released guidelines

"* * * for use in establishing effective cash management practices for Government organizations in order to maximize cash balances available to the Treasury for investment and to avoid unnecessary borrowing to finance Federal programs."

DEFENSE PLANS TO STRENGTHEN CASH MANAGEMENT

The Department of Defense made a review of its cash management policies, practices, and organization as requested by the President's Federal Cash Management Project staff. A report to the Project's executive director, dated September 6, 1978, included a number of actions which were planned for implementation. For example, the military services plan to intensify quarterly reviews of cash balances and plan to incorporate new cash management guidelines from the Treasury in their regulations. Also, Defense audit organizations plan to emphasize cash management requirements in their scheduled audits.

CHAPTER 2

CASH REPLENISHMENT TECHNIQUES IN

THE FAR EAST ARE INEFFICIENT

Present cash replenishment techniques in the Far East are cumbersome and inefficient and result in millions of dollars being prematurely removed each month from the Treasury's account at the Federal Reserve Bank of San Francisco. Whenever the Treasury Department borrows funds to finance premature disbursements, unnecessary interest costs are incurred. Altering procedures to allow replenishment twice a month instead of monthly, delivering directly to activities requiring the cash, reducing cash ordering leadtime, and consolidating and halving reserves held to meet unforeseen needs, could reduce the Treasury's borrowing costs by about $650,000 annually.

CURRENT REPLENISHMENT PROCEDURES

The Pacific Central Funding Office in Okinawa is responsible for replenishing the U.S. currency requirements of Defense activities in the Far East. Located at Kadena Air Base and under the supervision of Headquarters Pacific Air Forces in Hawaii, the Central Funding Office supports subfunding offices in Korea, Japan, the Philippines, and Taiwan through monthly currency shipments from the Federal Reserve Bank of San Francisco. From January through November 1977, about $153.5 million in U.S. currency was supplied to Defense activities--an average of about $14 million a month.

Generally, the cash replenishment system works as follows:

--Subfunding offices report currency requirements to the Central Funding Office on the 10th of each month preceding actual receipt of cash.

--The Central Funding Office then forwards a consolidated cash order and Treasury check to the Federal Reserve Bank of San Francisco.

--During the first week of the month two Central Funding Office couriers travel from Okinawa to Travis Air Force Base, California, to obtain the ordered currency.

--The currency is transported in a sealed metal container via regularly scheduled military aircraft to Okinawa, accompanied by the two couriers.

--In Okinawa the currency is broken into bundles by the Central Funding Office for transfer by courier later in the month to subfunding offices.

The major exception to the above system is that Clark Air Base in the Philippines satisfies its own cash requirements through purchase (recoupment) of dollars from the Central Bank of the Philippines. The Central Bank receives a credit to its account at the San Francisco Federal Reserve Bank for the amount of dollars recouped by Clark.

CHANGING THE REPLENISHMENT METHOD WILL SAVE MONEY

Savings of over $700,000 annually are possible if:

--U.S. currency is replenished twice monthly instead of monthly (estimated interest savings: $245,000).

--U.S. currency shipments are made directly to subfunding offices, thereby eliminating the need for the Central Funding Office (estimated staff savings: $83,000).

--The time between the actual receipt of cash and the time it is needed is reduced (estimated interest savings: $184,000).

--Safety reserves now maintained at separate Defense activities are consolidated and halved to reflect more frequent replenishment (estimated interest savings: $212,000).

Twice monthly replenishment from the Federal Reserve Bank would reduce interest costs

If U.S. currency requirements in the Far East are replenished twice monthly instead of monthly, the amount of each cash withdrawal from the Treasury's account at the Federal Reserve can be approximately halved. This would reduce the length of time cash is idle, thereby reducing unnecessary interest costs to the Government. Monthly cash replenishment has averaged about $14 million from January through November 1977. If $7 million is acquired one-half month later, annual interest savings would approximate $245,000 ($7 million for 15 days each month at 7 percent, the approximate June 1978 Treasury borrowing rate).

Military officials in Hawaii and at subfunding offices in the Philippines and Korea generally agreed that cash should be replenished twice monthly.

Some Air Force officials at Okinawa, however, told us that they were against more frequent cash replenishment because it would mean increased travel for the couriers and their morale would be adversely affected. At the present time, couriers are assigned exclusively from Kadena Air Force Base, Okinawa. If a morale problem did occur, it could be alleviated by either rotating courier duties among personnel assigned to the four subfunding offices or increasing the number of couriers assigned to Kadena. The Air Force could also ship cash twice monthly via the U.S. Postal Service.

Although adoption of any of the above alternatives would result in additional expense to the Air Force, the Government, as a whole, would still benefit through large reductions in interest cost. An Air Force official informed us that the Air Force would consider how much additional expense (if any) it would incur to effect a net savings on Government interest cost.

Another alternative would be for the Air Force to eliminate altogether the requirement for couriers and sanction unaccompanied cash shipments. Couriers are used by accountable finance officers primarily as a precaution against their being held personally liable for cash losses or shortages.

Military officials in Hawaii said that couriers add little to existing security because cash travels on military aircraft, lands at protected military flight lines, and is met by authorized finance officers. Ground security forces also provide security at stopover points. Cash is transported in sealed, metal containers which weigh enough to discourage all but the most concerted theft attempt.

Moreover, in a memorandum to the military departments dated July 30, 1976, the Assistant Secretary of Defense, Comptroller stated that the Military Airlift Command could accept responsibility for currency shipments. He further stated that such shipments may be made to, from, and between overseas locations.

The Air Force can develop procedures to protect both the cash shipments and the accountable finance officers. We discussed such a system with Air Force and Treasury officials whereby cash could be shipped without couriers, yet offering protection to accountable finance officers from cash loss or shortage. The general details of that system follow.

At present, cash orders are filled at the Federal Reserve Bank of San Francisco. The procedures used by the Bank to ensure that sealed cash containers actually contain the cash ordered meet the Treasury's standards. Under an unaccompanied system, as the sealed cash order proceeds to the destination subfunding office, it could be transferred between responsible officers on board Military Airlift Command flights, without further count and verification, as long as the Federal Reserve seals on the cash containers remain intact. As responsibility passes, signatures could be exchanged stating that the seals are intact. At the destination a finance officer would break the seals and verify the amount of cash in the presence of another authorized person.

A responsible Treasury official said that cash shipments need not be accompanied by couriers. With regard to the potential personal liability of the accountable finance officer in the event of loss or shortage of cash, she said that if the Air Force developed and followed proper procedures to safeguard the shipment of cash, relief from loss or shortage would be available under the Government Loss in Shipment Act (40 U.S.C. 721). To ensure this, she said that the Air Force should submit proposed procedures and signatory forms to the Treasury for approval.

Direct delivery to subfunding offices would reduce interest and staffing costs

Unnecessary interest costs can be avoided if cash is obtained as close as possible to the time needed for disbursement. Peak cash needs for military activities correspond with mid-month and end-of-month payrolls. However, during the period July through November 1977, cash shipments arrived at the Central Funding Office, Okinawa, about the fifth of each month, due in part to the time needed to count, package, and redistribute cash to subfunding offices. With direct deliveries to subfunding offices, the time required by the Central Funding Office to handle the cash would be eliminated and the offices could obtain dollars closer to the time they need them for disbursement. We estimate that, with direct delivery, cash could be "bought" from the Federal Reserve Bank a week later than it now is and still be delivered to subfunding offices in sufficient time. If cash shipments were delayed by 1 week in the Far East, annual interest savings would be about $184,000.

Direct delivery to subfunding offices would eliminate the need for the Central Funding Office as there would be no need to redistribute cash and the subfunding offices could submit cash requirements directly to the Federal Reserve.

The Central Funding Office is authorized a captain, a master sergeant, and two staff sergeants. Standard military compensation cost computed by Defense for these grades totals $82,579 a year.

Safety reserves could be consolidated and halved

The Central Funding Office and subfunding offices in the Philippines maintain separate safety or contingency reserves intended to meet unforeseen cash needs above normal requirements. The following table shows contingency reserves identified during our review.

Cash Contingency Reserves in the Far East

Location (note a)	Amount (millions)
Central Funding Office (Okinawa)	$1.76
✓ Subic Bay Naval Base (the Philippines)	4.00
✓ Clark Air Base (the Philippines)	.30
Total	$6.06

a/Eighth U.S. Army activities in Korea recently cancelled a $1 million evacuation fund and have no other formally defined contingency fund.

Under the present system, contingency funds are projected to meet unforeseen cash needs until the next cash replenishment, or 1 month. Current military guidance does not establish criteria for the location or amount of contingency funds allowable. In the absence of clear criteria, the subfunding offices determine and hold their own contingency reserve. Since it is highly unlikely that disbursing activities would simultaneously have large unforeseen cash needs, consolidating the funds now held by the subfunding offices should reduce the total amount needed.

Okinawa would appear to be a reasonable location for the consolidated safety reserve because Kadena Air Base has a satisfactory storage capability for currency, and the central location of Okinawa with its large number of regularly scheduled military flights would allow response to emergency cash requests within 48 to 72 hours. Subfunding officials stated that most, if not all, emergency needs would be known that far in advance.

Consolidating the reserve in Okinawa and replenishing cash needs twice monthly should allow the Air Force to halve contingency reserves. A reduction of about $3.03 million will yield a $212,000 annual interest savings to the Government.

TWICE MONTHLY RECOUPMENT COULD REDUCE COSTS

Twice monthly recoupment of U.S. currency may be more desirable than direct shipment provided an economical and reliable source of usable currency can be obtained. Dollars available through recoupment are currently insufficient to meet all Defense requirements in the Far East. However, twice monthly recoupment can meet part of Defense cash requirements in the Philippines and Korea.

As noted earlier, Clark Air Base in the Philippines began recouping all its U.S. currency needs from the Central Bank of the Philippines in July 1977, and in December 1977 planned to begin recouping twice monthly. In Korea, up to $1.5 million was reportedly available from the Korea Exchange Bank. Army and military banking officials had made limited use of this source, although the Exchange Bank had agreed to pay a 0.1 percent premium to sell its excess dollars to Defense activities. At our suggestion, Army officials agreed to consider further recoupment. If one-half month's requirement could be obtained each month, one of two monthly deliveries from the Federal Reserve Bank could be eliminated in the future.

In contrast to the Philippines and Korea, recoupment in Japan does not appear to be cost effective. Japanese banks have stated that Defense would have to pay a premium up to 1.25 percent to buy dollars locally--over $12,000 per $1 million. Current replenishment procedures are more economical.

CONCLUSION

The Department of Defense can save the Government substantial interest costs by changing its method of cash replenishment to military installations in the Far East.

RECOMMENDATIONS

We recommend that the Secretary of Defense instruct the Secretary of the Air Force to develop and implement the procedures necessary to:

--Institute twice monthly replenishment of Defense Far East cash needs.

--Initiate direct cash deliveries to subfunding offices.

--Minimize the elapsed time between the receipt of cash and when it is needed.

--Consolidate cash reserves at a single location.

--Use twice monthly recoupment procedures in lieu of direct delivery where it is economical and feasible to do so.

Further, we suggest that the Secretary of the Air Force consider the feasibility of eliminating the requirement for couriers to accompany cash shipments.

CHAPTER 3

NEED TO IMPROVE CASH

REPLENISHMENT CONTROLS IN EUROPE

The Army, which has the primary responsibility for cash management in Europe, is not effectively managing its European cash resources. Its cash management controls and monitoring efforts were insufficient to ensure that the dollars in military banking facilities and finance and accounting offices were not in excess of need. Because it did not know daily the amount of dollars available to meet payrolls and other financial obligations, the Army could not determine whether the right amount of dollars was being purchased at the right time from European banking institutions.

HOW THE RECOUPMENT PROCESS WORKS IN EUROPE

The primary means of replenishing U.S. currency in Europe is through the recoupment process. Approximately $10 million is recouped each month on behalf of the United States by officials of the American Express International Banking Corporation.

The $10 million acquired monthly on behalf of the Army is added to the military banking system to offset (1) dollars spent by members of the military community on the European economy, (2) dollars taken from Europe by individuals, and (3) the removal of large denomination bills and currency unfit for circulation. These dollars are replaced to meet payday and other disbursement needs.

Dollars are replenished in Europe on an as-needed basis, as determined by officials of American Express International Banking Corporation, the larger of the two organizations providing military banking services. Basically, dollars are purchased (recouped) from the Zurich, Switzerland money market.

Early each month an American Express official, having determined how many dollars are needed and when, arranges transactions with Zurich bankers and Bundesbank (the German Central Bank) officials, agreeing on the face value of dollars and Deutsche marks (German currency) to be purchased and prices to be paid. These transactions guarantee a profit to the Army, in the form of excess Deutsche marks, because the arrangements made with Zurich bankers are to pay them fewer Deutsche marks (for the same amount of U.S.

dollars) than were purchased from the Bundesbank with the U.S. Treasury check. The American Express official informally notifies responsible Army officials, who routinely approve the transactions when assured of their profitability.

Specifically, recoupment works as follows. During the month, in accordance with the recoupment transaction agreements, the American Express official requests and receives Treasury checks from one of the military finance offices. The checks are used to purchase Deutsche marks from the Bundesbank. The Deutsche marks are placed in an interest-earning account until transferred later in the month to the Zurich bankers in exchange for dollars, which are then delivered to the American Express military bank headquartered in West Germany.

The principle that underlies successful recoupment is that more Deutsche marks per dollar can be purchased early in the month from the Bundesbank than will be needed when exchanged with Zurich bankers for a like amount of dollars toward the end of the month (based on the agreements made earlier in the month). This is predicated on the value of the dollar decreasing against the Deutsche mark. When this happens, as it did during most of 1977, the excess Deutsche marks remaining after the transactions are completed represent profit. In effect, these transactions are forward purchase agreements; thus, they are not speculative in nature.

CASH CONTROLS ARE INSUFFICIENT

Generally, the Army has insufficient knowledge of total available U.S. cash in Europe. In this respect, responsible officials in the Army's Finance and Accounting Office do not know daily the total amount of dollars in the system (military banks and finance and accounting offices) available to meet operating needs.

Army officials received daily reports of transactions and cash balances from the military banks, but we were told this data was rarely used to monitor or manage cash balances. For instance, while the reports occasionally showed large balances of currency unfit for circulation and total cash onhand in excess of the authorized limit, the Army rarely contacted military banks to reduce those balances.

Neither Army nor military banking officials received daily reports of transactions and cash balances from military finance and accounting offices. Since dollars flow freely and frequently between military banks and military finance and accounting offices, the lack of this information meant that responsible officials did not know the total dollars available to meet financial obligations. Consequently, officials were not able to determine whether cash onhand was in excess of need.

We did not determine the adequacy of cash balances during this review. However, we noted in our March 17, 1978, report (FGMSD-78-20) that we and the Army Audit Agency had found numerous instances of excess cash at military banks and finance and accounting offices amounting to about $35.5 million.

Without complete knowledge of the cash that is available, officials cannot identify excess cash and take the actions necessary to eliminate it, thus reducing Treasury interest costs. Officials also cannot determine whether, and to what extent, cash should be replenished.

ARMY NEEDS TO STRENGTHEN REPLENISHMENT CONTROLS AND MONITORING EFFORTS

Recoupment decisions, as well as recoupment transactions, were made by American Express officials without adequate monitoring by the Army. As noted above, each month American Express decided how much and when to recoup and informed the Army of the results of the transactions.

American Express officials said that recoupment was profitable for the United States in 1977. (Army officials confirmed this but were unable to provide details.) The profit, including interest earned on Deutsche marks, accrued to the Army. As noted earlier, American Express requested and received Treasury checks from a military finance and accounting office and used them to purchase Deutsche marks which were placed in an interest-earning account until used to purchase dollars.

The Treasury, to the extent it borrows funds to finance disbursements, pays a generally much higher interest rate on borrowed funds than the rate earned on the Deutsche marks. Excessive or premature disbursements cause the Treasury to incur a needless expense.

Army officials, because they did not know the total dollars available in the banking system, were in no position to determine the amount to be recouped. Further, they did not (1) monitor transactions to assure conformance with the informally approved plan for recoupment or (2) inform the finance office responsible for the issuance of Treasury checks to American Express of the amount of the approved plan.

Thus, responsible Army officials did not know whether, and to what extent, cash needed to be replenished, whether the monthly recoupment plan was implemented as approved, whether the results as reported by American Express were accurate, or whether the Treasury checks received by American Express from the military finance office were correct in amount and timely as to disbursement.

If dollars are recouped prematurely, or in excess of need, the Treasury incurs unnecessary interest expense. This interest expense may exceed the profit made on recoupment. The Army does not receive the information necessary to determine this, and because of its lack of program oversight and control, the Army cannot properly exercise its cash management responsibility.

In addition, lack of the program information noted above prevents the Army from determining whether recoupment is a more cost beneficial method of replenishing dollars than direct cash shipments from the United States.

Providing dollars in Europe by recoupment is advantageous to the U.S. Government as long as it is profitable. It is profitable as long as the gains from recoupment transactions, together with the interest earned on the Deutsche marks held awaiting exchange for U.S. dollars, exceed the interest expense incurred by the Treasury between the time of issuance of the Treasury checks used to purchase Deutsche marks and their exchange for U.S. dollars.

This was the case during most of 1977, as the dollar declined in value against the Deutsche mark, and the Deutsche mark interest rate stayed close to the prevailing U.S. Treasury borrowing rate.

Economic forces, however, are not stable. Should the dollar strengthen in value, and should the gap between interest rates widen, recoupment would be either less profitable or perhaps not profitable.

The alternative to recoupment is to ship dollars directly from the United States. We asked Army and American Express officials if contingency procedures had been developed to ship needed dollars directly to Europe from the Federal Reserve Bank of New York. We were told by these officials that no such procedures existed.

CONCLUSIONS

The Army is not adequately managing cash in the military banking system in Europe. This responsibility has been assumed by commercial bankers operating military banking facilities.

Defense controls and program monitoring of total cash in Europe and the recoupment process are not adequate to assure that

--excess dollars are not being retained,

--only dollars actually needed are recouped,

--Treasury checks drawn to finance recoupment are neither excessive nor prematurely disbursed,

--recoupment transactions are made in accordance with the informally approved plan, and

--recoupment can be determined to be the most beneficial replenishment technique.

RECOMMENDATIONS

We recommend that the Secretary of Defense instruct the Secretary of the Army to:

--Develop cash management systems which will allow responsible officials to (1) track the daily amount of U.S. cash in the military banking system and (2) determine whether cash onhand exceeds needs.

--Develop and implement the procedures necessary to closely control and monitor recoupment program transactions and results to ensure that only dollars actually needed are recouped, that Tréasury checks drawn to finance recoupment are neither excessive nor prematurely disbursed, and that recoupment transactions and results are consistent with the approved plan.

--Develop data to determine on an ongoing basis the most beneficial cash replenishment technique, and to develop contingency procedures for shipping cash directly to Europe from the Federal Reserve Bank of New York.

CHAPTER 4

EXCESS CASH CONTINUES TO BE MAINTAINED IN THE FAR EAST

Within the past 5 years, we have twice reported that Defense disbursing activities were maintaining excessive cash balances. Defense officials acknowledged that excess cash was being maintained and, in certain instances, took corrective actions. Still, we found that subfunding offices in the Far East had $6 million in excess of needed average daily cash balances. Defense can save the Treasury about $345,000 annually in interest costs by eliminating the excess cash.

The underlying reason that excess cash is maintained is that since the Treasury bears the interest cost for public borrowings, Defense organizations have little incentive to improve cash management.

EXCESS CASH BALANCES AT SUBFUNDING OFFICES

Cash acquired in advance or in excess of need generates an unnecessary interest burden to the U.S. Treasury. It is to the Government's advantage for Defense activities to limit onhand cash balances to the minimum necessary to meet immediate requirements and allow for emergency situations.

Defense disbursing activities are authorized to hold cash onhand up to amounts approved by parent commands. In justifying cash authorization levels, the disbursing activities are instructed to accurately determine cash requirements to avoid unnecessary interest costs to the Treasury. However, based on a review of cash requirements at subfunding offices in the Philippines and Korea, we believe ceilings established by cash authorizations did not preclude excess cash balances.

We compared actual average daily balances with optimum average daily balances (after adjusting for cash reductions expected from twice monthly replenishment). Our calculation of optimum average balances was based on past cash requirements at each subfunding office.

As shown in the following table, average daily balances at three subfunding offices could be reduced by about $6 million.

Comparison of Onhand with Optimum Cash Balances

Location	Current average (note a)	Optimum average (note b)	Excess	Interest savings if eliminated (note c)
	------------(000 omitted)------------			
Subic Bay Naval Base (the Philippines)	$5,468	$1,090	$4,378	$ 306
Clark Air Base (the Philippines)	347	133	214	15
Eighth U.S. Army (Korea)	2,885	1,470	1,415	99
Consolidated Contingency	-	-	-	d/ (75)
Total	$8,700	$2,693	$6,007	$ 345

a/Adjusted to reflect effect of twice monthly replenishment.

b/Based on historical requirements.

c/Based on 7-percent interest rate.

d/Because contingency reserves were not provided for in our calculation of optimum average daily balances, the interest costs associated with an estimated consolidated contingency reserve were subtracted from savings that would result if excess balances were eliminated.

Military finance officials in the Philippines and Korea generally acknowledged that cash balances were excessive. Army finance activities in Korea subsequently reduced cash authorizations by about $3.6 million effective December 1, 1977, which could be expected to reduce the onhand cash excesses identified above. Finance officials in Subic Bay agreed to take corrective action as a result of our findings.

INADEQUATE CONTROLS OVER LEVELS OF CASH BALANCES

At most locations we visited, limited attention was being devoted to minimizing cash balances. As noted in our previous two reports, there appears to be little incentive on the part of Defense cash managers to minimize balances since interest costs incurred on funds outstanding are borne by the Treasury.

Defense regulations require quarterly inspections of each cash fund, in part to determine if unnecessarily large cash balances are being maintained. Despite our past recommendations that cash balances be monitored and maintained at levels commensurate with operating needs, the required inspections have, in some cases, been limited to cash counts with little or no effort directed to identifying unnecessarily large balances.

Lack of clear guidance on how to determine cash authorizations may be hindering effective control of excess cash balances. For example, the military services use different historical base periods--ranging from 1 to 6 months--to compute authorizations. Some disbursing activities included cash collections in computing cash requirements while others did not. Also, no clear criteria exist for computing and determining contingency requirements, or whether and to what extent contingency reserves are to be included in cash authorizations.

Cash authorizations are intended as a management tool to minimize cash balances, but they appear to be of limited value for that purpose. Authorizations establish ceilings; however, a disbursing activity can still maintain cash balances in excess of its day-to-day needs and remain within its authorization. Since interest is incurred on cash actually held, some additional control appears necessary over day-to-day cash balances. One control successfully applied by military banking facilities in Korea is a target average daily balance, based on past requirements. Periodic comparisons of the actual average daily balance with the target highlight excessive balances.

OTHER COST-REDUCING CASH MANAGEMENT CONSIDERATIONS

Other means exist for reducing interest costs in addition to refining cash replenishment procedures and improving program monitoring and cash management controls.

More frequent return of unusable currency

Military banking facilities and disbursing activities accumulate unusable currency (bills denominated above $20 and all unfit currency) from normal daily operations. At irregular intervals this money is mailed to the Federal Reserve Bank of San Francisco for credit to the Treasury's account. During 1977, the following amounts were deposited.

Location (note a)	Amount deposited
Central Funding Office, Okinawa	$ 385,500
Subfunding Office, Subic Bay, the Philippines	879,500
Subfunding Office, Korea	4,723,785
Total	$5,988,785

a/Unusable currency accumulations at Clark Air Base were negligible.

Current Federal Reserve Bank guidance allows for the deposit of unusable currency in standard units (10 packages of 100 notes each) at any time. Since November 1977, the Bank began accepting monthly deposits of bills of larger denomination ($10, $20, $50, and $100) in smaller packages when a local disbursing office is unable to accumulate a standard unit.

Deposits of unusable currency by many finance offices have not been timely, even under the old criteria which required that standard units be accumulated. For example, during 1977 the Subic Bay Naval Base Disbursing Office made only two deposits. On several occasions the subfunding office in Korea accumulated over $750,000 before shipping it to the Federal Reserve.

Delaying the deposit of unusable currency increases the interest burden on the U.S. Treasury. Once the Federal Reserve Bank credits the deposit, the credit can be used to meet the Treasury's obligations and to reduce the amount of borrowing. We estimated that in 1977 the interest cost associated with unusable currency held in disbursing activities and military banks in the Far East amounted to about $34,000. We believe a significant amount of this could have been saved with more timely deposits.

Authorized retention and use of $50 and $100 bills

Defense and Treasury policies prohibit the overseas recirculation of currency denominated over $20, except $50 and $100 bills issued to Europe-based personnel going on leave. Disbursing offices and military banking facilities could accept large bills from authorized personnel and activities but could not reissue them. This policy was initiated about 15 years ago with the intention of discouraging counterfeiting.

Since this policy was issued, the value of the dollar has declined significantly. Department of Commerce statistics show the purchasing power of the dollar has declined over 50 percent since 1962. Because of this decline, counterfeiting may prove less of a risk now than when the Treasury originally adopted its policy. Furthermore, Secret Service officials said that the risk of loss from counterfeiting is not significant enough to warrant noncirculation of $50 and $100 bills overseas.

In 1977, large bills ($50 and $100 denominations) comprised 65 percent of the total value of unusable currency returned to the Federal Reserve from Korea and 96 percent of the amount returned from the Philippines. We estimated that holding $50 bills as unusable in the Philippines and Korea cost the U.S. Treasury about $10,000 in interest during 1977. Considerably more would be involved on a worldwide basis. Army officials estimated that by using $50 and $100 bills in Europe, the cash custody accounts could be reduced by $1 million.

If these large bills were retained for circulation at overseas activities, the need to return them and the time needed to replace them with usable currency would be eliminated. Savings would result because (1) less money would need to be replenished and (2) interest costs associated with the time large bills are retained as unusable would be eliminated.

We discussed authorizing the use of $50 and $100 bills overseas with Defense and Treasury officials. Subsequent to our discussions, the Treasury, on August 31, 1978, wrote Defense that it has no objections to the use of $50 and $100 bills in Europe, except that Defense may not purchase those denominations through the recoupment process. The Treasury and Defense will consider the practicability of this action before authorizing the use of $50 and $100 bills in the Far East.

CONCLUSIONS

Excess cash continues to be a problem at Defense disbursing activities in the Far East, despite our two previous reports on this subject to the Secretary of Defense.

There is little incentive for Defense managers to minimize cash balances, since interest costs incurred on funds outstanding are borne by the Treasury. Notwithstanding this, Defense should strengthen its overseas cash management program.

Better controls and increased program monitoring continue to be needed. Clear criteria for determining realistic cash levels should be developed. Noncompliance with quarterly inspection regulations should be stopped, and unusable currency should be returned to the Federal Reserve promptly.

RECOMMENDATIONS

We recommend that the Secretary of Defense assign specific responsibility to the Assistant Secretary of Defense (Comptroller) for devising a system of incentives to encourage effective and efficient cash management in the Department.

We also recommend that the Secretary of Defense instruct the Secretary of the Air Force to improve its Far East cash management program by

--issuing clear guidelines for determining realistic cash levels, developing better controls, and increasing program monitoring to ensure that cash balances are commensurate with cash needs and to identify and eliminate excess cash balances;

--emphasizing the need for all quarterly inspections of cash funds to include a determination that cash onhand balances do not exceed operating needs; and

--returning unusable currency to the Treasury as frequently as allowed under Federal Reserve criteria.

CHAPTER 5

SCOPE OF REVIEW

We reviewed the management, monitoring, and control of the overseas cash management program. We analyzed Department of Defense regulations, tested cash records, and reviewed systems, document flows, and reports pertaining to the determination and replenishment of overseas cash needs. We interviewed officials of Defense, the Treasury, the Federal Reserve Bank of San Francisco, the Bank of America, Chase Manhattan Bank, and the American Express International Banking Corporation regarding cash management activities.

We made the review at Headquarters, Department of Defense, Washington, D.C. and military commands and banking facilities in Hawaii, Okinawa, Republic of the Philippines, Korea, and Frankfurt, Heidelberg, and Mannheim in West Germany.

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