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U.S. TREASURY

Observations on Plans to Study Genuine and Counterfeit U.S. Money Abroad

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our observations on the Department of the Treasury's October 1996 audit plan and its April 1997 addendum to study the uses, holding, and counterfeiting of U.S. currency in foreign countries. As we reported in February 1996, the Secret Service used its detection data to reflect the actual amount of counterfeit U.S. currency notes abroad, despite limitations in these data that raised doubts about their usefulness for measuring counterfeiting activity. Subsequently, Congress passed the Antiterrorism and Effective Death Penalty Act of 1996 (P.L. 104-132, Apr. 24, 1996) which, among other things, requires that the Secretary of the Treasury develop a plan that is designed to enable the Secretary to (1) study the use and holding of genuine U.S. currency in foreign countries and develop useful estimates of the amount of counterfeit U.S. currency that circulates outside the United States each year, (2) conduct audits based on this methodology, and (3) report triennially on the results.

My remarks today are based both on our report on the Treasury's original plan entitled U.S. Currency: Treasury's Plans to Study Genuine and Counterfeit U.S. Currency Abroad (GAO/NSIAD-97-104, Apr. 11, 1997), and our assessment of the Treasury's subsequent addendum to the plan.

Summary

Our review of the Treasury's original plan submitted to Congress indicated that it did not explain how it would enable the Treasury to meet the audit objectives required under the act. The plan's audit objectives were not clearly stated. Although the Treasury's plan identified some elements of a methodology that could be employed to collect information about the uses of genuine U.S. currency abroad, it did not specify how the Treasury intended to analyze the information that might be collected. The plan also did not define the methodologies that the Treasury expected to use to estimate the amount of genuine and counterfeit U.S. currency in circulation abroad.

After we outlined our concerns to Treasury and Federal Reserve officials, the Treasury agreed to submit to Congress an addendum to the plan. The addendum's purpose was to more fully explain the objectives and the methodologies the Treasury intended to use. On April 21, 1997, the Treasury sent its addendum to Congress.

The addendum adds some clarity to the Treasury's audit plan, but some questions remain. The addendum describes the Treasury's audit objectives, provides new information that makes it easier to understand the methodologies the Treasury intends to use to develop estimates of the amount of genuine and counterfeit U.S. currency abroad, and provides current Federal Reserve estimates based on those methodologies. However, the addendum does not clearly address a deficiency in the plan that we previously reported. Specifically, the addendum does not fully describe the methodology the Treasury will use to collect, summarize, and report information on the uses of genuine U.S. currency abroad. Furthermore, because much of the Treasury's methodologies for developing estimates are based on existing data, it is not clear what additional fieldwork or information is needed. The addendum does not explain how the audit steps from the original plan, particularly those for the interviews planned for future trips abroad, are to be incorporated into any of the methodologies described in the addendum. For example, questions remain about what useful new information the overseas trips are expected to yield and how it will be integrated into the Treasury's estimates of the amount of genuine and counterfeit U.S. currency abroad and information on the uses of genuine U.S. currency abroad.

With that overview, let us now go back and provide some contextual background and discuss our observations on the Treasury's original plan and the addendum in more detail.

Background

All currencies are susceptible to counterfeiting, but the stability and worldwide acceptance of U.S. currency, in particular, have made it a target for international counterfeiters. Although the extent of counterfeit U.S. currency produced and circulated in foreign countries is difficult to determine, an evaluation of the threat can be used to allocate scarce resources to its detection and to assess the effectiveness of measures to combat counterfeiting.[1] In the past, the Secret Service used its detection data to reflect the actual amount of counterfeits abroad. However, as we

[1]Other tools may include evaluating the quality or usage of the counterfeits, the type of equipment used, the type of perpetrator, and the connection with other crimes. See GAO/NSIAD-97-104.

reported in February 1996, the limitations associated with such data raised doubts about their usefulness for gauging counterfeiting activity.[2]

Counterfeiting of U.S. currency, if it became widespread, could undermine confidence in the currency and perhaps even reduce the international holdings of U.S. currency and negatively affect the U.S. economy. When U.S. currency remains in circulation abroad, it essentially represents an interest-free loan to the U.S. government. The Federal Reserve has estimated that the U.S. currency held abroad effectively reduces the need for the government to borrow up to $250 billion a year and thus may lower the government's interest costs by over $10 billion a year. If confidence in the dollar were undermined, individuals might switch to other currencies, which would reduce this benefit to the United States. It was within this context that the Treasury was called upon to develop better ways to, in essence, monitor the extent of genuine and counterfeit U.S. currency abroad.

The Treasury's Original Plan Was Unclear and Incomplete

The audit plan originally submitted to Congress by the Secretary of the Treasury did not demonstrate how it would enable the Treasury to meet the audit plan objectives required under the law. A written plan should define the audit's objectives and the scope and methodology to achieve those objectives.[3] The Treasury plan's audit objectives were not clearly stated. Concerning scope, the original plan provided a time line for completing the audits, site selection criteria for regions of the world, and information and data sources. Although the original plan provided some information on data gathering, it did not adequately explain the analytical methods the Treasury intended to use to achieve the objectives. For example, the original plan identified data sources and provided questions

[2]In 1996, we reported that the available data presented many limitations, and we questioned whether the Secret Service had a sufficient basis to conclude either the approximate magnitude or the trend of counterfeiting activity abroad. Some specific limitations of the data are that they (1) included only those counterfeit detections that were reported to the Secret Service; (2) may have underreported the occurrence of high-quality currency notes because those notes are difficult to detect; (3) may have reflected factors other than increasing counterfeit activity, such as improvements in the ability to detect counterfeits or to determine their source; and (4) may have shown fluctuations over time that were skewed because of the occurrence of unusually large seizures. See Counterfeit U.S. Currency Abroad: Observations on Counterfeiting and U.S. Deterrence Efforts (GAO/T-GGD-96-82, Feb. 27, 1996) and Counterfeit U.S. Currency Abroad: Issues and U.S. Deterrence Efforts (GAO/GGD-96-11, Feb. 26, 1996).

[3]The objectives are what an audit is to accomplish and can be thought of as questions that auditors seek to answer. Objectives identify the audit subjects and performance aspects to be included, as well as the potential finding and reporting elements that the auditors expect to develop. Scope is the boundary of the audit. It addresses such things as the time period and number of locations to be covered. The methodology comprises data-gathering and analytical methods auditors will use to achieve the objectives. See Government Auditing Standards: 1994 Revision (Washington, D.C.,: U.S. General Accounting Office, June 1994).

that may be asked of foreign financial and law enforcement officials, but it did not fully explain how this information would be analyzed and synthesized to address each of the audit plan objectives set forth in the act.

The original plan did not describe analytical methods for studying the holding of genuine U.S. currency abroad and developing estimates of counterfeit U.S. currency abroad. However, it did describe elements of a methodology that might be used to study the use of genuine U.S. currency abroad. According to the original plan, the Federal Reserve would attempt to specify and test a model to support or refute an assumption about currency movement outside the United States. The assumption was that U.S. currency would move between and among individuals and business firms in such a way that the portion of U.S. currency held abroad that was received by the Federal Reserve each year through its foreign-origin currency receipts (at least 13 percent in 1995) was representative of the total amount of U.S. currency abroad. The Federal Reserve's model was expected to focus on the factors that cause certain amounts to (1) come into the possession of financial institutions abroad, (2) be regarded as surplus to the needs of those individual financial institutions, (3) be sold subsequently to correspondent banks,[4] and finally, (4) be deposited by a correspondent bank at the Federal Reserve.[5] However, the plan did not fully explain how the Treasury intended to analyze the information obtained to reach conclusions about the use of U.S. currency abroad.

After we outlined our concerns about the original audit plan to Treasury and Federal Reserve officials, the Treasury official responsible for the plan advised us that the Treasury planned to submit a written addendum to Congress that would explain in more detail the Treasury's proposed methodologies, the assumptions the Treasury made, and the limitations associated with the resulting estimates. As stated, the Secretary of the Treasury submitted an addendum to Congress in April 1997, to more fully explain the objectives and methods the Treasury intends to use to report on the uses, holding, and counterfeiting of U.S. currency abroad. In the

[4]A correspondent bank is a financial institution that regularly performs services for another in a market inaccessible to the other. In banking there is usually a depository relationship that compensates for expenses and facilitates transactions.

[5]Information about how citizens and businesses, other than financial institutions, use U.S. currency abroad is likely to be addressed as part of the information on how and why financial institutions obtain U.S. currency. Financial institutions obtain U.S. currency for many reasons and from many sources; for example, in countries with unstable currencies, traders may deposit proceeds from sales transacted in U.S. currency.

addendum, the Treasury stated that it had begun fieldwork and intended to report to Congress sometime before the September 1999 deadline.

Treasury's Addendum Adds Clarity, but Some Questions Remain

The Treasury's addendum addresses some of the issues we previously raised, but questions remain. The addendum provides the Treasury's objectives, the methodologies that the Treasury intends to use to meet its objectives for developing estimates of genuine and counterfeit U.S. currency abroad, and estimates resulting from those methodologies. However, the addendum does not fully address a concern we previously reported about the Treasury's limited explanation of how it intends to analyze and report information on the uses of genuine U.S. currency abroad. The Treasury has already collected information on the uses of U.S. currency in 18 locations around the world, but the methodology for analyzing and reporting such information is not explained. Further, given that some of the data on currency usage has been collected and that much of the Treasury's methodologies for developing estimates use existing data, it is not apparent what additional fieldwork and information the Treasury needs to complete to meet its objectives.

The addendum addresses some of the deficiencies we identified in the original plan. The addendum describes, in detail, the methodologies the Treasury will use to develop estimates of the amount of genuine and counterfeit U.S. currency abroad and provides estimates based on these methodologies. The methodologies are based on data already maintained by the Federal Reserve and assumptions that, according to the addendum, are supported by evidence that has been gathered from overseas sources, including overseas trips made by the Treasury, Secret Service, and Federal Reserve.[6]

The addendum provides answers to the questions on the amount of genuine and counterfeit U.S. currency circulating abroad by providing Federal Reserve estimates. According to the addendum, the Federal Reserve estimates that about $200 billion to $250 billion of U.S. currency, or more than half the roughly $375 billion in circulation outside of banks in 1995, was abroad. The 1996 estimate had not yet been completed, but the available information suggested that approximately $215 billion to $265 billion out of about $400 billion of U.S. currency was held abroad at the end of last year, according to the addendum. The addendum also cites

[6]As of February 12, 1997, visits had been made to 18 countries or entities where U.S. currency was used or distributed to a significant extent. These locations are Argentina, Bahrain, Belarus, Cambodia, Egypt, England, Indonesia, Hong Kong, the Philippines, Russia, Saudi Arabia, Singapore, Switzerland, Taiwan, Thailand, Turkey, the United Arab Emirates (Abu Dhabi and Dubai), and Vietnam.

a Federal Reserve estimate of total counterfeit U.S. currency in circulation of $40 million to $67 million worldwide. Of this amount, the Federal Reserve estimates that $15 million to $25 million in counterfeit $100 notes circulate outside of the United States.[7] According to the Federal Reserve, the estimates suggest that 1 in 10,000 U.S. currency notes is likely to be counterfeit.

Although the addendum addresses our previous concern about how the Treasury intends to develop estimates of genuine and counterfeit U.S. currency circulating abroad, it does not clearly address our previous concern about the analysis and reporting of information on the uses of genuine U.S. currency abroad. To address this objective, the addendum states the Treasury and the Federal Reserve will develop models for currency usage in selected countries or regions where U.S. currency is widely used, such as the former Soviet Union and Argentina. Each model is expected to account for the relevant variables that dictate the usage and flows of U.S. currency, such as economic conditions (for example, inflation and trade), the level of development of the banking and financial systems, political stability, currency and foreign exchange controls, laws regarding the use of U.S. currency for certain transactions, the number of expatriate workers, and the amount of tourism. The addendum also cites the possibility of modeling how much domestic currency residents of a country would hold in the absence of any foreign currency holdings. Because the addendum does not identify additional information the Treasury would need to develop such models, it is not clear what additional work the Treasury needs to perform. Although, as of February 1997, information had been collected in 18 countries or entities where U.S. currency was used or distributed to a significant extent, including the former Soviet Union and Argentina, the methodology for analyzing and reporting information on U.S. currency usage abroad, including how specific models are to be integrated into the process, had not been defined.

Finally, the Treasury had already conducted a number of interviews worldwide using similar questions on U.S. currency usage, holding, and counterfeiting to those listed in the original plan, but the addendum only makes a passing reference to overseas visits.[8] What additional information

[7]Overall, according to the Federal Reserve, $100 notes accounted for approximately three-quarters of the value of all counterfeit notes passed last year.

[8]The addendum refers to foreign currency audits and other information from foreign central banks in its description of how the Treasury intends to produce estimates of genuine U.S. currency held in various regions of the world. The Treasury has previously obtained such information during overseas visits.

was to be derived from such visits and what additional fieldwork needed to be conducted in order to meet the Treasury's objectives were not discussed. Although the Treasury may have other reasons for overseas trips, such as using them as a forum for discussions, exchanges of ideas, and counterfeit-detection training, it is not clear from the addendum how sending U.S. officials on additional trips abroad would provide useful information for reporting purposes under this act.

Mr. Chairman and Members of the Subcommittee, that concludes our prepared statement. We will be pleased to answer any questions you may have.

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