REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Overseas Military Banking: How It Is Financed And Managed

Department of the Treasury

Department of Defense

The extension of 'home town' banking services to U.S. Armed Forces personnel stationed abroad has grown into a worldwide network of military banking facilities being subsidized by the Treasury Department.

This report describes the financial and management arrangements which exist between the banks and the Departments of Treasury and Defense. It points out the need to reassess certain aspects of the program as a means of reducing the subsidy cost and improving overall administration and the need for some congressional action.

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

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To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the financing arrangements and management of overseas military banking facilities.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget and to the Secretaries of Treasury, Defense, Army, Navy, and Air Force.

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

GAO General Accounting Office
MBF Military banking facility

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

OVERSEAS MILITARY BANKING: HOW IT IS FINANCED AND MANAGED

Department of the Treasury
Department of Defense

D I G E S T

Under sponsorship of the U.S. Treasury, commercial banks provide banking services to U.S. military and civilian personnel stationed overseas through facilities established at military installations.

The banking institutions' costs to operate these facilities have consistently exceeded the income they derive. Treasury traditionally has borne the losses on the premise that banking services are essential for morale purposes and that the added cost of providing these services should not be borne by the users.

Treasury reimbursed the banks $16.7 million for operating losses reported by overseas military banking facilities during 1972-74. Additional undetermined costs are incurred by the Department of Defense for logistic support provided free to the banks.

Although the need for these Government-sponsored banking services appears desirable, some aspects of the present program should be reassessed if these services are to be provided at the lowest possible cost. More important considerations include the following:

--Since the banks are assured of having the operating losses of their military banking facilities reimbursed and are exposed to little financial risk, they have little or no incentive to operate the facilities profitably or efficiently. (See pp. 4 and 16.)

--Reimbursement of losses is provided in the form of Treasury deposits placed with the banks in amounts sufficient to generate the earnings needed to offset these losses. Since Defense does not have to pay for the banking

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services received, its incentive to keep program costs down is diminished. (See pp. 4 and 17.)

--Banking facility operating losses could be reduced, possibly significantly, if the earnings rate on accountholders' deposits was based on the banks' actual earning capacities rather than on existing Treasury formulas. The losses also could be reduced if improved military support was provided to the military banking facilities and if reimbursement claims of the banks were scrutinized more closely. (See pp. 5, 10, and 17.)

--Management direction to, and oversight of, the facilities needs improvement. Specifically, there is a need to establish more definitive and standardized program guidelines and to improve onsite audit coverage. (See pp. 7, 14, and 17.)

In commenting on this report, Treasury and Defense generally agreed with GAO recommendations and outlined the actions they have taken, or are considering, as to weaknesses identified in the report. (See apps. III and IV.)

In discussing the merits of whether Defense should reimburse Treasury for the bank operating losses currently borne by Treasury, the two Departments seemed to agree that it would be unrealistic for Treasury to continue to manage the program if Defense were to assume its funding.

The Congress should consider transferring the responsibility of both program funding and management from Treasury to Defense. This would place program costs with the agency primarily deriving the benefit. And, it would promote efficiency by compelling installation commanders to be held principally accountable for holding costs of the services provided by the banks as low as possible

In addition, Congress should require the administering agency to submit an annual appropriation request covering anticipated expenses. Program costs then would be identifiable and would assure that operation of the program meets with legislative approval.

CHAPTER 1

INTRODUCTION

Military banking services for U.S. servicemen and other authorized personnel have been provided at overseas locations since U.S. occupation forces were assigned to Europe and the Far East following World War II. (See app. I.) U.S. banking institutions, in their designated capacity as depositories and financial agents of the United States, provide the services under the direction of the Secretary of the Treasury. The services are provided at what has become known as Military Banking Facilities (MBFs), usually situated on or near military installations.

Currently, the Chase Manhattan Bank, American Express International Banking Corporation, Bank of America, and First National City Bank operate MBFs overseas under Treasury auspices. These banks are responsible to the Department of the Treasury for the total operation of their MBFs and for reporting allowable expenses incurred and income derived from MBF operations. The MBF operations are distinct and separate from the banks' commercial branches and other activities.

Overseas MBFs accept deposits, cash checks, make loans, and provide other customary teller-oriented banking services for military personnel and authorized civilian employees and their dependents, and for military finance officers and nonappropriated fund activities (i.e. military clubs, post exchanges, etc).

As of December 31, 1974, the four U.S. banks had 2,370 employees operating 222 MBFs overseas, with 181,703 dollar checking accounts totaling $164 million and 142,093 savings accounts totaling $97 million. (Appendix II lists the number of facilities, employees, accounts, and account balances by location).

ORGANIZATIONAL RESPONSIBILITIES

The Departments of Defense and Treasury jointly share the responsibility for banking facilities on military installations.

Over the years Defense, in cooperation with Treasury, has published policies and procedures governing the establishment, operation, and termination of MBFs operating worldwide. The component services' instructions on MBFs are, for the most part, predicated upon the Defense directives. Instead of issuing its own operating guidelines, Treasury also uses the Defense directives.

Department of the Treasury

Within the whole scheme of military banking, Treasury's role is predominant. Its Foreign Banking Staff within the Bureau of Government Financial Operations determines whether the benefits that would be derived in establishing an MBF justify the cost to Treasury. The Treasury, which receives requests for MBFs directly from the military departments, is responsible for:

--Approving or disapproving the requests.

--Obtaining estimated income and expense statements from banks for operating new facilities.

--Selecting the banks to operate facilities.

--Determining the charges or fees for the services to be provided.

--Monitoring the operations of MBFs until they are terminated.

--Serving as principal liaison with the banks operating the facilities.

--Determining the amount of reimbursement, if any, the banks will receive from the Treasury for operating the facilities.

Department of Defense

Within the Office of the Secretary of Defense, the Assistant Secretary of Defense (Comptroller) is responsible for overall military banking functions. The Assistant Secretary of Defense (Installations and Logistics) is responsible for developing policies and procedures governing logistical support, including the use of Defense property and real estate furnished for the use of MBFs, and for seeking resolutions to logistics problems brought to his attention

Unified commands are responsible for overall coordination of military banking programs in their respective jurisdictional areas. Policy and administrative matters affecting Defense management of MBFs flow through normal military command channels for information and coordination.

Military services

Each military service is required to:

--Supervise the MBFs under its jurisdiction.

--Evaluate bank services in relation to its requirements.

--Examine bank practices and procedures to insure that the interests of Defense personnel are protected.

--Review MBF operating statements submitted by the banks and render an appraisal of the service.

--Provide the MBF with the necessary logistical support, fixed facilities, and other furnishings free of charge when it is not financially self-sustaining.

SCOPE OF REVIEW

Our review was primarily directed toward evaluating the administration and operations of MBFs overseas under Treasury auspices. We examined the policies and procedures for program costs, manner of reimbursing banks for MBF operating losses, effectiveness of Treasury and Defense oversight, and need for banking services being provided. We generally did not appraise the quality of services provided by the banks. This matter is covered in a "Report on Overseas Military Banking Facilities" by the Chairman, Subcommittee on General Oversight and Renegotiation, House Committee on Banking, Currency and Housing, dated October 23, 1975.

During mid-1974, we visited the headquarters and field offices of the U.S. Treasury Department, major military commands, and four banking institutions in the United States, Europe, and Pacific areas. We interviewed bank, Treasury, and Defense officials responsible for carrying out the banking program and examined pertinent records and files relating to our areas of interest.

CHAPTER 2

TREASURY FINANCING ARRANGEMENTS

The four banks operating overseas MBFs reported losses totaling $16.7 million during the 3 years ended December 1974. This loss consisted of net expenses of $50 million from overseas operations plus $5.4 million in headquarters expenses, reduced by $38.7 million in earnings on depositor account balances credited to Treasury by the banks. Through the existing financing arrangements discussed below, Treasury reimbursed the banks $17.6 million during 1972-74 for losses incurred during the period and for previously unreimbursed losses.

EARNINGS ON COMPENSATING BALANCES

The deficiency between reimbursable bank expenses and earnings from overseas military banking operations is financed by Treasury in the form of non-interest-bearing dollar deposits placed with the banks, commonly referred to as compensating balances. The banks report net reimbursable MBF losses to Treasury on either quarterly or monthly statements, which Treasury uses in analyzing and determining the amounts of reimbursement required through compensating balances.

In determining the amount of compensating balance to be placed with a bank that operates MBFs, Treasury considers (1) the amount of cumulative loss, (2) how long the bank has operated at a loss, (3) anticipated losses for the next year, (4) any portion of loss which may not be reimbursable, and (5) the period of time during which reimbursement of the loss is to be made.

The compensating balances are maintained in demand accounts, and bank earnings on them are credited against bank reported losses at the 180-, 181-, or 182-day Treasury bill rate in effect at the time the balance is placed with the bank. Treasury's rationale in using this rate is that it represents a reasonable estimate of what the banks can expect to earn on such balances. The 180-, 181-, or 182-day Treasury bill rate has been used since September 1972; before that time the 90-, 91-, or 92-day Treasury bill rate was used. The bank can invest these funds in Treasury bills or elsewhere, and retain any income earned above the Treasury bill rate. However, the bank must be prepared to return the compensating balance on a 3 business-day notice, should Treasury decide it needs the funds.

As an example of how the banks are reimbursed by Treasury, assume a bank incurs a net loss of $220,000 and that the 180-, 181-, or 182-day Treasury bill rate is 5 percent. The bank would be entitled to enough Treasury funds to produce $220,000 of income, or the equivalent of $4.4 million for 1 year ($220,000 ÷ 5% = $4,400,000).

During the 3 years ended December 31, 1974, Treasury maintained compensating balances with three of the four banks for various periods of time, withdrawing the balances nine times. The total amount on deposit with the banks ranged between $63 million and $303 million, and the computed income on these balances totaled $17.6 million. One of the three banks has not had a compensating balance since June 1973. The fourth bank, which reported losses of $325,000 during these 3 years, has not had a compensating balance since August 1968.

Since October 1971, Treasury has allowed one bank to reduce its income credit on the compensating balance for lost earnings computed on the amount of past and present losses not yet reimbursed. The lost earnings are computed at the same rate as earnings on the compensating balance are computed. This bank reduced Treasury's income credit on the compensating balance by $429,000 for lost earnings on its loss carryover during 1972-74.

EARNINGS ON DEPOSITOR ACCOUNT BALANCES

Earnings on depositor account balances (referred to as a statistical income credit) constitutes the major source of MBF income. These balances, less funds needed for day-to-day operations, check clearing, and loans, are transferred to the parent bank's headquarters to be reinvested along with other bank funds. By mutual agreement between Treasury and the banks, Treasury shares in the interest earned on the reinvested funds at preestablished rates. The rates vary according to the type of deposit and monetary market conditions.

Funds available for reinvestment purposes flow from balances in dollar demand and savings accounts, dollar time accounts, and local-currency demand accounts. Earnings on dollar demand and savings accounts accounted for the largest portion of this income ($37.4 million of a total $38.7 million). In examining the earnings credited, we found that the banks were or appeared to be capable of earning substantially more income on the use of the deposits than was being reflected in the financial reports submitted to Treasury.

The earnings rate for dollar demand balances is based on the average interest rate on 3-month Treasury bills. The rate is adjusted monthly and is computed on the average rate of the bills outstanding at the end of the previous month. The earnings rate on passbook savings accounts is based on the current interest rate paid to depositors plus 1 percent. These earnings rates are applied to the average daily investable balances at the bank's headquarters. During 1972-74, the banks provided Treasury with statistical income credits of $25.3 million and $12.1 million on dollar demand and savings account balances, respectively.

Before January 1, 1975, the earnings rate on dollar demand accounts had been 1 percent below the Treasury bill rate to allow the banks a profit. This 1 percent was eliminated because Treasury recognized that higher rates of return were available to the banks from investing the account balances.

Although we did not attempt to determine how the banks invest these funds, it seems logical to assume that they would be invested at the best possible rate of return. We noted that the prime interest rate (the rate banks charge their larger and best corporate customers for short-term loans) was consistently higher than the Treasury bill rate during 1972-74. Using the prime interest rate as a guide to what banks could probably earn on investing account balances, we recalculated the potential earnings on the dollar demand and savings account balances generated from overseas banking over the 3 years. On this basis, the banks would have earned $56 million on these accounts as compared with the $37.4 million reported using the Treasury formula. This additional potential income, if credited to Treasury, would have entirely eliminated the reimbursable MBF loss of $16.7 million claimed in 1972-74.

CONGRESSIONAL OVERSIGHT

The cost to and method used by Treasury in reimbursing the banks via compensating balances for MBF losses have not been subject to the usual congressional oversight of Government programs, because they are not included in Treasury's appropriation request. The Secretary of the Treasury does include a statement in his annual report to the effect that certain banks have Federal fund deposits as compensation for performing essential Government business.

The costs and other data have been reported to the Chairman, House Committee on Banking and Currency, at his request on at least two occasions--in July 1969 and August 1971.

CHAPTER 3

PROGRAM GUIDANCE, MANAGEMENT, AND OVERSIGHT

In reviewing the management and operation of several overseas MBFs, we identified a number of weaknesses in operating practices. A significant one was the lack of a complete and standardized set of instructions to guide the banks and military commanders who carry out the many facets of the overseas military banking program efficiently and consistently. Treasury and Defense management attention and corrective measures also appeared to be needed in (1) fulfilling more of the banks' logistic support needs wherever economies can be achieved, (2) obtaining greater cooperation from the military services in helping the banks to collect on bad checks and loans, (3) reducing bank operating expenses and insuring that expenses are reasonable and properly chargeable, and (4) strengthening oversight of the program.

PROGRAM GUIDANCE

Treasury has done little to formalize and publish a manual of standard guidelines for banks and military commanders to use in administering and evaluating military banking operations. Rather, it communicates with individual banking institutions as the need arises for policy guidance and operating procedures; and many of its day-to-day decisions on MBFs are made without the benefit of formalized criteria for uniform and consistent application.

Lacking such definitive Treasury guidance, (1) banks have not been constrained from expanding MBF services or relocating their facilities, (2) no ceiling exists on the amount of loss that may be reimbursed by Treasury, (3) frequent conflicts and misunderstandings have occurred over the reasonableness and allowability of MBF expenses, and (4) inconsistencies have evolved in bank reporting of MBF operating results.

To compensate for the incompleteness of Treasury guidance on operating procedures, two banks have developed their own manuals based on a combination of Treasury letters and their own commercial banking policies. Another bank told us it intends to develop an operations manual for its overseas MBFs but that this would be difficult because Treasury letters apply policy or raise questions on a country-by-country basis.

Establishment and expansion of facilities

Treasury determines whether the benefits that would be derived in establishing an MBF justify the cost. We found, however, that the criteria Treasury used in its decisions did not include constraints on costs it is willing to bear for operation of MBFs or expansion or relocation of existing MBFs.

For example, Treasury authorized the establishment or expansion of 17 MBFs during 1973, for which costs estimates indicated that 4 would operate at a profit and 13 at a loss. However, in only two of the authorizing letters did Treasury stipulate that the bank would be held to the cost esimate submitted and, in both cases, the estimates provided for the MBFs to operate at a profit. A Treasury official informed us that the limitation was included in the authorizing letter because the banks were selected through competitive bids. The official said that in authorizing other MBFs Treasury expects the banks to keep within their cost estimates.

We noted that two MBFs in Germany were extended from part-time to full-time facilities in May 1973 without prior Treasury approval. Treasury subsequently noted the change and requested the bank to justify it. From the justification submitted, Treasury approved the operation of the two full-time facilities in September 1974.

We also noted that another MBF in Germany was moved from one installation to another without seeking Treasury approval. The bank and the military viewed the relocation as involving only a change in physical location of an existing, approved MBF. From our review of the circumstances, we believe the change was more in the nature of opening a new MBF and the usual procedures for establishing an MBF should have been followed. We noted that many patrons maintained accounts at the newly opened MBF but actually transacted their banking at another MBF in the area.

MBF expenses

The lack of standardized guidelines for allowability of certain expenses included on bank reports to Treasury have given rise to inconsistent operating practices and numerous requests for clarification and explanation of expense items included in MBF reports. Bank officials informed us that even a list of allowable and unallowable expenses would be helpful. Further discussion and examples of questionable MBF expenses claimed by the banks begins on page 12.

Treasury has recently proposed that on a trial basis, banks submit annual operating budgets for their MBFs. Bank officials generally have been enthusiastic to this proposal and expressed the hope that use of these budgets would eliminate the numerous Treasury requests for item clarification.

Reporting

Under the present system of reporting, it is generally not possible to identify the cost of operating an individual MBF, evaluate the reasonableness of specific items of income and expense, or compare the results of banks participating in the military banking program. Each bank submits financial data in a different format and often consolidates the results of several offices, which makes it difficult, if not impossible, to make a meaningful evaluation of the data.

A Treasury official told us that differences in accounting and internal procedures among the banks made it impractical to require uniform reporting. However, since MBF operations are similar regardless of which bank is involved, we believe a standard classification of income and expenses and report format is feasible and should be developed. Much of the data now reported by the banks is similar, and it is largely the differences in the way the data is presented that makes it difficult to analyze. Banking officials are not entirely satisfied with the reporting system and expressed willingness to cooperate with Treasury and with each other in an effort to reach agreement on an acceptable standard reporting format.

Fees for MBF services

Treasury does establish uniform fees for MBF services and tries to make them comparable to fees charged by banks in the United States. However, for various reasons, actual fees charged to MBF customers sometimes differ by country and by bank. Treasury-established fees currently charged by MBFs are as follows.

Service	Fee
Checking account maintenance (note a)	40¢/mo. and 10¢ a check
Returned checks	$2 plus out-of-pocket expenses
Check cashing:	
U.S. Treasury checks, postal money orders, and checks drawn on MBF	None
Checks drawn on U.S. banks (note b)	25¢ per $100
Money orders sold	25¢ per $100
Sale of local currency (note c)	.75 of 1 percent above MBF acquisition cost
Personal loans	1 percent a month of unpaid balance (minimum charge of $5)

a This fee does not apply if accountholder has military pay sent directly to his account or maintains a minimum balance of $300.

b Checks not to exceed $300. Checks in excess of $300 may be accepted for collection at the same fee.

c May vary because of exchange rates and/or local conditions. Special rates apply for bulk purchasers.

MILITARY LOGISTIC SUPPORT

The military banking program, while principally financed and managed by Treasury, operates almost exclusively for the benefit of Defense personnel. This unique arrangement intensifies the need for Treasury and Defense to cooperate closely on MBF support to ensure that program costs to the Government are kept to the minimum.

To help offset operating costs and reduce the Treasury subsidy, the military services are required to furnish a variety of logistic support services to the banks. These services, provided without charge so long as the banks are experiencing operating losses in their overseas MBFs, are intended to minimize MBF operating costs.

Logistic support services normally furnished to MBFs include land and building space, maintenance and repair work, utilities, custodial and guard services, communications, and housing for bank personnel in some instances. The military services are not required to accumulate nor report on the costs for providing this support.

The services to be provided for each MBF are supposed to be set forth in a formal agreement between the operating bank and the commander of the installation where the MBF is located. At many installations we visited, these formal agreements did not exist, were being revised, or could not be found. One bank official advised us that such agreements were not of much value because the military provided only logistic support that was readily available, irrespective of what was set forth in the agreement.

We found that, in many instances, the military services were not providing adequate logistic support to MBFs, so the banks had to contract out for the services and charge the expense to Treasury. For example, one bank was billed for civilian guard services by the Army in Okinawa and charged the expense to Treasury. In Europe, space was being rented for offices and storage and the cost charged to MBF operations. In the Frankfurt area alone, rental costs amounted to $104,241 in 1973, which included three offices totaling about $8,600 a month and a storage building for MBF records at about $200 a month. Two of the rental contracts were allowed to expire in mid-1974, and some departments of the bank moved into quarters furnished by the military. However, about $2,400 monthly rental is still being paid on one office building and record storage space costing about $340 monthly is still being rented in Frankfurt and elsewhere in Germany. A bank official said the rental charges would be terminated in the near future.

This bank also spent $90,630 in 1973 for janitorial services and supplies for its operations in Germany. We were informed that, because janitorial services provided by the military were inadequate at many MBFs, the banks frequently supplemented them with their own janitors.

UNCOLLECTIBLE CHECKS AND LOANS

A major category of MBF expense is writeoffs of uncollectible checks and loans. During calendar year 1974, net writeoffs by overseas MBFs totaled about $327,000. These writeoffs are the results of MBF patrons--largely military personnel and their dependents and civilian Government employees--defaulting on their returned checks and loan repayments.

Although we could find no written agreement between Treasury and the banks expressly setting forth Treasury's obligation to reimburse the banks for uncollectible MBF checks and loans, it is the practice followed. Treasury considers seeking restitution from the defaulting parties to be impractical because the banks have already tried to collect on the obligations. One bank charged off $217,000 in bad debts during 1974 and estimates it spent an additional $350,000 to make recoveries, resulting in a cost to Treasury of about $567,000.

A Treasury official advised us that the possibility of pay setoffs against the defaulting parties had been discussed with Defense officials; however, Defense believes there is no legal provision for such setoffs since banks operating MBFs are not considered instrumentalities of the U.S. Government. Rather, Defense views MBFs as agents of the Treasury and in a different status from Government agencies and nonappropriated fund activities. The U.S. Army Finance and Accounting Center cited the lack of statutory authority in refusing to collect an unpaid MBF loan from a former officer's retirement pay. Other Defense components have made similar determinations.

We were told that local commanders, when asked, do cooperate with bank managers in making recoveries from personnel when they are able to do so; however the extent of cooperation depends on the attitude of the local commander. Where local commanders no longer exercise control, such as when the individual has been transferred to a new post or left the service, the bank is forced to make collection on its own or to write it off and charge the expense to Treasury. Army officials told us that bad debts arising from the military banking program are bank problems and that the Army does not act as a collection agency.

Officials of one bank said they experienced high losses from bad checks in Vietnam and had received very little cooperation from the military in recovering these losses. One of them suggested that it may be appropriate for military personnel, when leaving an installation, to be required to check with the MBF and satisfy any outstanding financial obligations to the MBF as part of the normal clearance procedure.

BANK OPERATING EXPENSES

Treasury's guidance on allowable MBF operating expenses is generally vague, and as a consequence Treasury has reimbursed expenses which did not appear to be appropriate.

Treasury takes the position that it is not possible to completely itemize allowable expenses, and it views reimbursement of expenses in relation to country conditions, institutional policies of the operating banks, and related circumstances. It has designated certain expenses as nonallowable, including (1) dinners, entertainment, and other public relations expenses, (2) office parties, (3) contributions, (4) employee club dues, (5) advertising, and (6) other expenses not directly related to services offered by MBFs.

We found, however, that the banks have continued to include expenses specifically prohibited by Treasury as well as items that appear to be questionable as MBF operating expenses. Because the items were usually grouped into miscellaneous expense categories or authorized reimbursable costs, they frequently escaped Treasury's attention.

Bank officials feel that Treasury's position of not allowing such expenses is unreasonable and argue that they are incurred as a normal and necessary part of MBF operations. The officials point out that Treasury's policy frequently conflicts with commercial bank practices and believe Treasury should be more receptive to allowing reimbursement for a reasonable amount of such expenses.

The absence of uniform reporting criteria also makes it possible for the banks to include nonallowable or questionable expenses in their reports under captions which make them difficult for Treasury to identify in its review process. For example:

--One bank included an employee summer picnic costing $1,895 and a Christmas party costing $1,880 under a "Local Staff Expenses" caption in its report to Treasury.

--Another bank charged $35,000, representing the uninsured portion of a cash shipment lost in transit to one of its commercial branches, to an income account on its MBF report, thus reducing earnings reported to Treasury. Recording the transaction in this fashion precluded Treasury analysts from detecting the erroneous charge during their analysis of the bank's MBF report. After we discovered the transaction during an onsite review of this bank's ledger records and brought it to the attention of bank officials, the bank made an appropriate adjustment to a subsequent report.

--A third bank billed Treasury for more than $17,000 for a study by in-house consultants on MBF operations in Japan. Such studies are supposed to be coordinated with and authorized by Treasury, but Treasury was not informed that the study was being made, or of its purpose or results. Treasury analysts were unable to detect that the study costs were charged to MBF operations because the cost was shown as an intra-company fee.

OVERSIGHT

Despite the large-scale banking activities at overseas military installations and the continuous subsidies provided, neither Treasury nor Defense were performing any indepth audits of the program. The only active Government monitoring of the military banking program is performed by a Treasury headquarters group. However, Treasury oversight appeared to lack the scope necessary to determine whether the services provided are commensurate with the cost of the program and to identify the changes needed to improve program and cost effectiveness.

In the absence of specific Treasury instructions for review and audit of MBFs, Defense regulations set forth the responsibilities for monitoring the military banking program, not only by Treasury, but by Defense and "other supervisory authorities (bank examiners, etc.)" as well. However, Defense and Treasury have interpreted the review and audit functions as largely a Treasury responsibility. Treasury's oversight role is performed on a centralized basis in Washington, D.C., by a small staff of analysts. Essentially, the staff performs desk audits of MBF reports submitted by the operating banks, supplemented by occasional short field visits for observation and coordination.

Treasury has stressed that its reviews of MBF reports are analytical in nature rather than actual audits. In our opinion, the analytical review is made very difficult due to the shortcomings and variations in bank reporting techniques. Furthermore, some banks have been submitting consolidated country reports, which do not permit analyses of income, expense, and transaction data of individual MBFs.

Defense regulations require that commanders of military installations review MBF financial statements rendered by operating banks and provide comments to Treasury, through command channels, on the reasonableness of the operating results and quality of the banking services. This review requirement generally was not being complied with at the time of our field review. In some instances, installation commanders did not receive copies of the MBF statements; in others, where statements were furnsihed, no substantive reviews were being made. When comments were made, they addressed the reasons for significant variances from the preceding period, rather than whether the results of operations were reasonable in relation to the bank services being provided. Military officials were not always aware of the extent to which they were supposed to oversee MBF activities. We observed that military officials normally were more concerned with the quality rather than the cost of MBF services.

MBFs are examined periodically by each bank's own internal auditors or by a firm of certified public accountants. Although the cost of these examinations are charged as MBF operating expenses, copies of the reports generally have not been made available to the military or to the Treasury. We found no indication that MBFs were being reviewed by independent bank examiners.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS, AGENCY COMMENTS AND OUR EVALUATION, AND MATTERS FOR CONSIDERATION BY THE CONGRESS

Providing assurance that U.S. servicemen and their dependents stationed in foreign countries are able to receive customary banking services at a reasonable cost appears to be an appropriate objective. However, the complex and worldwide MBF network that has evolved and the amount of Treasury subsidy needed to sustain it point to a need to reassess the fundamental premises of the program.

One of the most fundamental aspects of the program concerns the manner in which banks are reimbursed for operating MBFs. The banks are guaranteed that any operating losses suffered by MBFs will be offset by means of Treasury deposits (compensating balances) placed with the banks. Through the use of these deposits, Treasury is able to finance bank losses from MBF operations without seeking congressional authorization and appropriations through the normal budgeting process.

Also, the arrangement assures the banks that their MBF losses will be offset and gives them little incentive to minimize these losses. It should be noted, however, that MBF efficiency cannot necessarily be gauged by the amount of its operating gain or loss because of the variability in such factors as labor costs, size and location of the military installation being served, and extent of military support provided.

The compensating balances that Treasury places with the banks and the funds placed on deposit with MBFs by accountholders yield a statistical income credit to Treasury based on a formula involving Treasury bill rates. The banks retain any income earned from investing these deposits above the credit given to Treasury. The banks are not required to disclose their actual earnings on the deposits. In view of the assured subsidy, the banks incur little risk in operating the MBFs. Therefore, we believe Treasury should periodically evaluate the banks' earning potentials to insure that it is receiving an equitable return on the deposits, based on prevailing monetary market conditions.

Another fundamental program consideration is whether Treasury should continue to bear the cost of MBF net operating losses without reimbursement from the Defense Department. It is Defense--whose activities originate the requirements for banking services and whose personnel are the primary users--which principally benefits from the MBF program. Treasury absorption of MBF operating losses, which aggregate substantial amounts annually, appears to result in understated Defense costs. It also lessens the incentive for the military services to curtail their banking requirements or to assume a greater role in reducing MBF losses. Inadequate logistic support for MBFs at some installations and uncollectibility of service members' defaulted checks and loans have significantly increased MBF operating losses, thus increasing Treasury costs.

In addition, management direction and oversight of the banking program needs to be improved. Although MBF services have been provided at overseas locations for many years, Treasury--as the principal policymaker--has generally not issued standardized and definitive operating instructions to the banks or to the various military commands for their use in managing and supervising MBFs. In the absence of such guidance, disparities in MBF operating practices and lack of uniformity in bank accounting and reporting practices have evolved. Consequently, conflicts and misunderstandings have occurred regarding what MBF expenses may properly be reimbursed by the Government. Also, the ability to make meaningful financial analyses, comparative reviews, or audits of MBFs has been adversely affected. Neither Treasury nor Defense were performing any indepth audits of MBFs overseas.

RECOMMENDATIONS

We recommend that the Secretary of the Treasury:

--Reassess the use of compensating balances to finance MBF operating losses and consider an alternate method, such as direct reimbursement.

--Reassess existing methods for determining Treasury's share of earnings on MBF balances, to insure that the methods are fair and reasonable to the Government as well as to the banks.

--Examine the feasibility of Treasury being reimbursed by Defense for MBF operating losses Treasury currently bears.

--Consider requiring the banks to submit annual MBF operating budgets to enable Treasury to better evaluate performances.

--Formulate standardized MBF operating instructions.

--Strengthen program oversight, giving special attention to opportunities for reducing the Treasury subsidy.

--Formulate specific procedures for banks and military commanders to follow in attempting to reduce MBF losses attributable to bad checks and loans.

We recommend that the Secretary of Defense:

--Review prevailing practices for providing logistic support to MBFs to insure consistency of application and to provide such support whenever total costs to the Government can be reduced.

--Require the military services to take a more active role in the oversight of MBFs.

AGENCY COMMENTS AND OUR EVALUATION

Treasury responded that the use of compensating balance to finance bank operating losses has involved significantly less cost to the Government in the past than would have been incurred had direct reimbursement been used. (See app. III.) A Treasury official explained that the compensating balance method of reimbursement permitted operating cash surpluses representing non-earning assets to be placed and withdrawn from the banks as available or needed. A subsequent change in procedures has reduced the amount of cash Treasury maintains as a non-earning asset.

Treasury agrees that the formula for determining its share of earnings to be derived from MBF account balances needs to be continually reassessed and maintains that it is doing so. We do not necessarily disagree with Treasury's rationale for basing earning rates on risk-free obligations, such as Treasury bills, but its expectation of soon adopting a new earning formula on individual accounts supports the present need to make some rate readjustments.

Reimbursement of MBF operating losses by Defense has "substantial appeal" to Treasury, inasmuch as it places the cost of the program with the agency that most directly benefits from it. If it is decided that Defense is to bear the cost of the program, we agree with Treasury that Defense should assume the managerial role.

Treasury generally agreed that steps can be taken to strengthen program management and oversight. For example, Treasury deems the suggestions that banks submit MBF operating budgets and that there be more onsite inspection of MBFs by qualified auditors to be desirable. Also, there is agreement on the desirability to bring together in a single manual the various Treasury instructions issued with regard to MBF operations; however, our claim that there is an "absence" of standardized instructions was challenged. We did not mean that such instructions did not exist, but rather that they were incomplete and lacked authoritativeness. The report has been revised to clarify this matter. Finally, Treasury acknowledged the risks associated with cashing checks and making loans to military personnel, but stated that the advantages in terms of services provided outweigh the losses incurred and it is working continuously with Defense to strengthen procedures for reducing defaults on such transactions.

Defense commented that significant steps have already been taken to insure consistency of logistic support of MBFs among the Military Departments and to provide such services whenever total costs to the Government can be reduced. (See app. IV.)

Further, we were advised that the requirement that field commanders review and submit comments on MBF quarterly reports is now being enforced. Internal audit organizations are to begin making selective reviews of the implementation of military banking directives during scheduled installation audits. However, Defense views the audit of bank records and operations as outside the present authority of its audit organizations.

With regard to transferring funding responsibility for MBF operating losses from Treasury to Defense, the latter contends that if it were to assume this obligation, it should also be given authority to establish and discontinue facilities, determine user charges, and take related actions having a direct impact on the amount of MBF operating losses. This is consistent with Treasury's position and, in our opinion, entirely proper. Should these responsibilities be transferred, as we are suggesting to the Congress, some of our recommendations to the Secretary of the Treasury would necessarily apply to the Secretary of Defense.

MATTERS FOR CONSIDERATION BY THE CONGRESS

The cost to the Government for sponsoring a military banking program for U.S. personnel overseas, while not precisely known, is nonetheless significant and likely to remain so for years to come. As this report points out, it may be detrimental to efficient program management to have funding and management responsibility vested in one executive department (Treasury) while another (Defense) receives the benefit. Accordingly, Congress should consider transferring these responsibilities to the Defense Department.

Also, to permit identification of program costs and to assure that operation of the program meets with legislative approval, Congress should require the agency charged with the program's administration to submit an annual appropriation request covering anticipated expenses. If, as Treasury suggests, the use of non-earning cash assets can be used to reduce the cost to the Government for reimbursing the banks for MBF operating losses, this optional reimbursement method should perhaps be retained and used as conditions permit.

ORIGIN OF MILITARY BANKING FACILITIES

Early in 1941, the War Department recognized the need for establishing banking facilities at various military installations throughout the United States to meet the requirements of a greatly expanded Army. In May 1941, the Army authorized commanding officers to negotiate with local banks for the establishment of banking facilities through branch banks at their installations. Within the year it became apparent that local banks were unable to meet the situation adequately because of limitations and restrictions on branch banking contained in State and national banking laws.

The problems involved in establishing the banking facilities were ultimately brought to the attention of the Treasury Department. After studying the needs of the War Department, Treasury sponsored legislation in the 77th Congress which would have authorized the Comptroller of the Currency to permit national banks to provide needed banking facilities at U.S. military reservations and Navy yards and stations. The proposed legislation became Senate bill 1603 and passed the Senate on April 3, 1942.

While the bill was pending in the House, Treasury, after further study of the matter, advised the Secretary of War on April 30, 1942, that it had determined that the problem of making certain banking services available on military installations could be met by an extension of its existing Depositary and Financial Agent system. The authority of the Secretary of the Treasury to designate national banking associations as depositaries and financial agents is found in the National Bank Act of June 3, 1864 (12 U.S.C. 90). This authority was subsequently extended in 1928 to include State banks and trust companies which were members of the Federal Reserve System and in 1942 to include any bank insured by the Federal Deposit Insurance Corporation.

Under the Depositary and Financial Agent System, the Secretary of the Treasury, upon request of the War Department, would (1) authorize banks designated as depositary and financial agents of the U.S. Government to render banking services on military reservations, (2) determine whether the need was sufficiently urgent to justify the expense involved, and (3) select the banks which would operate the facilities. The military services were to furnish quarters, office equipment they might have available, guards, janitor service, light, water, power, heat, and sewerage in support of the facilities.

In his annual report for fiscal year ended June 30, 1943, the Secretary of the Treasury reported that arrangements had been made with 155 designated depositaries and financial agents of the Government to establish banking facilities at 160 Army posts and Navy stations.

Throughout World War II, MBFs continued to be used extensively. Following cessation of hostilities, the War Department had some doubts about the authority for establishing MBFs and for continuing existing facilities. On May 21, 1947, the Under Secretary of War requested the opinion of the Attorney General of the United States on these matters.

The Attorney General's opinion, rendered on January 20, 1948, concluded that continuing the MBFs was authorized and that providing them at Army installations clearly furthered Government operations by promoting the morale of Army personnel and reducing absenteeism and loss of time in obtaining necessary banking services. Accordingly, MBFs have continued to be established and operated, not only on military installations throughout the United States but, also on U.S. military installations in many foreign countries.

Overseas MBFs were first established in Germany at the end of World War II to serve U.S. occupation forces. At the request of the Army, American Express offices began selling travel tours and certain other services to U.S. Forces in Germany in August 1946, and because banking facilities were not available, a broadening of American Express services was sought. In February 1947, Treasury granted American Express a license to perform banking services for U.S. Forces and to act as a general depository of official and quasi-official U.S. funds. American Express opened its first banking facility at Frankfurt in March 1947, followed soon with offices in other parts of Germany.

The Chase Manhattan Bank was allowed to open a facility in Frankfurt in 1974, and since that time American Express and Chase Manhattan have been the only American banks operating MBFs in Europe. Chase Manhattan also operates a facility in the Netherlands. American Express maintains a much larger system and has offices in several European countries.

There are no U.S. bank-operated MBFs in Spain and Italy. Military finance offices provide banking services in Spain and local Italian-owned banks provide them on military installations in Italy. The Treasury Attache in Rome is responsible for the banking arrangements between the banks and military officials in Italy.

In the Far East, American Express opened its first banking facility in April 1950. The Bank of America, Chase Manhattan, and First National City Bank have also opened MBFs on military installations in the Far East, including Japan, Korea, Taiwan, the Philippines, and Thailand. A foreign commercial bank, which was established primarily for the convenience of local nationals and operates without a Treasury subsidy, supplements banking services at two large U.S. bases in the Philippines.

OVERSEAS MILITARY BANKING FACILITIES AT DECEMBER 31, 1974

Location	No. of MBFs	No. of employees	Accounts maintained: Demand (note a) Number	Demand (note a) Balance	Savings Number	Savings Balance
Crete	1	2	54	$ 34,645	22	$ 7,905
Cuba	1	16	2,335	5,921,218	5,545	10,838,648
England	15	148	13,692	11,199,779	6,823	4,528,348
Germany	125	1,241	97,500	113,999,270	78,236	47,323,653
Greece	3	29	2,689	3,110,370	1,711	2,014,953
Guam	3	61	4,937	3,380,394	3,189	2,066,023
Iceland	1	8	1,295	1,282,008	1,193	642,194
Japan	21	215	10,502	18,050,611	9,138	8,141,736
Korea	17	117	9,126	10,443,746	10,779	5,615,026
Morocco	1	6	557	926,885	417	478,747
Netherlands	3	7	285	198,790	491	422,408
Okinawa	11	201	13,695	11,950,285	12,672	7,072,064
Philippines	3	103	9,524	11,659,733	4,828	3,762,841
Taiwan	7	44	3,362	4,969,072	2,175	1,711,642
Thailand	10	172	12,937	12,727,209	4,874	2,866,230
	222[b]	2,370	182,490	$209,854,015	142,093	$97,492,418

[a]Includes 787 local currency accounts with a balance of $45.7 million authorized in England, Germany, Morocco, and Thailand.

[b]Consists of 144 facilities operating at least 5 days a week, 73 operating part time, and 5 currency exchange outlets.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

FISCAL ASSISTANT SECRETARY

October 7, 1975

Dear Mr. Fasick:

This is in further reply to your letter of June 20, with which you forwarded copies of a draft report to the Congress entitled "Overseas Military Banking -- Its Financing and Management Arrangements."

(See GAO note)

The following comments are on the specific recommendations you have made on page 29[1] of your draft for consideration by the Secretary of the Treasury. For clarity, I will first repeat your recommendation and follow with our comments.

Recommendation: Reassess the use of compensating balances as the method by which Treasury finances the banks' operating losses giving consideration to adopting an alternative method of financing the losses such as by direct reimbursement.

Comment: The use of compensating balances has involved significantly less cost to the Government than what would have been incurred if direct reimbursement had been used. For the period covered by your report, i.e., calendar years 1971--1973[2] the cost to the Treasury for maintaining compensating balances with banks operating overseas facilities was nominal. The balances that were maintained were a part of the Treasury's operating cash and were placed with the banks when we had surplus cash and were withdrawn when we needed the cash. The balances maintained with the banks would otherwise have been in the form of non-earning assets and their placement with the banks did not, therefore, create any additional cost to the Treasury. While changes in the handling of our operating cash which have taken place in the last year have minimized the amount of Treasury cash maintained as a non-earning asset, there is still from time to time an advantage in the use of compensating balances as compared to direct payment.

In an earlier part of your report you have said that the Congress may wish to consider requiring the Treasury or DoD to include in its annual appropriation request an amount for the operation of the military banking facility program. We do not object to the appropriation requirement should

GAO note: Deleted comments relate to matters not discussed in this final report.

[1]Page number references may not correspond to the pages of this report.

[2]Report updated to cover the period 1972-74.

the Congress determine that an appropriation should be required. We do believe, however, that the use of compensating balances should be retained as an optional method of accomplishing the reimbursement of bank costs.

Recommendation: Reassess existing arrangements for determining Treasury's share in the banks' earnings on depositor account balances that are invested by the banks to insure that the methods are fair and reasonable to both the banks and the Government.

Comment: We agree that the formula for determining analysis credit to be derived from account balances should be continually reassessed and this has been done as evidenced from the changes that we have made from time to time in such formulas.

Your report does not acknowledge some basic principles which we feel must be followed in establishing an earning credit formula. First, we feel that the balances that banks are required to secure by the pledge of collateral, i.e., Treasury accounts, disbursing officers' accounts, and non-appropriated fund accounts, must be treated differently than accounts of individuals which do not require a pledge of collateral.

For those accounts that must be secured, we feel that the earning value must be related to the yield of eligible collateral. Since the collateral must be Treasury or agency securities or securities fully guaranteed by the Government, it is simply a question of selecting certain securities in which the balances are considered to be invested. The need for relating earning rates to specific categories of securities is essential in order that there may be a base from which any change may be made. For example, if as is the practice we use Treasury bill rates, we have the option of changing to a new formula without substantial delay and without capital gains or losses. If we were to relate earning rates to long-term securities, we would either have to give advance notice of any change matching the maturity of the securities, or we would have to adjust to the current market prices which could involve significant gains or losses. We feel this is highly undesirable. For those accounts that must be collaterally secured, we feel, therefore, that the earning rates should continue to be based on the Treasury bill rates.

For accounts of individuals, both demand and savings, where collateral is not required, there is still a basic requirement that determination of earning value be based on the assumption that the funds are invested in specific types of investments with specific terms. Here again there must be a fixed, even though phantom investment, if we are to know how to implement any future change in the earning rate formula.

We do not feel that the funds can be considered to be invested in anything involving an investment risk. Unless the Treasury is willing to assume that risk, it would not be equitable to the banks to use such measure.

For that reason, we cannot concur in your suggestion for the possible use of the prime rate. If we did so, we would be subject to demands by the banks for reimbursement of losses they sustain on such loans. In our opinion, therefore, the investment must be considered as being in risk-free obligations such as (1) Government obligations, (2) secured Federal fund loans, and (3) certificates of deposit with the banks themselves. On the last item, if we use the rates the banks are themselves paying, we would not be involved in any investment write-offs for our relationship with the banks would be the ordinary depositor/bank relationship. This latter basis is the one we have used in establishing the value of certificates of deposit offered by overseas banking facilities to their customers.

As explained to your staff, we are considering further revisions in the formula for computing the earning value of accounts of individuals and we expect to adopt a new formula in the near future.

Recommendation: Examine the feasibility, in cooperation with the Secretary of Defense, of the Department of Defense reimbursing Treasury for the operating losses currently being borne by Treasury.

Comment: We have been considering this possibility for several months and it does have substantial appeal in that it places the cost of the program with the agency most directly benefiting from the program. As discussed with your staff we feel, however, that the recommendation is incomplete for if the Department of Defense is to bear the cost of the program, it is inevitable that they would assume the management of the program. It seems highly unrealistic that the Treasury could continue to manage the program if the Department of Defense funds its cost. It seems inevitable that Defense would expect to assume the decision-making role on such questions as (1) which military installations should be served by banking facilities, (2) what should the hours and days of operation be, (3) what should the user charges be, (4) what should check-cashing practices be, etc. We believe, therefore, that the only realistic question to be considered is "should the Department of Defense assume the management and the cost of the military banking facility program?" Should we determine that this action should be taken, we would, of course, have to allow the Department of Defense sufficient lead time to obtain appropriations to fund the cost.

Recommendation: Consider requiring the banks to submit annual operating budgets to Treasury to better enable Treasury, as well as the banks, to periodically evaluate the efficiency of operating practices.

Comment: We agree that the submission of operating budgets by banks is desirable even though there are a number of variables that cannot be anticipated and which would significantly affect the budget results. We had one of the banks informally present such a budget last year and we expect to adopt the practice of formal budgets. At a minimum this will permit identifying more closely what occasions deviations -- were they due to changes in exchange rates, new labor contracts, etc., or were they due to factors directly within the control of management.

Recommendation: Undertake the formulation of a set of standard instructions delineating the policies and practices the banks are to adhere to in operating and managing their overseas military banking activities.

Comment: Beginning on page 12 of your draft, you state that there is an absence of formal and standardized governing instructions which banks could use to guide them in the many facets of the overseas military banking program in a uniform and consistent manner. I disagree that there is an absence of standardized instructions.

Generalized instructions covering the establishment and operation of banking facilities are covered by Department of Defense Instructions No. 1000.11 and 1000.12 which were prepared jointly by Treasury and the Department of Defense. Specific instructions to banks going beyond the topics covered in the Department of Defense instructions are covered in individual letters to the banks. For example, in establishing rates of exchange to be used by military banking facilities in providing accommodation exchange service, we utilize a single letter to each bank, which letter is completely revised from time to time when the need arises for any change therein. The general policies and practices are identically stated in the letter to each bank. The application of the general policy varies with the exchange rate practices in the individual countries. In the letter to each bank we, therefore, cover the specific application of the general practice to the countries in which that bank operates. There would be no purpose in advising the First National City Bank of the specific application of the exchange rate principle to be followed in Germany, Thailand, and the United Kingdom since they do not operate in those countries. We use similar general letters to cover other major subject areas such as check-cashing practices, account service charges, loan procedures, etc. We agree that it would be desirable to bring together all of such instructions in a single manual, but this is a question of form and not of substance. Your report mentions no specific areas where instructions should be issued and have not been issued. We are, of course, not saying we have covered every possible area where questions could arise where the banks need guidance. On the other hand, we feel that our instructions are reasonably complete and if you disagree, we would like to see specifically what you feel should be covered and has not been covered.

Recommendation: Strengthen their oversight role of the entire banking program, giving special consideration to opportunities for reducing losses subject to Treasury reimbursement.

Comment: The Treasury's oversight has been predominantly accomplished by desk audit based upon reports received from the banks, from the military commands and upon data from other sources. In addition, Treasury representatives from time to time have visited the Commands being served by military banking facilities and have conducted management reviews of the banking facilities. Within the limits of available resources, it has been felt that the benefits of the management reviews exceed what could be accomplished by a financial audit. We agree that financial audits should also be performed, at least on a limited basis. We believe that financial audits could most effectively be performed by the staff of the military departments served in the countries in which the overseas facilities are located. We intend, therefore, to develop an audit program and request the Department of Defense to carry out periodic financial audits either through the Defense audit organizations, or through base comptrollers, or other qualified personnel.

Recommendation: Formulate, in cooperation with the Secretary of Defense, specific procedures for the banks and military commanders to follow in reducing losses attributed to bad checks and defaulted loans.

Comment: We have continuously been working with the Department of Defense to strengthen procedures for the banks and military commanders to follow in order to reduce losses with respect to bad checks and defaulted loans. The Department of Defense advises us that there is no legal basis for the use of setoffs on obligations of military personnel to banking facilities in the same way that such setoffs are used for pay and allowance for obligations to the Government or to non-appropriated fund activities. Inherent in the practice of cashing stateside checks and cashing checks of account holders at overseas installations and treating such checks as cash items in the United States, there are risk factors which cannot be avoided. While there have been losses, we feel that the advantages in terms of services provided to military personnel outweigh the losses that are being incurred.

Sincerely,

David Mosso

Mr. J. K. Fasick
Director
International Division
U. S. General Accounting Office
Washington, D. C. 20548

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

COMPTROLLER

August 26, 1975

Mr. J. K. Fasick
Director, International Division
United States General Accounting Office

Dear Mr. Fasick:

The Secretary of Defense has asked that we respond to your letter of June 20, 1975, in regard to the draft report on Overseas Military Banking, Its Financing and Management Arrangements, OSD Case #4105.

Of the two recommendations for the Secretary of Defense, the first is that we review logistic support services to insure consistency among the Military Departments and to provide such services whenever total costs to the Government can be reduced. We agree with this recommendation, and significant steps already have been taken to implement it. As the report indicates, some banking offices already have been moved to Defense quarters, and it is anticipated that all of the banking offices in the Frankfurt area will have been relocated to Defense quarters by the end of 1975.

In addition, the adequacy of janitorial services is now under review at 48 locations in Germany, and corrective action is being taken where appropriate. Logistic support policies are adequately described in Military Department regulations, and the formal agreements between the operating bank and each installation commander are being reviewed and brought up to date wherever necessary. Increased emphasis on communications with Treasury and the operating banks should help us to learn about and eliminate deficiencies promptly.

The second recommendation for the Secretary of Defense is that the Military Departments be required to take a more active role in the audit and oversight of the overseas banking program. We support the intent of this recommendation. Since last fall the Military Departments have been enforcing the requirement that field commanders review and submit comments on the quarterly reports of each banking facility. In addition, our internal audit organizations will make selective reviews of the implementation of our military banking directives during scheduled installation audits.

We believe, however, that the audit of bank records and operations is outside the present authority of Defense audit organizations. If such authority were provided, the workload would be more than could be absorbed under current personnel limitations. Of course, cost benefit questions would arise in regard to possible savings in the audit of bank operations in comparison to savings that might result from alternative assignments for our auditors.

Two of your recommendations for the Secretary of the Treasury call for Defense involvement in their implementation, and comments on those recommendations are included in an attachment to this letter. We ask that both this letter and the attachment be made part of the final version of your report.

Since 1947 the overseas banking program has provided necessary personal services for our men and women, military and civilian, and their dependents at overseas posts. The work of the Treasury Department has been essential to the success of the program, and we appreciate very much the continued support received from that department. We welcome periodic reviews of the program. Such reviews can help us to locate and remedy deficiencies and to identify ways of improving services and lessening the total cost to the Government.

Sincerely,

Terence E McClary

Attachment

ADDITIONAL DEPARTMENT OF DEFENSE COMMENTS
ON
GAO DRAFT REPORT OF JUNE 20, 1975,
OVERSEAS MILITARY BANKING, ITS FINANCING AND MANAGEMENT ARRANGEMENTS
OSD CASE # 4105

1. Recommendation for Secretary of the Treasury: "Examine the feasibility, in cooperation with the Secretary of Defense, of the Department of Defense reimbursing Treasury for the operating losses currently being borne by Treasury."

   COMMENT: We do not believe it would be feasible for Defense to pay operating losses from appropriated funds without the transfer from Treasury to Defense of the authority to establish and discontinue banking facilities, determine user charges, and take related actions that have a direct impact on the amount of the operating losses. However, such changes would appear to conflict with other recommendations for the strengthening of Treasury's management role.

2. Recommendation for Secretary of the Treasury: "Formulate, in cooperation with the Secretary of Defense, specific procedures for the banks and military commanders to follow in reducing losses attributed to bad checks and defaulted loans."

   COMMENT: The Military Departments now have specific procedures for helping the banks to reduce losses attributed to bad checks and defaulted loans. We agree that these procedures should be reviewed and strengthened, where appropriate, to give the banks the maximum amount of assistance permitted under present laws.

3. General Observation on page 17[1] of Draft Report: "One bank official advised us that such agreements were not of much value, because the military still only provided what logistic support was readily available, irrespective of what was contained in the agreement."

   COMMENT: It is difficult to respond to this type of generalization. The Department of Defense would be pleased to know of specific deficiencies in the implementation of the formal agreements between the operating bank and the installation commander and to act promptly to remedy such deficiencies.

4. General Observation on page 20 of Draft Report: "One bank official informed us that they experienced high losses from bad checks in Vietnam. They stated further that they had very little cooperation from the military in recovery of these losses."

   COMMENT: In a combat environment accompanied by frequent troop movement and constant rotation, it is to be anticipated that local commanders would often find it difficult if not impossible to render full support in collection actions.

[1] Page number references may not correspond to the pages in this report.

PRINCIPAL OFFICIALS RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
DEPARTMENT OF THE TREASURY		
SECRETARY OF THE TREASURY:		
William E. Simon	May 1974	Present
George B. Shultz	June 1972	May 1974
John B. Connally	Feb. 1971	June 1972
David M. Kennedy	Jan. 1969	Feb. 1971
FISCAL ASSISTANT SECRETARY:		
David Mosso	Aug. 1975	Present
John K. Carlock	June 1962	July 1975
DEPARTMENT OF DEFENSE		
SECRETARY OF DEFENSE:		
James R. Schlesinger	July 1973	Present
William P. Clements (acting)	May 1973	June 1973
Elliot L. Richardson	Jan. 1973	May 1973
Melvin R. Laird	Jan. 1969	Jan. 1973
ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER):		
Terence E. McClary	June 1973	Present
Don R. Brazier (Acting)	Jan. 1973	June 1973
Robert C. Moot	Aug. 1968	Jan. 1973
DEPARTMENT OF THE ARMY		
SECRETARY OF THE ARMY:		
Martin R. Hoffman	Aug. 1975	Present
Howard Callaway	May 1973	July 1975
Robert F. Froehlke	July 1971	May 1973
Stanley R. Resor	July 1965	June 1971

DEPARTMENT OF THE NAVY

SECRETARY OF THE NAVY:

J. William Middendorf II	June 1974	Present
John W. Warner	May 1972	Apr. 1974
John H. Chafee	Jan. 1969	May 1972

DEPARTMENT OF THE AIR FORCE

SECRETARY OF THE AIR FORCE:

John L. McLucas	July 1973	Present
Dr. Robert C. Seamans, Jr.	Feb. 1969	May 1973

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