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Report to Congressional Requesters

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ARMY BUDGET

Potential Reductions to the Operation and Maintenance Budget

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The Honorable John C. Stennis
Chairman, Committee on Appropriations
United States Senate

The Honorable Bill Chappell, Jr.
Chairman, Subcommittee on Defense
Committee on Appropriations
House of Representatives

This report responds to your requests that we evaluate the Army's justification for its fiscal year 1989 operation and maintenance (O&M) budget to identify potential reductions and budget issues.

As arranged with your offices, we focused our analysis on five O&M budget activities that, in total, represent about 50 percent of the Army's $22.085 billion O&M budget request: the flying hour, force modernization, depot maintenance, base operations, and real property management activities programs. These areas were selected based on the amount of funding requested, the growth in the program since fiscal year 1988, or expressed congressional interest. Our objectives, scope, and methodology are discussed in appendix I. In May and June, we presented the preliminary results of our analyses to your offices for use during Committee markups. The results of our evaluation are summarized below and discussed in more detail in appendix II.

We identified net potential reductions of about $18.3 million in two of the five programs we evaluated: $12.4 million in the flying hour program and $5.9 million in the force modernization program. The potential flying hour program reductions are based on an historical underuse of funded flying hours by the active Army and the Army Reserve, reductions in the Army's rotary-wing aircraft inventory, and changes in planned student-aviator training requirements. The potential flying hour reductions were offset by about $3.7 million because aircraft cost factors have increased since the budget was prepared. The net potential reductions identified in the force modernization program are due to changes in the numbers of systems that will be fielded and sustained during the budget year.

As part of our analysis, you asked us to examine budget execution data and related information to identify issues that might be useful during

Committee deliberations on the fiscal year 1989 budget. The issues we identified are discussed in appendix III.

As you requested, we did not obtain agency comments on this report. However, we discussed its contents with the Army's Deputy Comptroller for Financial Management and other budget and program officials and have included their comments where appropriate.

As arranged with your offices, we are sending copies of the report to concerned congressional committees; the Secretaries of Defense and the Army; and the Director, Office of Management and Budget. Copies will be made available to others upon request.

Frank C. Conahan
Assistant Comptroller General

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Abbreviations

FCFA	Foreign Currency Fluctuation Account
GAO	General Accounting Office
O&M	operation and maintenance
OSD	Office of the Secretary of Defense
TRADOC	Training and Doctrine Command

Introduction

The Army's operation and maintenance (O&M) budget request for fiscal year 1989 is $22.085 billion, or about 4.5 percent more than the $21.131 billion appropriated by the Congress for fiscal year 1988. The separate O&M budget requests for the Army National Guard and the Army Reserve are $1.797 billion and $795 million, respectively. This represents decreases of 3.2 percent for the Guard and 7.3 percent for the Reserve in the amounts appropriated for fiscal year 1988.

The Army's O&M appropriation covers a diverse collection of functions and activities necessary for operating and sustaining U.S. forces. The appropriation provides the day-to-day funding to fly aircraft, operate tanks and other weapon systems, and train troops. It also includes funds for paying civilians; contracting services for maintenance and repair of equipment and facilities; and for fuel, supplies, and repair parts for weapon systems and equipment.

The Army's O&M budgets by program category for fiscal years 1986 through 1988, the budget request for fiscal year 1989, and program changes from fiscal year 1988 to fiscal year 1989 are presented in table I.1.

Table I.1: The Army's O&M Budgets by Program Category for Fiscal Years 1986 to 1989

Dollars in millions

Program	Fiscal Year 1986	1987	1988	1989	Program change
General purpose forces	$3,379	$4,169	$3,475	$3,669	$194
Intelligence	248	279	302	305	3
Communications	1,060	1,040	988	1,011	23
Environmental restoration	125	195	178	[1]	
Central supply	2,348	2,495	2,929	3,005	76
Depot maintenance	1,993	2,057	2,149	2,454	305
Training	1,046	1,176	1,072	1,129	57
Medical	1,314	1,447	2,306	2,326	20
Other	604	671	671	698	27
Administration	811	868	853	959	106
Other nations support	165	217	242	252	10
Special operations forces	0	0	190	179	−11
Base operations	5,911	6,422	5,776	6,098	322
Total	**$19,004**	**$21,036**	**$21,131**	**$22,085**	

[1]The Army does not budget for this program. The Office of the Secretary of Defense provides funds during the year of execution.

Table I.1 shows that the largest dollar increases in the fiscal year 1989 O&M budget are planned for the base operations program (includes funding for real property management activities) and the depot maintenance program. Funding for the flying hour program and the O&M portion of the force modernization program is subsumed within several of the budget programs identified.

Using different cost categories from those included in the table, the Army plans to spend about 27 percent of its fiscal year 1989 O&M budget for personnel compensation and benefits; 37 percent for contract services; about 25 percent for supplies, fuel, and equipment; and the remaining 11 percent for travel, communications, utilities, and rent.

Objectives, Scope, and Methodology

Our objectives were to evaluate the Army's justifications for its fiscal year 1989 O&M budget request and spending patterns for prior years to identify potential reductions and budget issues. We focused our analyses on five O&M budget activities: the flying hour, force modernization, depot maintenance, base operations, and real property management activities programs.

We interviewed O&M budget and program officials at Headquarters, Department of the Army, Washington, D.C., and three major Army commands: Headquarters, U.S. Army, Europe; U.S. Army Materiel Command, Alexandria, Virginia; and U.S. Army Forces Command, Fort McPherson, Georgia. We analyzed execution data for prior-year budgets, budget justifications, cost estimates, reprogramming actions, and other cost, production, and planning documents related to the Army's budget requests.

To analyze the flying hour budget, we compared budget and execution data for several years to determine whether the Army has been able to fully execute its budgeted program. To determine whether budgeted costs were realistic, we compared (1) current and budgeted cost factors, (2) the budgeted number of aircraft with projected aircraft inventories, and (3) the budgeted student-aviator training estimates with current projections. We also identified and analyzed flight simulator usage to determine whether it had been considered in developing the flying hour budget.

To analyze the force modernization budget, we compared current schedules of when equipment would be fielded with those used to develop the

budget. We then recomputed costs based on the newer schedules and Army fixed and variable cost estimates.

To analyze the depot maintenance budget, we compared budget and execution data for several years to determine whether the Army had obligated these funds in accordance with its budget justifications. We also compared the amounts of work funded with prior-year appropriations that the Army plans to carry over to the next fiscal year with the amounts of carryover planned by the other services.

To analyze the base operations and real property management activities budgets, we compared obligation plans to actual obligations for several years to determine whether the funds had been obligated in accordance with budget justifications. At two major commands where expenditures exceeded obligation plans, we attempted to determine the reasons for the differences. We also (1) analyzed year-end funding actions to identify how such funds were being obligated and (2) compared the budgeted foreign exchange rate for the deutsche mark with the actual exchange rate to determine any impact on the Army's budget.

Our evaluation was performed from March to July 1988 in accordance with generally accepted government auditing standards.

Potential Reductions in the Army's Fiscal Year 1989 Operation and Maintenance Budget

We assessed the Army's fiscal year 1989 O&M budget to identify areas where funding could potentially be reduced. We identified about $18.3 million in net potential reductions—$12.4 million to the flying hour program and $5.9 million to the force modernization program. The $12.4 million flying hour program reduction consists of $7.2 million for underuse of funded flying hours, $4.2 million for planned reductions in the aircraft inventory, and $4.75 million for changes in planned student-aviator training requirements. These reductions are offset by about $3.7 million because aircraft cost factors have generally increased since the budget was prepared.

The $5.9 million net potential reduction for the force modernization program consists of a $6.04 million reduction related to decreases in the number of units to be fielded and sustained for two systems and a $0.14 million increase due to increases in the number of units to be fielded and sustained for two other systems.

Potential Adjustments to the Army's Flying Hour Program

In its fiscal year 1989 budget request, the Army requested about $314.7 million for 1,809,277 flying hours: $242.2 million for 1,337,236 flying hours for the active Army and $72.5 million for 472,041 hours for the Army Reserve components—369,455 hours for the Army National Guard and 102,586 hours for the Army Reserve. The fiscal year 1989 budget request is $11.9 million more than the fiscal year 1988 budget.

In preparing its fiscal year 1989 budget for the flying hour program, the Army used the number of aircraft authorized for each command and activity and prior-year flight hour use as the basis for determining the number of flying hours needed for the active Army and the projected number of aircrews to be trained as the basis for determining flying hour requirements for the Army Reserve and the Army National Guard.

As shown in table II.1, our analysis of the Army's flying hour programs for fiscal years 1985 through 1988 showed that, except for the Army National Guard, the Army has not used some of the flying hours it has funded.

Table II.1: Hours Budgeted and Used in the Army's Flying Hour Program

Component	Fiscal year 1985	1986	1987	1988[a]
Active				
Budgeted	1,276,457	1,504,882	1,507,275	1,449,193
Funded[b]	1,376,218	1,504,882	1,330,664	619,723
Used	1,225,735	1,266,146	1,299,401	598,525
Difference	−150,483	−238,736	−31,263	−21,198
Percent difference	−10.9	−15.9	−2.3	•
National Guard				
Budgeted	318,694	306,197	358,460	359,013
Funded[b]	329,029	306,197	358,460	153,539
Used	319,330	330,104	363,163	160,853
Difference	−9,699	23,907	4,703	7,314
Percent difference	−2.9	7.8	1.3	•
Reserves				
Budgeted	90,572	105,187	89,931	95,943
Funded[b]	90,476	100,053	89,931	37,097
Used	70,273	73,026	80,616	32,003
Difference	−20,203	−27,027	−9,315	−5,094
Percent unused	−22.3	−27.0	−10.4	•
Total unused	**180,385**	**241,856**	**35,875**	**18,978**
Total percent unused	**10.0**	**12.6**	**2.0**	•

[a]The budgeted hours are for the entire fiscal year while the funded, used, and difference figures are for the first half of the fiscal year.

[b]Includes adjustments made by the Army.

Table II.1 shows that the active Army has not used 2.3 to 15.9 percent of its total funded hours during fiscal years 1985-87. Similarly, the Army Reserve has not used 10.4 to 27 percent of its total funded hours. The National Guard, however, used 1.3 to 7.8 percent more hours than funded in fiscal years 1986-87.

Army program officials said that the underuse of funded flying hours by the active Army and Army Reserve has been caused by a variety of factors, including aircraft groundings, aircraft unavailability, poor weather conditions, delayed aircraft fieldings, and overly optimistic estimates of the training that could be accomplished.

Based on the Army's historical patterns of flying fewer hours than funded, there appears to be potential to reduce the Army's fiscal year 1989 flying hour program. Using the minimum budget underrun of 2.3 percent for the active Army and 10.4 percent for the Army Reserve

would indicate a reduction of $5.6 million (30,756 hours) for the active Army and $1.6 million (10,669 hours) for the Army Reserve.

Aircraft Inventory Adjustments

The Army plans to reduce the size of its helicopter fleet by eliminating 450 older aircraft (350 UH-1 aircraft and 100 OH-58 aircraft) in fiscal year 1988 and 900 more UH-1 and OH-58 aircraft by the end of fiscal year 1994.

The Army reduced its fiscal year 1989 flying hour budget by 70,895 hours ($8.8 million) to account for the elimination of the older aircraft in fiscal year 1988. In its calculation, the Army assumed that the 350 UH-1 aircraft would have been flown 4,760 hours a month or 13.6 hours per month each and the 100 OH-58 aircraft would have been flown 1,147 hours a month or 11.5 hours per month each. In fiscal year 1987, the UH-1 aircraft averaged 17 hours per month and the OH-58 averaged 14.4 hours per month. Using these figures, we estimated that the Army could have reduced its fiscal year 1989 budget by 88,680 hours ($11.0 million) as compared to the actual reduction of 70,895 hours ($8.8 million). Accordingly, a reduction of $2.2 million to the Army's fiscal year 1989 flying hour budget would appear to more accurately reflect the effect of eliminating the 450 aircraft in fiscal year 1988.

The Army's fiscal year 1989 flying hour budget also includes 32,949 hours ($4.1 million) for 170 older aircraft that will be eliminated from the inventory by the end of fiscal year 1989. The elimination of these 170 aircraft is the first part of a 6-year planned reduction of 900 aircraft. The Army has not, as yet, identified the commands that will lose aircraft or when each aircraft will be retired during fiscal year 1989. Therefore, the Army did not adjust its fiscal year 1989 budget for the elimination of these aircraft. If the Army eliminates these 170 older aircraft throughout fiscal year 1989, in contrast to eliminating them on the last day, it may need only about half of the 32,949 hours in the budget for these aircraft, which would allow a potential budget reduction of about $2 million.

Changes in Student-Aviator Training Requirements

Based on an Army midyear review of the fiscal year 1988 flying hour program, the Training and Doctrine Command (TRADOC) has reduced its programmed flight hours by 51,000 hours ($9.4 million). These flying hours are not needed because of a significant decrease in projected student-aviator training requirements. During the first half of fiscal

year 1988, TRADOC did not use 17,743 hours of the 249,973 hours it had programmed. In the last two quarters, TRADOC has estimated that it will not need 32,257 hours of the 250,800 hours originally programmed.

Army officials told us that the Army plans to reprogram $8.5 million of the $9.4 million reduction in flying hours to Fort Rucker to fund contracts for aircraft maintenance, refueling, and flight training. The remaining $0.9 million will be redistributed to the flying hour program for the Military District of Washington.

An Army flying hour program official told us that the Army plans to reduce TRADOC's flying hour budget for fiscal year 1989 by a minimum of $4.75 million because of expected decreases in student-aviator training requirements. It appears, therefore, that the Army's fiscal year 1989 flying hour budget could be reduced by this amount.

Changes in Aircraft Cost Factors

The Army used December 1986 cost factors (adjusted for inflation) to estimate costs of its fiscal year 1989 flying hour program. In May 1988 new cost factors were developed for each aircraft type.

As shown in table II.2, some of the revised rates are higher and others lower than those used by the Army in preparing the fiscal year 1989 flying hour budget. Using these new cost factors, we estimate that the Army will need about $3.7 million more than it has requested to fully execute its planned fiscal year 1989 program.

Table II.2: Changes in Flying Hour Program Costs by Aircraft Type for Fiscal Year 1989

Aircraft	Programmed hours	Budget cost rate	Change in cost per flight hour	Change in funds required
AH-1	176,252	$205	$10	$1,762,520
AH-64	78,490	413	−1	−78,490
CH-47A	19,518	707	18	351,324
CH-47D	44,459	536	−42	−1,867,278
CH-54	7,326	693	7	51,282
OH-58A	318,221	102	7	2,227,547
OH-58D	24,109	98	51	1,229,559
UH-1	642,747	130	9	5,784,723
UH-60	221,839	268	−9	−1,996,551
OH-6	43,628	105	53	2,312,284
C-12	55,200	112	−47	−2,594,400
OV-RV-1	30,337	299	29	879,773
RU-21	2,558	189	−62	−158,596
T-42	5,498	67	−44	−241,912
U-8	10,820	92	−21	−227,220
U-21	42,678	120	−57	−2,432,646
UV-18	2,700	135	−76	−205,200
RC-12	21,660	127	−49	−1,061,340
TH-55	1,940	74		
C-20	1,200	•		
Total additional funds required				**$3,735,379**[b]

[a]Revised cost factor information was not available.

[b]Amount has not been adjusted to reflect potential reductions identified in this report because required information was not available.

Use of Flight Simulators Is Not Considered in Calculating Flying Hour Budgets

Army flying hour program and budget officials told us that flight simulator usage is not being explicitly considered in the development of the Army's flying hour program budget. They said that the use of flight simulators is not factored into the flying hour budget and that they were not aware of how many flight simulators are available and the number of hours they use to train flight crews each year. They also said that another Army group maintains statistics on flight simulators and that it does not provide such information to the flying hour program. The numbers of hours of flight simulator use in fiscal year 1987 is shown in table II.3.

Table II.3: Flight Simulator Usage in Fiscal Year 1987

Aircraft	Hours used
AH-1	64,850
AH-64	23,917
CH-47	8,078
UH-1	230,521
UH-60	15,643
Other simulator use	21,256
Total	**364,265**

The Army could provide the Congress with statistics on flight simulator use as part of its flying hour budget in the same way that it discloses such information in its budget for operating its main battle tank.

Potential Adjustments to the Army's Force Modernization Program

The Army's force modernization program provides funding for the fielding and sustaining of major new or modernized equipment entering the Army's inventory. The one-time costs associated with introducing and distributing new or modernized equipment into the Army's inventory are referred to as fielding costs. These costs include initial provisioning of repair parts and supplies, operator training, training materials and publications, and operational testing. In contrast, sustainment costs are those associated with the operation and support of systems that have been fielded. They include the costs of depot maintenance, modification, supply operations, and in-house and contractor logistical support.

The Army has requested about $2.2 billion in its fiscal year 1989 O&M budget for the force modernization program. This request includes $389 million for fielding additional systems and $1.8 billion for sustaining fielded systems. In developing its fiscal year 1989 budget in December 1987, the Army estimated, for each force modernization system, the number of systems it thought it would field and sustain during the year.

Our analysis focused on the Army's 44 intensively managed force modernization systems, which account for $1.9 billion, or about 86 percent, of the force modernization program. The Army is planning changes in the number of units to be fielded and sustained for 4 of the 44 systems. Increases in the number of units to be fielded and sustained have resulted in understated budget requirements for 2 of the systems and reductions in the number of units have resulted in overstated requirements for the other 2 systems. Table II.4 compares the estimated

number of systems to be fielded and sustained as reflected in the distribution fielding plan (which was used to prepare the fiscal year 1989 budget request) with the revised distribution fielding plan.

Table II.4: Changes in Force Modernization System Fielding and Sustainment Plans for Fiscal Year 1989

	Number of systems to be fielded			Number of systems to be sustained		
System	Budget plan	Revised plan	Difference	Budget plan	Revised plan	Difference
Single Channel Ground and Airborne Radio System	4,016	2,677	−1,339	2,711	1,619	−1,092
Armored Combat Earthmover	34	35	+1	26	27	+1
CH-47D Helicopter	49	41	−8	250	246	−4
Trailblazer	4	6	+2	6	6	0

Based on the changes in the numbers of systems to be fielded and sustained and the Army's estimates of the average variable unit costs for fielding and sustaining each system, there is a potential to reduce the force modernization program budget by about $5.9 million, as shown in table II.5.

Table II.5: Net Potential Reductions in the Force Modernization System Budget

Dollars in millions

System	Budget request	Estimated potential adjustment
Single Channel Ground and Airborne Radio System	$21.3	−$4.30
Armored Combat Earthmover	5.3	+0.11
CH-47D Helicopter	67.7	−1.74
Trailblazer	10.8	+0.03
Total	**$105.1**	**−$5.90**

Issues Related to the Army's Fiscal Year 1989 Operation and Maintenance Budget

In conducting our work, we obtained information on certain trends and issues that we concluded could be useful to the Committees on Appropriations as they consider the Army's budget request. These involve

- the use of mission funds for base operations activities,
- the use of depot maintenance funds for central supply and transportation activities,
- requests for O&M funding for depot maintenance work to be conducted in the succeeding fiscal year without justifiable standards for the carryover,
- the use of an overstated foreign exchange rate, and
- the use of year-end funds in areas of congressional concern.

Use of Mission Funds for Base Operations Activities

Our analysis of the Army's O&M budget execution information for fiscal years 1986 and 1987 disclosed that about $481 million, or about 2 percent of the funds originally planned for mission activities, was used for base operations activities: about $198 million of $13.1 billion in fiscal year 1986 and about $283 million of $14.6 billion in fiscal year 1987. These funds were used primarily for seven base operations activities: food services; furnishings; automation; morale, welfare, and recreation; plans, training, and mobilization; real property maintenance and repair; and minor construction.

Our further analysis of program execution information for fiscal year 1987 disclosed that Forces Command and U.S. Army, Europe, were responsible for using about $215 million, or 75.8 percent, of the fiscal year 1987 mission funds that were used for base operations activities—$138 million by the Forces Command and $77 million by U.S. Army, Europe.

Army budget officials confirmed these spending patterns and said that such funding migrations had occurred every year since fiscal year 1983. Subsequently, on March 1, 1988, the Comptroller of the Army, in testimony before the House Subcommittee on Readiness, Committee on Armed Services, confirmed that O&M funds budgeted for mission activities were being used for base operations activities.

Army budget officials told us that mission funds migrate to base operations accounts because base operations costs are largely "fixed" costs and the Army does not request sufficient funding to cover these costs. They pointed out that installation commanders are hard-pressed to cut

the cost of base operations when 80 percent of the cost involves personnel and contractual services. The officials also said that the Army continues to underbudget and underfund base operations activities because it prefers to show more "tooth than tail" in its budget, meaning that it wants to show more funding for readiness and training than for support functions in its budget. They provided us with an analysis showing that without additional base operations funding, execution of the fiscal year 1988 O&M budget will require using about $900 million in mission funding for base operations. This amount was calculated by subtracting the $5.5 billion allocated for base operations in fiscal year 1988 from the $6.4 billion obligated for base operations a year earlier.

Unless they are aware of the pattern of mission funds migrating to base operations, decisionmakers can be misled. To illustrate, in March 1987, the Army requested $75 million in supplemental appropriations for fiscal year 1987, which it stated were to support increased mission-related activities. The commands were using mission funds throughout fiscal year 1987 for base operations activities. Therefore, when the Congress approved one-half the supplemental request for mission accounts, it was, in effect, indirectly supporting increased base operations activities. At the time it requested the supplemental appropriation, the Army was withholding about $144 million in O&M funds for contingencies. It released $94.2 million of these funds to Forces Command and U.S. Army, Europe, in September 1987. These commands also received about $34.8 million of the $37.5 million supplemental appropriation, and these funds were largely used to purchase replenishment spares to help support the following year's training plans.

Use of Depot Maintenance Funds for Central Supply and Transportation Activities

The Army's depot maintenance account provides funds for modifying and converting materiel in the Army's inventory, for overhauling and repairing major equipment and secondary items, and for maintenance support activities, such as maintenance engineering and new equipment training.

The Army's O&M budgets for fiscal years 1985 through 1988 included about $2.3 billion each year for depot maintenance operations. Our analysis of budget execution information for fiscal years 1985 through 1987 showed that a net total of about $376 million had not been used for depot maintenance activities—$37 million in fiscal year 1985, $170 million in fiscal year 1986, and $169 million in fiscal year 1987. Most of these funds (87 to 96 percent) were transferred to the Army's central

supply and transportation account. According to an Army budget official, the funds migrated because the Army has traditionally underbudgeted and underfunded the central supply and transportation account. He expressed the view that this is caused by the perception that funding for depot maintenance can be obtained more easily from the Congress because it is more closely related to readiness.

Depot Maintenance Budget Request Includes Funds for Work to Be Completed in Succeeding Fiscal Year

In budgeting and scheduling for the depot maintenance work at Army depots, the Army assumes that a certain portion of the funded work will not be completed during the fiscal year and will therefore be carried over into the next fiscal year. This "funded carryover" does not include the value of work steps completed by the end of the fiscal year. The Army's fiscal year 1989 organic depot maintenance budget of about $1.1 billion assumes that a funded carryover of $273 million will exist at the start of the fiscal year and that it will fund depot operations through the first quarter. The budget also assumes that there will be a 3-month funded carryover at the end of fiscal year 1989.

The Office of the Secretary of Defense (OSD) has not established standards for how much funded carryover is acceptable for each military department. During budget reviews, however, it has challenged each department to defend its level of carryover. Army officials believe that a carryover is needed to ensure continuity of operations and that 3 months of carryover is an acceptable amount. The Army is collecting production information and comparing it with certain repair cycle times in an attempt to establish a defensible standard carryover for each of its depots. We believe that once standards are established the Army will have a better basis for estimating its O&M funding needs for depot maintenance.

In fiscal year 1985, the Army's funded carryover was $611 million (about 6 months of work orders). However, as a result of concerns raised by OSD, the Army has been reducing the carryover. According to Army officials, the funded carryover was reduced to $475 million (4.9 months) in fiscal year 1986 and to $331 million (3.5 months) in fiscal year 1987. The Army's goal is to reduce the funded carryover to $273 million (3 months) at the end of fiscal year 1988. By way of comparison, the Air Force's organic funded carryover was 2.5 months for fiscal year 1985, 2.7 months for fiscal year 1986, and 2.2 months for fiscal year 1987.

We recognize that some funded carryover is needed to allow for continuity of operations. However, this carryover should be based on a justifiable standard, which currently does not exist. If the Army could reduce its funded carryover to the Air Force's level, the amount of funded carryover would be $72.8 million less than the Army's budgeted amount.

Budget for Foreign Currencies Is Understated

The total cost of maintaining U.S. armed forces overseas may not be revealed in the budget because of the assumed relationship of the dollar to the currency of the country in which U.S. forces are stationed. This currency relationship, or exchange rate, affects those functions or activities that involve purchases of foreign currency to pay for services received. During fiscal year 1987, about 57.6 percent of the Army's obligations involved purchasing foreign currencies. To provide a stable budget exchange rate, the Army formulates and executes its budget for foreign currencies at constant budget rates recommended by OSD. If the actual rate is lower than the budgeted exchange rate, more dollars will be needed to meet obligations.

OSD provides guidance to the military services on what exchange rates are to be used in preparing the budget. OSD generally establishes the budget exchange rates based on its review of actual exchange rates in December of the fiscal year preceding the budget year. However, OSD did not establish a new budget exchange rate in December 1987 for the services to use in preparing their amended fiscal year 1989 budgets. Instead, it used the rate established in December 1986, which was used to prepare the biennial budget for fiscal years 1988 and 1989. The effect on the Army is significant in West Germany because 90 percent of the Army's obligations involving foreign currencies in Europe require purchases of deutsche marks (DM) and the exchange rate for the DM has fallen almost 18 percent below the budgeted rate for fiscal year 1988. As shown in table III.1, the actual exchange rates have been lower than the budgeted rates for the past several years.

Table III.1: Differences in Budgeted and Actual Average Deutsche Mark Exchange Rates

Fiscal year	Budget rate	Average actual rate	Difference	Percent difference
1985	3.22	3.06	0.16	5
1986	3.73	2.08	1.65	44
1987	2.46	1.87	0.59	24
1988	2.06	1.69[1]	0.37	18

[1]As of July 1988.

The Foreign Currency Fluctuation Account (FCFA) is an OSD account used to accumulate or offset the differences experienced between budgeted exchange rates and actual rates when payments are made. Moreover, the FCFA provides the mechanism needed to obligate funds based on a stable budget exchange rate. For example, the stabilized budget rate for the DM in fiscal year 1988 is 2.06 DM to $1 compared to a July 1988 exchange rate of 1.69 DM to $1. The difference of .37 DM to $1 must be made up by using FCFA funds or obtaining funds elsewhere. If the Army incurs a 100 DM transaction, its account will reflect an obligation of $48.54 (100 divided by 2.06 = $48.54). If the disbursement rate is 1.69 DM, the actual cost will be $59.17 (100 divided by 1.69 = $59.17). The FCFA pays the difference: $59.17 - $48.54 = $10.63. Since fiscal year 1985, the Army has had to obtain increasingly larger sums from the FCFA as the value of the dollar has continued to decline against the DM.

Table III.2 shows the funds obtained by the Army from the FCFA for lower-than-budgeted DM exchange rates since fiscal year 1985.

Table III.2: FCFA Outlays for Lower-Than-Budgeted Deutsche Mark Exchange Rates

Dollars in millions

Fiscal Year	Outlays
1985	$3
1986	756
1987	911
1988	(estimated) 913

The fiscal year 1989 budget rate for the DM is 2.06, and the actual rate has been about 1.70 DM for most of fiscal year 1988. If this difference of .36 DM to $1 continues throughout fiscal year 1989, the Army estimates that it will be forced to obtain about $500 million from the FCFA to cover its fiscal year 1989 obligations that will be paid in DMs.

The FCFA, which receives direct appropriations from the Congress to keep it solvent, ran out of funds in fiscal year 1987. For fiscal year 1988, the Army has withheld about $490 million from its O&M appropriation as a reserve to compensate for a budgeted DM rate that was set too high.[1] In its June 10, 1988, report on the Defense Appropriations Bill for fiscal year 1989, the House Committee on Appropriations reported that the Department of Defense was not realistic in its use of overly optimistic exchange rates during the development of the fiscal year 1989

[1] Funding for FCFA is also taken from accounts other than the Army's O&M account.

amended budget. The report stated that if the current exchange rates remain in effect throughout fiscal year 1989, the Department of Defense will experience a shortfall of about $1 billion in O&M funding and $500 million in military personnel funding. The Committee found this decision to underfund known requirements objectionable. The Committee recommended a $376 million appropriation for the FCFA, which is intended to help address the identified O&M and personnel funding shortfalls. Funding shortfalls above this level are to be addressed through normal reprogramming actions.

The Senate Committee on Appropriations, in its report of June 24, 1988, also said that the Army had been unrealistic and concluded that the Army had sought to lower its appropriation requirements and produce a budget request "within the budget summit agreement limits." Although a substantial shortfall was likely, the Committee was unwilling to appropriate additional funds because, it said, to do so would reward the Army for intentionally underbudgeting for foreign currency costs.

Year-End Funding in Areas of Congressional Concern

During the last month of each fiscal year, the Army identifies O&M funds that have not been obligated and are not expected to be obligated by the end of the fiscal year. These funds are reallocated to areas where they can be obligated. The majority of this year-end funding comes from contingency or "withhold" accounts at the department and major command levels.

In fiscal year 1987, for example, the Department of the Army released a total of $143 million to its commands in September 1987 for year-end obligations. About $89.7 million, or 62.7 percent, of the total year-end funding[2] was intended for base operations and real property management activities, and the remaining $53.3 million was intended for mission-related areas for supplies, equipment, and spare parts that would largely be used to carry out training activities in the following fiscal year.

The commands establish funding priorities based on reviews of prioritized lists of unfunded projects received from their installations. We reviewed the lists of projects submitted to Forces Command and U.S. Army, Europe, in September 1987 and found that the commands had used some of their year-end funds in the areas of morale, welfare, and

[2]Funds from within the major commands were included in the total.

recreation and automation. These are areas in which the Congress has taken special interest in recent years.

Funded morale, welfare, and recreation projects included renovating a gym ($1.2 million), repairing a gym ($346,000), repairing the roof of a recreation center ($336,000), repairing a recreation center balcony ($229,000), renovating a community club ($476,000), equipping a child care center ($245,000), and furnishing a child care center ($159,000). Funded automation projects included purchasing computer paper ($200,000), mainframe software and modems ($400,000), personal computers, printers, and software ($300,000), local networking ($720,000), and automated data processing hardware and software ($400,000).

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