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**IMPROVING MARINE CORPS MANAGEMENT
OF FOREIGN CURRENCY FLUCTUATION
TRANSACTIONS**

by

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December 2020

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FLUCTUATION TRANSACTIONS**

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Submitted in partial fulfillment of the
requirements for the degree of

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from the

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ABSTRACT

This project researched the policies and processes of the Marine Corps to manage foreign currency fluctuations. The research methodology began with a literature review, followed by a review of government laws, regulations, and policies. This research also included interviews with Headquarters Marine Corps personnel involved in foreign currency transactions and a data analysis of transactions in the Marine Corps' accounting system and defense budget rate reports. Investigation into how the Marine Corps pays for foreign currency losses found inefficient methods. The Marine Corps funds these expenses internally because Department of Defense policies hinder reimbursement. Furthermore, the current procedures lose fiscal transparency and hinder the auditability of foreign currency transactions. In addition to recommending courses of action to improve those issues, this project also addresses the exchange rates used when incurring foreign obligations. Through improved management of foreign currency transactions, the Marine Corps can annually reallocate millions of dollars of government funding to mission-essential expenses, increase its auditability as an executor of taxpayer funds, and alleviate concerns of fiscal law violations.

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LIST OF ACRONYMS AND ABBREVIATIONS

ASN(FM&C)	Assistant Secretary of the Navy (Financial Management and Comptroller)
CMA	Centrally Managed Account
DOD	Department of Defense
DON	Department of the Navy
DTC	Document Type Code
FC	Foreign Currency
FCF	Foreign Currency Fluctuation
FCFCD	Foreign Currency Fluctuation, Construction, Defense
FCFD	Foreign Currency Fluctuation, Defense
FHOPS	Family Housing Operation & Maintenance, Navy and Marine Corps
FMB	Financial Management – Budget, ASN(FM&C)
FY	Fiscal Year
GAO	Government Accountability Office (formerly General Accounting Office)
HQMC	Headquarters Marine Corps
ITS	International Treasury Services
KO	Contracting Officer
LOA	Line of Accounting
MCICOM	Marine Corps Installations Command
MILPERS	Military Personnel
NDAA	National Defense Authorization Act
O&M	Operations and Maintenance
OUSD(C)	Office of the Under Secretary of Defense, Comptroller
OMMC	Operations and Maintenance, Marine Corps
P&R	Programs and Resources Department, HQMC
PL	Public Law
RFE	Execution Branch, Budget and Execution Division, P&R, HQMC
RFF	Finance Branch, Fiscal Division, P&R, HQMC
RFI	Investment Branch, Budget and Execution Division, P&R, HQMC

SABRS	Standard Accounting, Budgeting, and Reporting System
SDN	Standard Document Number
SMARTS	SABRS Managements Analytical Retrievals Tools
USMC	United States Marine Corps

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I. INTRODUCTION

The Marine Corps operates worldwide and frequently purchases goods and services from foreign vendors. These purchases take place in the vendor's local currency. The purchasing contract obligates the government at an exchange rate, but the payment does not occur until goods are delivered or services are rendered. For this reason, the Marine Corps might pay the vendor several months later, at a different exchange rate. The difference between the contract price and the payment amount is the foreign currency fluctuation (FCF). This risk of fiscal uncertainty resides with the Department of Defense (DOD), as the vendor receives payment in their currency, with no fluctuation consequences.

This entire process starts with the contract. The current policy has contracting officers agree to a total cost, in the vendor's currency. The DOD assumes all risk of exchange rate changes, as the vendor is guaranteed a specified amount. Including an exchange rate as a negotiable term within the contract alleviates the fiscal uncertainty of subsequent fluctuations. Under this modification to policy, if the exchange rate fluctuates throughout the purchase process, then DOD suffers from no realized gains or losses.

Moreover, the exchange rate at which the contract is established sets the tone for the rest of the agreement. Inaccuracy of this initial rate exacerbates eventual fluctuations, as small changes to the final rate are worsened due to an imprecise rate at the beginning. DOD establishes this obligation rate far in advance, originally used when budgeting for an upcoming fiscal year. More recent rates are available for obligation at the push of a button and selecting these may help reduce the realized gain or loss upon eventual payment.

Congress created a specific pot of money to pay for losses due to FCF, and to store gains from FCF. In order to request reimbursement, Headquarters Marine Corps (HQMC), Programs and Resources (P&R) centrally manages FCF on behalf of the Marine Corps. They have the fluctuations consolidated into transactions by currency, which they can sum up and send to the Office of the Under Secretary of Defense, Comptroller (OUSDC).

The United States Marine Corps (USMC) has failed to obtain FCF funding from OUSD(C) in recent years, perhaps because of unclear policies leading to unmet thresholds and deadlines. P&R has requested reimbursement of FCF in their current year appropriations, but OUSD(C) often denies the request due to the relatively small amount or the time of year. In consequence, the Corps pays millions out of its internal funding to cover FCF losses. This funding could serve to man, train, or equip Marines if OUSD(C) instead provided FCF reimbursement in accordance with congressional intent. In order to obtain FCF funding, P&R and OUSD(C) should alter the process to transfer funding authority into P&R's account in advance, or to set a deadline for requests in which reimbursement of any amount is guaranteed.

Moreover, the process of consolidating transactions loses transparency of government spending and does not effectively monitor this aspect of financial management. When commands transfer the FCF to P&R, the accounting system does not maintain a link to the original transaction. Supporting documentation for these fluctuations must be intensely researched and unearthed upon auditing P&R's centrally managed transactions. Establishing and enforcing a policy to ensure the FCF adjustment includes the original document number, as well as providing supporting documentation at the time of adjustment, would help bolster Marine Corps auditability.

The process for USMC management of foreign currency fluctuations would benefit from adjustment and enforcement. The contracting policy puts the full weight of fiscal uncertainty on the Marine Corps and can be improved. P&R could also address the policy to select current exchange rates for obligation, possibly reducing eventual fluctuations. Once FCF gains or losses are realized, the process to obtain funding from the dedicated appropriation should be examined and adjusted to ensure it follows congressional intent and is enforced.

A. OBJECTIVES

After evaluating the current processes against published policies, laws, and good public management practices, this project forms recommendations intended to:

- Address the flow of funding to increase transparency and thus auditability, to guarantee that all spending complies with congressional intent, and to ensure that the USMC Operations and Maintenance (O&M) appropriation yields the greatest benefit to the readiness of the Corps.
- Improve the accuracy of selected exchange rates when contracting to minimize the realized gains and losses of FCF.
- Reduce overall fiscal uncertainty of FCF transactions for operational units and HQMC.

B. RESEARCH QUESTIONS

To accomplish these objectives, the project compiled two primary and four secondary research questions. The primary questions of this project address the weaknesses of the current processes and how to improve them. In order to address these, the secondary questions dive deeper into the specific processes utilized for obligating, liquidating, tracking, and funding foreign currency transactions.

- Primary Questions
 1. What are the major weaknesses of Marine Corps processes for managing foreign currency fluctuations?
 2. How can the Marine Corps improve these processes?
- Secondary Questions
 1. What are the Marine Corps processes to obligate funding on transactions with foreign vendors and can they be improved?
 2. What are the Marine Corps policies for considering the fluctuations of foreign currency exchange rates to manage gains and losses of disbursements?
 3. What accounting practices does the Marine Corps use to track transactions of foreign currency fluctuations?

4. How does the Marine Corps obtain external funding to pay for unbudgeted foreign currency fluctuations?

C. SCOPE AND METHODOLOGY

The scope of this project centers on USMC foreign currency transactions using its O&M appropriation. This project briefly addresses making changes from an acquisitions perspective—such as pursuing a forward exchange rate contract—but mainly focuses on financial management of foreign currency (FC) transactions. Hedging U.S. risks of exchange rates through other methods may be a topic for future research under an acquisitions focus.

The methodology involved in this research began with obtaining data relative to FCF and FC transactions. This data included reports; laws, regulations, and policies; interviews with involved personnel; accounting data; and budget reports. The Naval Postgraduate School and USMC Institutional Review Boards reviewed and approved the questions prior to the interviews. Analyzing this data resulted in findings of inconsistencies and shortfalls under the current policies and procedures. Determining possible courses of action led to this project's recommendations.

D. MAJOR RECOMMENDATIONS

The research culminated in recommendations that may improve multiple factors that affect the fiscal uncertainty of foreign currency fluctuation. First, adjusting acquisitions policies to share the burden of exchange rates would prevent the USMC from eventually realizing financial gains or losses. Next, incurring obligations at current rates may improve fiscal accuracy and reduce ensuing fluctuations. Lastly, P&R should evaluate its consolidation and tracking methods of FCF adjustments to implement a process that promotes accounting transparency and auditability. Accomplishing this may also help to obtain external funding from OUSD(C), as P&R requests for reimbursement would be explicitly substantiated through accounting and records management.

Next, Chapter II provides background information on foreign currency, defense appropriations, and fiscal law. Then, Chapter III reviews and analyzes data from public

reports, government documents, interviews, accounting data, and budget reports. Chapter IV postulates findings of these analyses and Chapter V outlines and elaborates upon the recommendations. This project concludes in Chapter VI with an answering of the research questions and tackling of the objectives.

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II. BACKGROUND INFORMATION

In order to comprehend the methodology, findings, and analysis of this report, the reader should first understand a few topics. This background information begins with an overview of foreign currency: its history, usage, and implications. It then covers several applicable United States appropriations, including the history and purpose of a defense-wide appropriation provided for foreign currency expenses. The background concludes with a brief overview of fiscal law and its applicability to foreign currency fluctuation policies.

A. FOREIGN CURRENCY OVERVIEW

This section briefly explains the history of exchanging currencies, followed by justification for conducting purchases in a foreign currency. This policy creates issues stemming from the varying exchange rates and elapsed time.

Following WWII, Allied powers signed the Bretton Woods agreement, which required member central banks to fix their currency to U.S. dollars, pounds Sterling, or gold. Setting currency values relative to another became a fixed exchange currency model. The fixed exchange rate system collapsed in 1973 in favor of a floating exchange rate regime. An open market determines a currency's strength in this structure, through supply and demand; although, governments and central banks can still intervene to influence their currency's value and maintain a favorable price (Mitchell, 2019).

USMC forces operate worldwide in numerous countries. When contracting vendor assistance in foreign nations, DOD components typically use the vendor's currency. Volume 5, Section 130302 of the DOD Financial Management Regulation (FMR) advises that they "arrange to accommodate the financial policies of each participating country or organization to the maximum extent feasible" (Office of the Under Secretary of Defense, Comptroller [OUSD(C)], 2019, p. 13-8). Paying a vendor in U.S. dollars would force them to assume the risk of exchange rate fluctuations. This additional risk limits the field of

vendors available for contracting, which U.S. forces avoid by contracting services through a vendor's currency.

The DOD budgets for foreign requirements far in advance of the actual contractual agreement, typically by more than 18 months. DOD has changed its methodology for estimating exchange rates, but they have consisted of miscellaneous calculations of an average of certain past rates. DOD annually publishes these budget rates for applicable foreign currencies.

The DOD incurs an obligation when it enters a legally binding agreement with a vendor in which it will purchase goods or services. When a component enters a contract with a foreign vendor, they use those previously set budgeted rates.

A liquidation occurs when the payment is disbursed to the vendor. The liquidation rate is the most up to date, as funding trades hands from U.S. forces to the foreign vendor. Volume 5, Chapter 13 of the DOD FMR appoints the International Treasury Services (ITS) system—at ITS.gov—as the DOD's preferred method for selecting precise exchange rates and issuing foreign currency payments.

Due to several reasons, such as production or shipping delays, the corresponding liquidation may occur long after the obligation. All else being equal, if the U.S. dollar increases in strength or the foreign currency weakens, then the corresponding liquidation will be less than the obligation, effectively gaining additional funds for the appropriation. On the other hand, a weakened U.S. dollar or strengthened foreign currency results in a loss, as the liquidation posts for higher than the obligation.

B. APPROPRIATIONS

Federal organizations receive funding through appropriations, which Congress enacts for specific uses. Approval of appropriations follow standard bureaucratic processes, which this section briefly describes. Several appropriations exist, but this section addresses pertinent ones that incur FC obligations.

1. Background

The House and Senate Armed Services Committees are the authorizing committees that produce the National Defense Authorization Act (NDAA) annually. The NDAA authorizes programs, as well as the appropriations to fund them, along with a multitude of other items, such as service personnel levels, authorized quantities for procurement programs, and other policies. It does not, however, provide budget authority.

Congressional Appropriations Committees of the House and of the Senate pass appropriations measures to provide budget authority to federal agencies, such as the DOD. “Budget authority allows federal agencies to incur obligations and authorizes payments to be made out of the Treasury” (Heniff Jr., 2012, p. 1). The regular appropriations acts passed by subcommittees each provide budget authority for the upcoming fiscal year (FY) within a specific appropriation.

In an instance where an approved appropriation does not have the balance to cover an expense, the services may submit a request for reprogramming to Congress for authorization. Reprogramming is defined as “...a change in the application of funds from the purposes originally budgeted. Reprogramming actions may be required because of cost and schedule changes, program performance, or increased or emergent requirements” (Assistant Secretary of the Navy (Financial Management and Comptroller) [ASN(FM&C)], 2015, pp. 2–15 – 2–16). According to the DOD FMR Vol 3 Ch 6, Congress views reprogramming “as a necessary, desirable, and timely device for achieving flexibility in the execution of DOD programs” (OUSD(C), 2019, p. 6-4).

2. Military Construction, Veterans Affairs, and Related Agencies Appropriations

These appropriations do not fall under the Defense Subcommittees and therefore are separate from the Defense appropriations. This Subcommittee has jurisdiction over the Family Housing Operation & Maintenance, Navy and Marine Corps (FHOPS) and other appropriations. FHOPS “provides for the operations and maintenance of family housing and related facilities” (ASN(FM&C), 2015, p. 1-23) for the Navy and Marine Corps—using accounting *Basic Symbol 0735*. A Family Housing Construction, Navy and Marine

Corps appropriation separately funds construction and improvement expenses for family housing, mobile home parks, and related projects.

3. Department of Defense Appropriations

The Senate and House Appropriations Subcommittees on Defense have jurisdiction over funding requirements for the U.S. military. This section addresses four appropriations relevant to this report.

This report centers mainly on the Operations & Maintenance, Marine Corps (OMMC) appropriation—under *Basic Symbol 1106*—and its implementation relative to foreign currency fluctuations. The OMMC appropriation is an annual appropriation that finances daily costs to equip and maintain the active forces of the Marine Corps (ASN(FM&C), 2015, p. 1-10). These expenses may include travel costs, supplies, fuel, maintenance equipment. Congress authorizes other O&M appropriations to fund similar costs of each service, as well as those for their reserve forces.

The Military Personnel, Marine Corps “appropriation provides annual financial resources to compensate active duty Marine Corps military personnel required to support the approved force structure” (ASN(FM&C), 2015, p. 1-5). MPMC finances salaries, allowances, bonuses, and moves for the Marine Corps. Congress provides other Military Personnel (MILPERS) appropriations to fund similar personnel requirements for each service, as well as costs for their reserve forces and retirees.

Procurement Marine Corps funds the procurement of weapons, hardware, and related systems used by Marine forces (ASN(FM&C), 2015, p. 1-17). Other Procurement appropriations fund Navy aircraft, Navy shipbuilding and conversion, Navy weapons, ammunition, and other equipment. Procurement appropriations are active for three years.

Congress established the Foreign Currency Fluctuation, Defense (FCFD) appropriation through Public Law 95-457 on October 13, 1978 as a no-year appropriation with the purpose of covering losses and storing gains from the fluctuation of foreign currency exchange rates. Title 10 United States Code (U.S.C.) § 2779 governs the use of FCFD.

Originally, Congress initiated the appropriation with a statutory limit of \$500 million, which they have subsequently raised to \$970 million. The appropriation cannot amass funding above this amount. In other words, the services cannot transfer in any gains incurred beyond this statutory limit. Instead, they accumulate as unobligated amounts in the appropriation. Maintaining a balance in the FCFD account ensures available funds can cover foreign currency losses to appropriations.

The FCFD appropriation supports O&M and MILPERS appropriations of the armed services. The Foreign Currency Fluctuations, Construction, Defense (FCFCD) appropriation supports foreign currency fluctuations affecting Military Construction and FHOPS. FCFCD has a separate statutory limit of \$125 million, as codified in Section 2779(b).

Conducting a reprogramming of funds from FCFD prevents an appropriation from obligating in excess of its budgeted authority due to exchange rate increases. If the payment to a vendor for a purchase results in a loss on an appropriation, then OUSD(C) can reprogram FCFD funds to that appropriation.

Section 2779(d) codified the restrictions on transferring unobligated O&M into FCFD, limited to two fiscal years once the appropriation expired. Funding gained due to foreign currency fluctuation, as well as unobligated balances of canceling appropriations, can be transferred into the FCFD account, up to its statutory limit. A reduction in foreign exchange rates can increase the unobligated balance of an appropriation; these gains can be saved through a transfer into the FCFD account.

4. Appropriations Life Cycle

O&M and MILPERS appropriations are examples of single-year appropriations, in that they cover charges only for the fiscal year—October 1 of the previous year through September 30 of the fiscal year—in which they are incurred, referred to as their period of availability. For example, on October 1, 2020, the fiscal year changed from FY20 to FY21. Single-year appropriations under FY20 become expired and could no longer incur new obligations; although, FY20 appropriations were still available for adjustments to existing obligations. FY21 is now in its period of availability and expires on October 1, 2021.

As a fiscal year ends, DOD financial managers typically strive to obligate as close to 100% of the appropriation's authority as possible, leaving very little available to cover future adjustments—referred to as reversions. A reversion addresses the reduction of an obligation, or gain, in an expired appropriation. Conversely, when obligations increase, possibly due to a price increase upon liquidation, the expired appropriation must have enough unobligated balance available to cover these negative reversions.

Moreover, these appropriations remain expired for five years, allowing adjustments to obligations within their authority, until they are ultimately canceled (also known as closed). Canceled appropriations can no longer be adjusted, and their unobligated balances are transferred back to the U.S. Treasury.

5. Centrally Managed Account (CMA)

Establishment of CMAs makes the expense of certain appropriations easier. On occasion, disseminating spending authority does not allow effective management of an appropriation or its subdivisions, thus, agencies utilize a CMA “that is managed at the highest practical level and allows officials at a lower echelon to incur obligations or charge expenditures to the CMA for authorized purposes without further determination or certification of fund availability for the individual transactions” (OUSD(C), 2019, p. 1-10). For example, establishing a CMA for FCFD allows agencies to utilize its authority without requiring the DOD to allot amounts from the defense-wide appropriation directly to the services.

C. FISCAL LAW

Congress initially enacted the Antideficiency Act through Public Law 97-258 in 1884, followed by significant amendments and revisions until they enacted the current version in 1982 under Title 31 U.S.C. § 1341. Aside from the U.S. Codes listed in this section, codes germane to fiscal law include 31 U.S.C. § 1301, 1341, 1342, and 1501–1519. The DOD FMR covers fiscal law limitations, including others not addressed in this report, in Volume 14.

Appropriations come with three categories of restrictions: purpose, time, and amount.

- Purpose: 31 U.S.C. § 1301 specifies that appropriations may only be used for expenses related to the purposes for which they were made. The “necessary expense rule,” a legal doctrine under the purpose statute, specifies that an appropriation must be used for its purpose, “unless there is another appropriation which makes more specific provision for such expenditures” (Government Accountability Office [GAO], 2017, p. 3-15).
- Time: 31 U.S.C. § 1502 addresses the time aspect of obligations, in which an appropriation may pay for expenses incurred only during its period of availability.
- Amount: 31 U.S.C. § 1341 prohibits the authorization or incurring of obligations against an appropriation in advance or excess of the amount available in that appropriation, unless authorized by law.

Approving officials in U.S. government organizations are susceptible to administrative and legal punishments if investigations find they violated fiscal law. Violations of only the purpose or time statutes can be corrected by shifting the expense to the more suitable appropriation. However, if the proper appropriation does not have an available amount, then correction of the violation may not be possible. Therefore, violation of the amount statute in addition to one of the others constitutes a legitimate violation of fiscal law.

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III. DATA AND ANALYSIS

The research methodology for this report began with a literature review; although, few published works addressed DOD foreign currency policies. On the other hand, a search for government reports yielded far more applicable works, specifically from the Government Accountability Office (GAO), as well as memorandums released by pertinent DOD components. This project obtained further data through first-hand interviews with personnel involved in FC transactions, followed by a limited analysis of available accounting and budgeting data.

A. LITERATURE REVIEW

1. Naval Postgraduate School Thesis, 1993

Ellsworth (1993) addressed the effects of exchange rate fluctuations on the procurement programs and proposed the creation of an additional Foreign Currency Fluctuation Fund, Defense Procurement appropriation to cover these adjustments. Due to the extended lead time involved in procurement, Ellsworth focused on the fluctuation from the time of budget submission until the actual expenditure, as opposed to this project's attention to obligations and expenditures.

Ellsworth proposed four methods to minimize exposure to exchange rate fluctuation: diversify transactions over several currencies, buy foreign currency in advance, set an exchange rate in advance, and contract through a domestic firm at a fixed price for foreign goods (pp. 8–9).

Although his procurement scope differs from this report's focus on OMMC, Ellsworth's proposals to reduce fiscal uncertainty still relate. However, the USMC may not have the ability to diversify between currencies, as their transactions with a vendor will likely be in that vendor's currency. Also, DOD does not make practice of purchasing and holding onto foreign currencies for public policy reasons, so as to appear not to manipulate international exchange rates. Moreover, contracting through an intermediary domestic company may be an option to reduce direct FCF risk, but that firm will likely reduce their

own risk by including FCF terms in the contract. On the other hand, Ellsworth's recommendation to set an exchange rate in advance is beneficial, from a fiscal perspective.

2. Public Budgeting and Finance Article, 2000

Groshek (2002) addressed "the government's general, risk-neutral approach to financial risk" and proposed that private firms would counter exchange rate losses similar to the DOD through moving production to countries with weakening currency, utilize forms of financial hedging, or pass losses onto their customers (p. 15). He pointed out that DOD does not have the luxury of simply relocating bases, and that "because of political and institutional constraints regarding the perceived speculative nature of the foreign currency markets, the DOD makes no attempt to manage its exposure via market-hedging mechanisms" (p. 17). He rationalized that the DOD does, however, pass foreign currency risk down to its "customers" by approving additional appropriations at the expense of taxpayers, implicitly referring to FCFD and FCFCD.

Groshek also addressed forward contracts and their benefits, relative to exchange rate fluctuations. He explained that "a forward contract requires both buyer and seller to exchange the pre-determined amount of two currencies at the specific future date and rate" (p. 27). This may prevent realized gains or losses due to rate fluctuation, but the rate will likely still differ from the spot rate at the time of payment. This suggestion supports Ellsworth's recommendation and an objective of this project to reduce fiscal uncertainty through locking an exchange rate at the time of obligation.

B. LAW, REGULATIONS, AND POLICY REVIEW

Various government agencies have investigated FCFD and ruled on its appropriate uses to pay for FCF. GAO, an agency under the legislative branch headed by the Comptroller General, provides auditing services and legal opinions to Congress. They have published several reports along these lines. This section also addresses the few policy documents that have been released by DOD and its components on the topic of FCF.

1. Comptroller General Decision B-133316, 1978

A report by the Comptroller General of the United States dated 18 days after the passing of Public Law (PL) 95-457 published a decision that payments in excess of an appropriation due to exchange rate fluctuations violate fiscal law. The Army posited that no officer or employee could be held responsible for the fluctuation of exchange rates; however, the Comptroller General ruled that a contracting officer (KO) should have terminated a contract that would exceed an appropriation's limitation, or stopped payment while the Army requested supplemental funding to cover the deficiency. The report cites the newly created FCFD as a measure to prevent future occurrences. This decision explains that obligating in excess of an appropriation's limit due to FCF is a violation of fiscal law (Comptroller General, 1978), and that the purpose of FCFD greatly diminished the risk of that occurring.

2. GAO Report GAO/NSIAD-86-173, 1986

The 1986 GAO report on *Improper Use of Foreign Currency Fluctuations Account* studied the DOD's use of the FCFD account relative to the O&M appropriations. GAO found that the services wrongly substituted expired O&M funds in place of FCFD funds. "OSD told the services (1) to report that they had used O&M funds to finance their 1983 losses due to foreign currency fluctuations even though they had already paid for these losses with FCFD funds, and (2) to return the FCFD allotted funds to the FCFD account" (Conahan, 1986, p. 6). GAO's investigation determined that the services took advantage of the FCFD account's ability to change the time and purpose characteristics of transferred funds. These procedures effectively circumvented congressional ceilings of appropriations and avoided returning canceling funds to the Treasury.

Citing PL 96-38, GAO explained that unused funds transferred out of FCFD could be returned, but that DOD officials claimed the law allows for the substitution of other available funds. GAO countered that the substitutions are unauthorized (Conahan, 1986).

3. GAO Report GAO-05-800R, 2005

GAO explained that NDAA FY05 (PL 108-375, Title X, Section 1006) tasked DOD to “identify alternative approaches [to projecting foreign currency exchange rates], including the feasibility of using private economic forecasting and approaches used by other federal departments and agencies, for selecting foreign currency exchange rates that would produce more realistic estimates” (Pickup, 2005, p. 1). This 2005 GAO document, *Review of DOD’s Report on Budgeting for Exchange Rates for Foreign Currency Fluctuations*, evaluated DOD’s April 15, 2005 response to Congress.

GAO reported on three approaches to selecting budgeted foreign currency rates that DOD evaluated: using a private forecasting company, using methods from other federal departments, and using various statistical methodologies. “According to DOD, they did not choose the private forecasting alternative because of the lack of visibility over key assumptions used in generating the forecast nor did they choose one of the methods used by the other federal departments because the other departments either did not forecast foreign currency rates or they did not have a uniform procedure for setting departmentwide rates” (Pickup, 2005, pp. 2–3).

GAO supported DOD’s selection of the centered weighted approach for FY06 budgeting due to its relative accuracy, repeatability, objectivity, and transparency. The centered weighted average statistically calculates budgeted exchange rates by combining recent rates with an average of past rates. GAO’s research projected that, at the time of publication, this method would reduce foreign currency fluctuation loss from \$1.7 billion using their previous methodology, to \$775 million (Pickup, 2005).

4. GAO Report GAO-18-221, 2018

GAO released a document in April 2018 reporting on *Actions Needed to Improve the Management of Foreign Currency Funds*. GAO examined DOD’s processes to manage FCF, specifically analyzing their revised exchange rate budgeting methodology, steps to reduce costs when selecting exchange rates to liquidate obligations, and management of the FCFD account balance.

a. Exchange Rate Budgeting Methodology

Due to the intricate details involved in DOD budgeting, from the lowest units to the consolidated final product, it begins approximately 18 months prior to the start of that FY. DOD establishes an exchange rate for use while budgeting for expected expenses in a foreign currency in an upcoming fiscal year, known as the “budget rate.” DOD has occasionally changed their methodology for setting the budget rate in an effort to find the rate that best matches the upcoming year’s anticipated fluctuations.

In 2005, GAO reported that DOD began using a centered weighted approach, combining an average of rates from the past five years with an average of the past twelve months, to estimate exchange rates. DOD continued using this methodology, until FY17, when they instead calculated a 6-month average of weekly rates from *The Wall Street Journal* (Russell, 2018).

GAO found that DOD’s revisions to its budget rates in FY14 through FY16 improved their accuracy, relative to market rates. Moreover, OUSD(C) reported to GAO that the FY17 change to their methodology further improved the accuracy of their budget rates. Utilizing budget rates closely aligned to the market decreases the risk of realizing gains or losses due to FCF.

GAO analyzed the variance between DOD’s budget rate and Treasury’s rate from 2009 to 2017. Figure 1 depicts how DOD’s budget rates for each of the nine currencies compared relative to the Treasury’s rates. GAO split each fiscal year in two to compare an average of two quarterly Treasury rates with an average of six DOD monthly rates; thus totaling 18 occurrences per year. The lighter bars on the left tally how many times in each fiscal year that DOD’s budget rate differed by less than ten percent of the Treasury’s rate. On the other hand, the darker bars on the right represent how many times the rates diverged by ten percent or more. For every year after FY09, DOD’s average budget rates fell within ten percent of the Treasury’s rate more often than not.

Figure 1 also highlights fiscal years 2014–2016 when DOD revised their budget rates. The chart shows an improvement in DOD rate calculation in 2014, returning to its previous state in 2015, and decreasing in accuracy the following year. GAO found that the

FY17 adjustment to its methodology helped DOD improve its rate accuracy above the previous year, but not as much as earlier years.

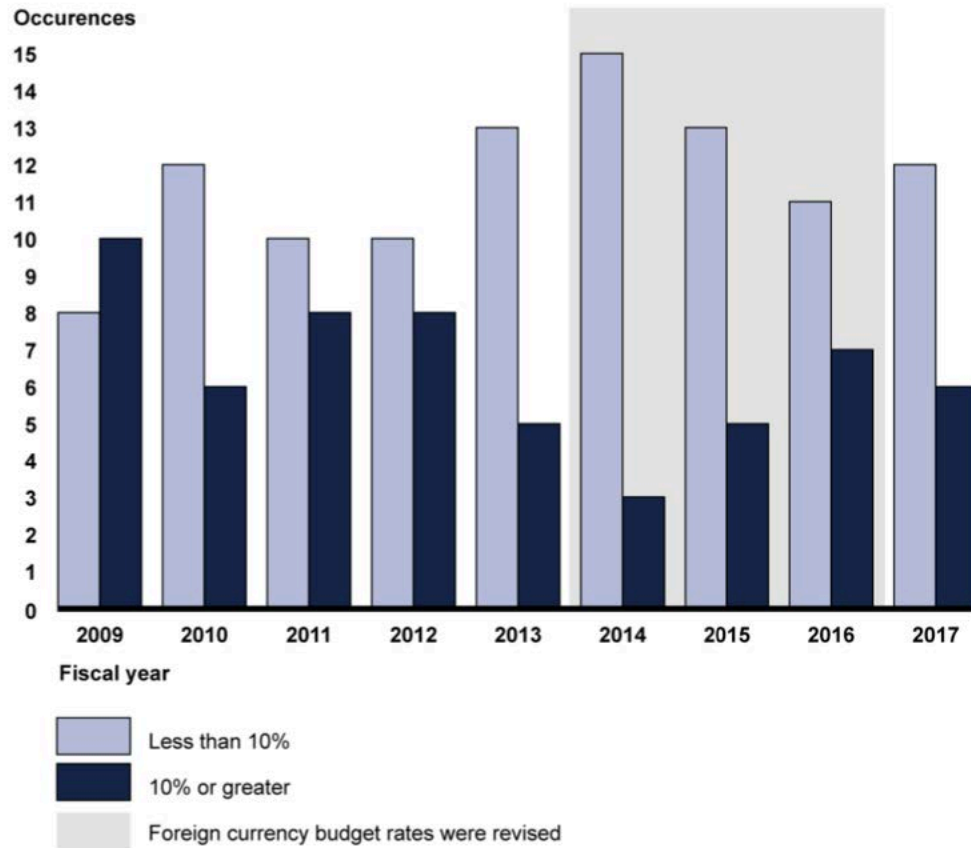


Figure 1. GAO Analysis on DOD Budget Rate Variance from Treasury Rates. Source: Russell (2018).

b. Liquidating Foreign Currency Obligations

Entering contracts with a foreign vendor in their currency, creates an obligation at the fiscal year's established budget rate. Subsequent disbursement of payment requires the selection of a current exchange rate. DOD references the ITS system to select this rate and make international payments. The ITS system offers various rates from a 5-day advance rate to a 2-day spot rate. Although cheaper, the spot rate requires delivery of payment within 2 business days. On the other hand, advanced rates provide additional time for

transaction processing, but are generally more expensive due to locking in a rate with more lead time (Russell, 2018).

c. FCFD Account Balance Management

Through 10 U.S.C. § 2779(d)(3), Congress has set the statutory limit of the FCFD account to \$970 million. The no-year appropriation cannot amass funding over this limit at any point in time and the services would instead maintain FCF gains in their accounts. GAO found that DOD appropriately used the FCFD account to cover realized losses from actual disbursements, as well as projected losses for unliquidated obligations. In addition to transferring FCFD out of the account to offset exchange rate losses, DOD can also collect funding to replenish the account. Transferable funding includes gains from FCF, unobligated O&M or MILPERS funding within two years after its expiration, as well as returning unused FCFD (Russell, 2018).

GAO discovered that DOD has maintained the FCFD account at its statutory limit at the end of every fiscal year since 2012, despite transferring funds out of the account, as depicted in Figure 2. Even in FY13, when DOD transferred superfluous funding from FCFD into its Working Capital Fund to offset fuel losses, they still replenished the account to its limit prior to the year's end. Section 8008 of the 2013 DOD Appropriations Act (PL 113-6, Division C) permitted this unconventional transfer from FCFD to the Working Capital Fund with Secretary of Defense approval and Congressional notification. Figure 2 also shows that DOD did not transfer any FCFD funding in or out of the account in FY15.

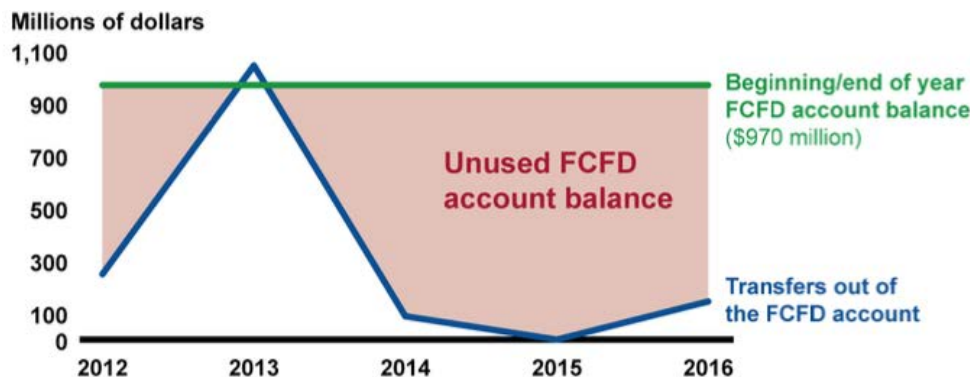


Figure 2. FCFD End-of-Year Account Balance. Source: Russell (2018).

GAO found that DOD maintains the FCFD account at its maximum amount in order to save unobligated O&M and MILPERS funding before the appropriations cancel. However, this process prevents DOD from storing FCF gains, as the FCFD account has already reached its limit from collecting unobligated funding (Russell, 2018).

d. Summary

This GAO report analyzed DOD's FCF management. They found that DOD has recently selected effective methodologies for estimating upcoming exchange rates. GAO proposed that an effective way to mitigate FCF was to establish obligations at an accurate rate. The DOD also makes use of the Treasury's ITS system to select liquidation rates; although, they have not implemented any policies mandating the consistent use of rates across the services. Lastly, GAO reported that the DOD mismanages the FCFD account balance. By maintaining it at its maximum, DOD loses the flexibility of the account to store gains. Furthermore, DOD has failed to analyze projected fluctuations to determine an adequate balance to hold (Russell, 2018).

5. Memorandums

The Execution Branch at HQMC P&R (RFE) releases an annual memorandum in September that addresses recording obligation and liquidation offsets. This letter—its FY19 iteration included as Appendix A—lists Standard Document Numbers (SDNs) and Lines of Accounting (LOAs) for the upcoming fiscal year. Subordinate units use these codes to obligate and liquidate that fiscal year's appropriations to cover changes due to FCF. This letter represents RFE's procedures to centrally manage an account for FCF.

OUSDC released a memorandum on 9 August 2019 soliciting DOD agencies for unobligated balances of expired FY17 and FY18 O&M and MILPERS appropriations to transfer into the FCFD appropriation (Appendix B). OUSDC wanted to restore FCFD funding by sweeping up unused funds from expired appropriations, specifically from FY17, since PL 96-38 allows transfers into FCFD for only two fiscal years after an appropriation expires. It is expected that OUSDC releases a similar letter annually. This memorandum supports GAO's 2018 finding that DOD makes every attempt to replenish

the FCFD account to its statutory limit before year-end, regardless of projected fluctuation requirements.

C. INTERVIEWS

1. RFI & MCICOM Procedures

The Installations Branch at P&R (RFI) manages Marine Corps FCF requirements for FHOPS. Financial Management – Budget 231 (FMB-231), under ASN(FM&C), distributes FHOPS appropriations to the Marine Corps through RFI. RFI then allocates the funds to Marine Corps Installations Command (MCICOM) for execution. As MCICOM oversees installations and housing around the world, FCF concerns them greatly.

At the beginning of each fiscal year, FMB-231 asks RFI—who relays the request to MCICOM—how much additional funding they anticipate needing, in that FY’s appropriation, due to expected FCF. MCICOM produces this estimate by looking back at the previous five fiscal years and calculating an average of FCF, disregarding outliers. In FY20, MCICOM requested and received \$1 million from FMB-231 in advance foreign currency funding.

FMB-231 then selects an amount and passes it into RFI’s FHOPS account, under the specific *Budget Line Item 080006*. Through this method, the Navy and the USMC can account for and track the FCF offset funding. Research for this report did not determine if FMB-231 obtains this additional funding from FCFD, FCFCF, or uses their own excess FHOPS funds; however, the FCF offset for FHOPS likely comes from FCFCF and definitively comes to the Marine Corps externally.

Similar to RFE, MCICOM releases an annual obligation and liquidation recording memorandum that sets an SDN and an LOA for FCF consolidation. This letter addresses only the Yen currency and they disseminate it specifically to Marine Corps Installations Command Pacific.

2. RFE Procedures

RFE centrally manages FCF expenses for OMMC at its level. At the start of every fiscal year, RFE creates SDNs and LOAs under the current year OMMC for each of the

nine currencies. This consolidates FCF expenses from subordinate commands at RFE. RFE uses *Document Type Code* (DTC) *FC* to differentiate FCF transactions from others (they used DTC *LP* prior to FY16). Finally, they use the 5-digit SDN serial number to specify the currency and purpose (e.g., “0YEN1” for the Japanese Yen vs. “0WON1” for the South Korean Won). Through this method, RFE can track FCF by currency and request reimbursement from OUSD(C).

The commands use these codes when facing a fluctuation to a FC transaction. Instead of disbursing funds under the original transaction, the command liquidates the transaction at its obligated amount and then increases the liquidation under the appropriate year of RFE’s FCF SDN to cover the loss. In the event of FCF gains, the consolidated SDN is deobligated by the fluctuation amount.

For example, on 4 Sep 2019, the Camp Foster Facilities Maintenance Branch obligated SDN M20233-19-SU-FE009 (contract number M67400-19-P-0090) for \$95,609.23 (¥10,669,397) to fund aerial hydroseeding services at Camp Butler training areas. Final disbursement of the contract occurred on 31 Aug 2020 for \$99,788.60. They obligated and liquidated the original transaction at the contracted \$95,609.23 and posted the FCF loss of \$4,179.37 under RFE’s FY19 SDN for Yen. This adjustment included a memo line that listed the original SDN and “FCF needs to be moved to Flux account.” Without this note, tracing the original transaction and the purpose of the adjustment could not easily occur.

Upon accumulation of FCF under these SDNs, RFE requests FCFD funding from OUSD(C). OUSD(C) has historically responded that RFE must meet a dollar threshold before they will transfer funding. A USMC official involved in the process described at least one lost opportunity to obtain FCF when P&R did not meet a threshold or deadline, both of which the official was unaware. In August 2019, when RFE requested \$854,000 for FY19, OUSD(C) responded with an ad hoc threshold of \$1 million before they would consider reprogramming. It appears that this threshold is simply an informal minimum amount for which OUSD(C) will reprogram. Over a month later, in late September, RFE requested \$1.486 million from OUSD(C), who responded that it was too late in the fiscal year for reprogramming to occur. RFE and the USMC has not received FCFD from

OUSDC) in recent years due to their failure to meet the dollar threshold by an unclear deadline. As such, RFE has resorted to covering FCF losses to transactions with their internal OMMC appropriations.

Moreover, RFE only requests reimbursement for the current year. As transactions for expired years continue to fluctuate and liquidate, RFE absorbs the prior year losses and does not request further reimbursement. It seems reimbursement should be possible because these are merely transfers of budget authority from FCFD, a no-year appropriation, to an OMMC appropriation that has not yet closed.

3. RFF Foreign Currency Disbursement

P&R's Finance Branch (RFF) promulgates the Marine Corps Fiscal Instruction Manual 7200.47 to provide guidance on fiscal transactions under their purview. Section 090504(f) dictates that disbursement of electronic fund transfers must use a value date based on the 3-day rate provided by the ITS system. Discussions with RFF personnel explained that they selected the 3-day rate due to its flexibility of time and its cost efficiency. They pointed out that overseas commands can rarely make disbursements within the 2-business-day window of the spot rate, and that the higher costs of extended 4- and 5-day rates were unjustifiable. For these reasons, RFF standardized and distributed USMC policy for selection of the ITS system's 3-day rate.

D. ACCOUNTING DATA

This project's research methodology included analyzing Standard Accounting, Budgeting, and Reporting System (SABRS) accounting data for the consolidated FCF SDNs. SABRS data can provide a snapshot of these transactions and their amounts, while also allowing investigation into their history and individual changes.

The USMC and Navy use SABRS as their primary system for accounting, budget execution, and reporting of funds. Further utilization of the SABRS Managements Analytical Retrievals Tools (SMARTS) allows personnel to analyze the data in SABRS and more effectively report DON execution. The Planning Estimate Active File in

SMARTS provides the current status of SDNs and can be filtered by several different codes. For example, RFE and MCICOM both use a DTC of *FC* to distinguish FCF SDNs.

1. RFE’s OMMC SDNs

Figure 3 depicts the liquidation amounts of the SDNs that RFE consolidates OMMC FCF into, from FY16 to FY20, retrieved from SABRS on October 21, 2020. The “Other Currencies” group consists of the Euro, Dinar, South Korean Won, Iranian Rial, Norwegian Krone, Brazilian Real, and a few others. Figure 3 illustrates that nearly all FCF of OMMC occurs in Yen. Moreover, the overall positive total of the consolidated SDNs represents losses for each of the five FYs presented.

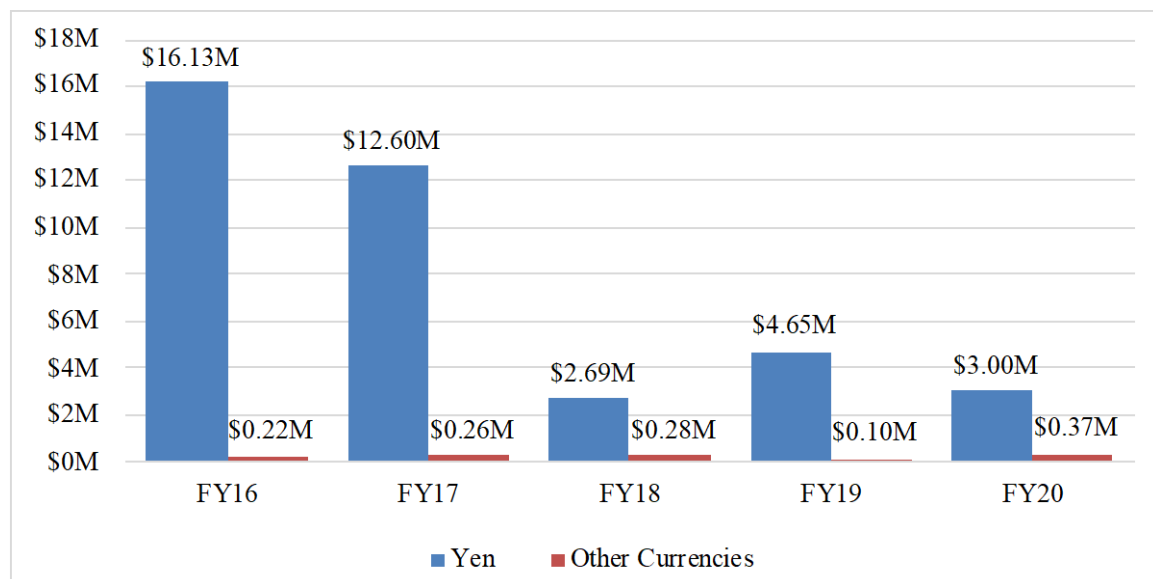


Figure 3. Liquidations against RFE’s FCF SDNs, by FY.

In FY20, the Yen transactions accumulated over three thousand liquidation adjustments, totaling \$3 million in losses. In order to differentiate between two categories of requirements that spend in Yen, Operating Forces Support (*Subhead and Fund Function 1A1A*) and Base Operating Support (*Subhead and Fund Function BSS1*), RFE created distinct SDNs. For FY20, those SDNs were M00085-20-FC-0JAPN for *1A1A* and M00085-20-FC-0YEN1 for *BSS1*; they totaled \$175,000 and \$2.83 million, respectively.

0YEN1 adjusted its liquidation amount (*Document Identifier Code DX0*) 2,586 times in FY20, ranging from a gain of almost \$2,000 to a loss of over \$185,000. Additionally, 0JAPN underwent 317 *DX0* adjustments, ranging from a gain of less than one dollar to a loss of almost \$45,000.

2. MCICOM's FHOPS SDN

MCICOM conducts foreign currency transactions only in Yen, so they establish one consolidated SDN per FY. Figure 4 depicts the liquidation amounts of this SDN, from FY16 to FY20, to cover FHOPS FCF, downloaded from SABRS on October 24, 2020. MCICOM did not request FCF funding for FY18 as the budget rates varied relatively little from the market rates. Therefore, MCICOM's preliminary estimates showed little to no FCF loss, at least for which they would require external funding. Although MCICOM requested and received \$1 million in FY20, as of this date they had only liquidated \$191,000. MCICOM expects future fluctuations over the next few FYs to continue adjusting this SDN, reducing its unliquidated \$809,000.

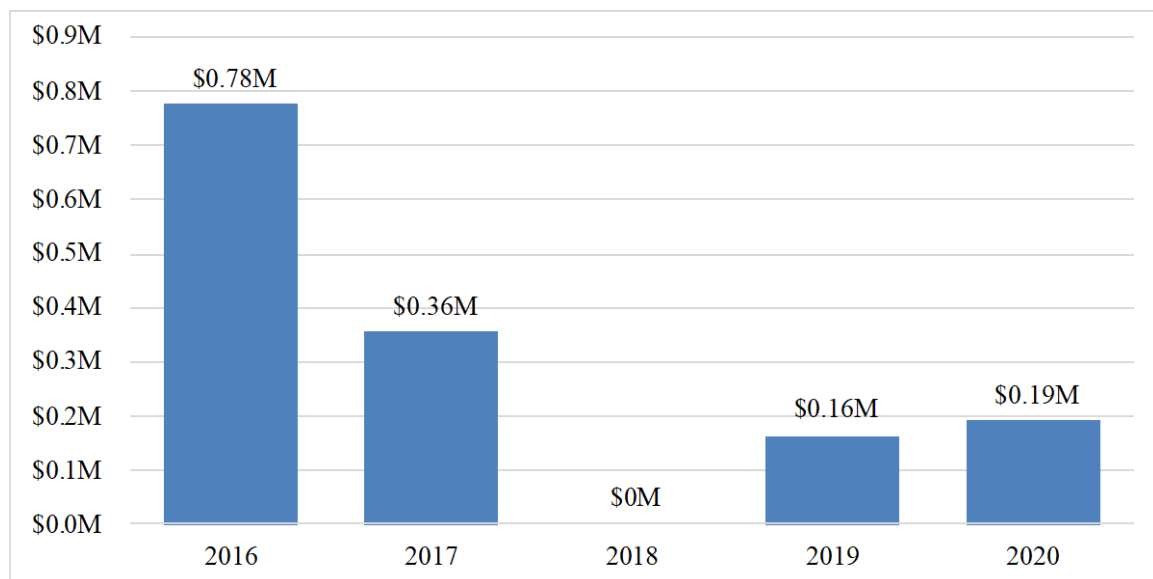


Figure 4. Liquidations against MCICOM's FCF SDN, by FY.

E. BUDGET DATA ANALYSIS

OUSD(C) releases a monthly report that consolidates pertinent foreign currencies, their budgeted rates for the FY, and their adjusting rates for that month. The September 2020 release is included with this report as Appendix C. Adjusting rates depict the exchange rate for that currency at the end of the report's month. Compiling the monthly OUSD(C) budget rate reports provides a visualization of their accuracy over time to determine if their methodology stands. Figure 5 charts the variance between the rates using Equation (1), with the rates in units of dollars per foreign currency (e.g., 0.15 \$/FC describes an exchange of \$0.15 for one unit of FC). Using this equation, a positive result represents an FCF gain because the adjusting rate has decreased below the budget rate, meaning it takes fewer dollars to exchange for one unit of FC.

$$\text{Variance \%} = (\text{Budget Rate} - \text{Adjusting Rate}) / \text{Budget Rate} \quad (1)$$

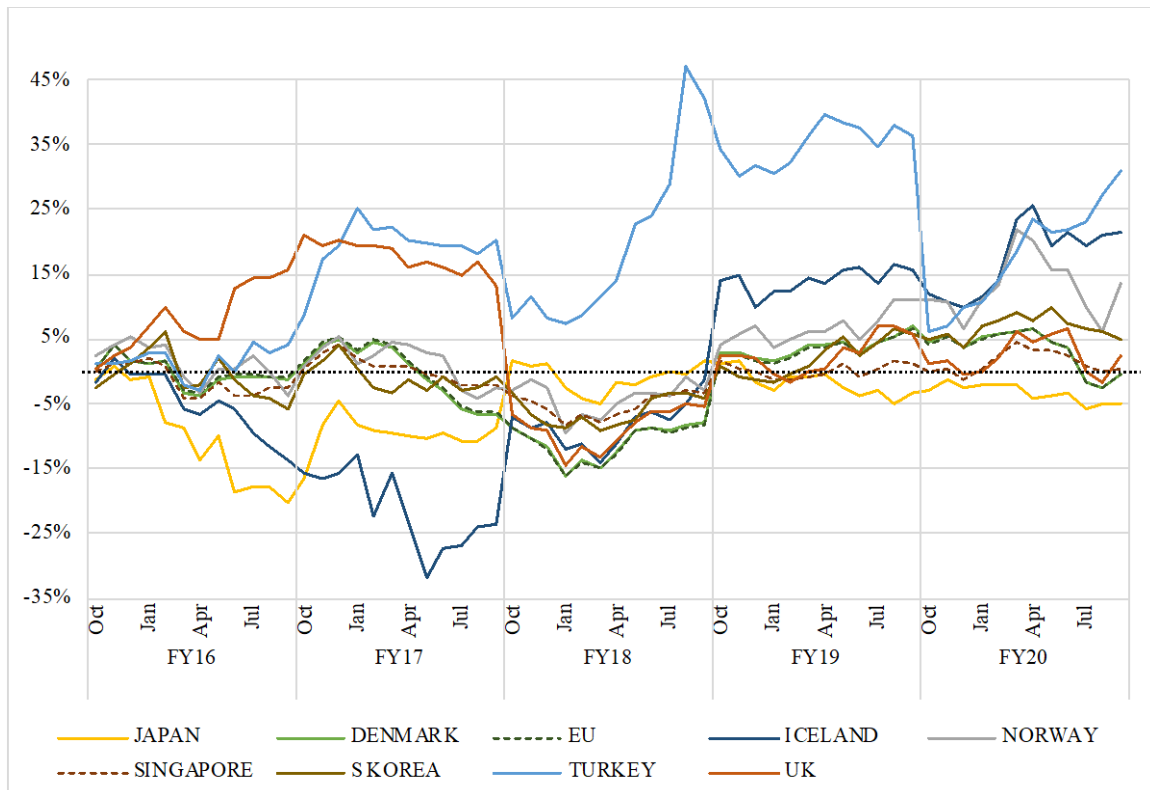


Figure 5. Variances between Adjusting Rates and Budget Rates.

In FY16, the monthly adjusting rates for Japan's Yen came in much higher than the year's budget rate, portrayed by the exceptionally negative line. This led to the excessive liquidation of RFE's Yen SDN depicted in Figure 3 and RFI's in Figure 4. Figure 5 also shows the FY18 rates for Yen, and most other currencies, suffered small variations, at least relative to other years. This reinforces the zero-dollar request from MCICOM depicted in Figure 4 and the comparably low liquidations at RFE in Figure 3.

Furthermore, Figure 5 illustrates that, except for Turkey's Lira in FY19, adjusting rates typically start the fiscal year with little variance from the budget rate, despite OUSD(C) having established the budget rate several months prior. As time passes, DOD components continue to obligate at the budget rate, while the adjusting rates fluctuate, resulting in liquidations that are no longer equal to the obligation. This variance continues until DOD implements a revised budget rate at the start of a new fiscal year; although, ongoing fluctuations continue to create variances between the two rates.

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IV. FINDINGS

This project's research methodology reviewed published reports and policy documents. After obtaining an understanding of FCF and its history, interviewees at P&R provided insight into the current processes and relative lack of standardized policies. A subsequent data analysis into the accounting system and established budget reports helped further illuminate shortcomings in these processes. This chapter addresses findings from the research and analyses of those discrepancies.

A. FISCAL LAW INTERPRETATION

RFE's process of using OMMC SDNs to consolidate charges for FCF losses may violate statutes of fiscal law, as explained in this section.

The purpose statute may be upheld as RFE still uses OMMC to cover OMMC requirements. However, the necessary expense rule clarifies that, "where an appropriation is made for a particular object, by implication it confers authority to incur expenses which are necessary or proper or incident to the proper execution of the object, unless there is another appropriation which makes more specific provision for such expenditures, or unless they are prohibited by law" (GAO, 2017, p. 3-15).

O&M is a general appropriation that pays for expenses as varied as civilian salaries, travel, fuel, and office supplies, while Congress established FCFD as an appropriation provided specifically for these exchange rate variances. Per the necessary expense rule, the specific appropriation should be used over the general appropriation. As such, FCFD may be more appropriate than OMMC in these instances. Through this interpretation of Congressional intent, using O&M to pay for FCF violates the necessary expense rule of the purpose statute.

RFE established their CMA policy for subordinate commands to use specific SDNs to consolidate exchange rate fluctuations within that transaction's fiscal year. In the instance that a transaction under an expired appropriation fluctuates, that year's OMMC SDN is obligated to cover the change. This process does not violate the time statute, as an appropriation is used to cover expenses incurred during its period of availability.

A breach of the purpose or time statutes on their own do not constitute enough to cite a violation of the Antideficiency Act, as the error can be fixed by transferring the expense to the correct appropriation. However, if the correct appropriation does not hold a sufficient unobligated balance to cover the charge, then the amount statute is in violation. In this instance, if the prior year's appropriation does not have an adequate amount available when a loss posts to the consolidated SDN, then the process to use OMMC to fund FCF, violates fiscal law.

B. TRANSPARENCY AND AUDITABILITY

Using RFE's and RFI's consolidated SDNs, tracking the source of FCF expenses becomes problematic. In the earlier example from the Camp Foster Facilities Maintenance Branch, their contract was due to liquidate \$4,179.37 higher in FY20, after the FY19 appropriation had expired. To cover the FCF costs, they added the loss to RFE's FY19 Yen SDN. Only a brief memo with the *DX0* liquidation adjustment pointed to the original SDN, permitting deeper research to justify this FCF offset. Nearly every other *DX0* on the investigated SDNs fails to include a descriptive memo, some citing only "FCF charge."

Throughout the course of this project, the research attempted to track the history of adjustments to the FY19 Yen SDN and failed to obtain source data for most of the *DX0* transactions. The costs associated with the consolidated SDNs would be increased with a memo that perhaps cited "FCF", "Flux", or another variation as justification, but had no explicit citation to the original transaction. In theory, subordinate commands could charge these consolidated SDNs for anything they want, despite no connection with foreign currency. This lack of control activities permits unnecessary risk and hinders oversight. Upon investigating these adjustments, auditors would be unable to tie *DX0* transactions to their original requirement except for the rare few memos that list the SDN. Moreover, P&R may be more likely to receive reprogrammed FCFD below OUSD(C)'s threshold if they provided greater assurance of their requirement through increased transparency.

C. OPTIONS FOR EXTERNAL FUNDING

The research analyzed four options to obtain external funding for USMC unbudgeted FCF: the status quo, a time threshold for reimbursement, front-loading FCFD

funding in advance, and conducting individual transfers for disbursement fluctuations. This section explores these options.

1. OMMC Status Quo

OUSD(C) established a dollar threshold that RFE must attain before conducting a reprogramming of FCFD to cover RFE's FCF losses. Setting a minimum dollar amount justifiably reduces the accounting labor required to conduct transfers from OUSD(C) to RFE to fund FCF losses. However, OUSD(C) has withheld FCF reimbursement to OMMC due to their failure to meet this threshold.

Without reimbursement, RFE suffers a top-line reduction, in which the USMC uses internal funding to pay for unbudgeted requirements. Furthermore, this appears to constitute a purpose violation because Congress provided FCFD to cover all fluctuations without specifying a threshold. As the purpose statute does not set a minimum amount, FCFD should cover all FCF requirements, even if it imposes an administrative burden.

2. Time Threshold

Every year, each SDN that RFE establishes to consolidate FCF for a single currency undergoes several changes to its obligations, exemplified by the three thousand adjustments to RFE's Yen SDNs in FY20. It seems that OUSD(C) established the dollar threshold to avoid myriad transfers for miniscule fluctuations. Instead of a dollar threshold, OUSD(C) could explicitly establish quarterly, semi-annual, or annual deadlines for RFE to submit requests for FCFD reimbursement. These requests should address reimbursement for the current year, as well as updated estimates for past years.

This would be a small change to the status quo at OUSD(C), while allowing RFE to obtain periodic FCFD reimbursements. This model still involves RFE using OMMC to pay for FCF, which may violate the necessary expense rule; however, this change may compromise between administrative burden and verbatim compliance, while ensuring that RFE receives FCFD to pay for FCF expenses.

3. Front Load

At the start of a fiscal year, RFE could estimate its total FCF losses for that FY based on exchange rate research, akin to RFI's process for FHOPS FCF. RFE could also reevaluate prior fiscal years to determine if they have enough unobligated funding remaining to cover further anticipated fluctuations or request additional FCFD. OUSD(C) could then front-load these estimates, or an agreeable alternative, from FCFD into the corresponding year OMMC appropriations through a transfer of budget authority.

RFE would readdress the remaining unused FCFD funding prior to the two-year-cutoff and return unneeded amounts. OUSD(C) can then reprogram that FCFD into another appropriation. This model already exists within DON to cover expected FHOPS FCF losses and would ensure that RFE receives the necessary FCFD to cover OMMC losses.

4. Individual Transfers

When an FCF loss is expected to liquidate under an OMMC appropriation, RFE could request the difference from OUSD(C). OUSD(C) would transfer the amount out of the FCFD account directly into the appropriate OMMC account. RFE could then increase the corresponding obligation, as now the appropriation would have an available FCF balance. This model is ideal because RFE would receive FCFD transferred into the necessary appropriation to cover the exact exchange rate loss as the expense incurs. This process would also prevent RFE from holding an excess balance in expired appropriations.

Individual transfers as expenses incur would be labor-intensive and would require close coordination between RFE and OUSD(C). Moreover, Congressional intent of FCFD would also require that RFE transfer individual gains to OUSD(C) as they occur.

D. REDUCING FISCAL UNCERTAINTY

Locking an exchange rate during the contracting process, as proposed by Ellsworth and Groshek, negates the risk of fluctuation from obligation to disbursement. Instead, the risk occurs at acquisition, when the vendor and the KO determine an agreeable rate so that each side pays or receives an unambiguous amount.

For example, if the exchange rate of U.S. dollars to the European Union's Euro is 1.15 (i.e., \$1.15 buys €1) but the KO and vendor expect the rate to drop, then they may contract at a 1.10 rate. If the vendor quotes the cost at €1,000 then the KO will obligate \$1,100. No matter the rate upon receipt and payment, the DOD will liquidate \$1,100. However, if the rate dropped lower at disbursement, to 1.05, then the DOD will have overpaid \$50. On the other hand, if the rate remained at 1.15, then the DOD will have saved \$50. This scenario could also address an expectation of no change to the rate, as well as an increase. In these scenarios, the DOD experiences only an unrealized gain or loss, but the final disbursement exactly equals the original obligation and suffers no fiscal uncertainty due to FCF.

Contracting a purchase at a specific exchange rate avoids discrepancies caused by fluctuations between obligation and liquidation. The DOD would not be concerned with the rate at liquidation varying from its obligation. The fiscal uncertainty is instead included as a negotiable item in the contract. Under this process, exchange rate fluctuations will cause only unrealized gains or losses.

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V. RECOMMENDATIONS

In accordance with the findings and analyses, this section provides recommendations to adjust those FCF processes. The foreign currency process begins with the policies for purchasing goods and services from foreign vendors. Next, the rate in which the obligation incurs is an significant topic in addressing FCF. Once the policies to reduce the risk of FCF is addressed, this section provides recommendations for P&R to obtain external funding for losses. Lastly, P&R should adjust the procedures to track FCF to ensure auditability of those transactions.

A. REDUCING OVERALL FISCAL UNCERTAINTY

Including the exchange rate as a negotiable item in a contract shifts the exchange rate risk from solely on the DOD, to an agreeable burden, shared with the vendor. The DOD would not realize losses or gains under the assurance that a disbursement would equal the obligation, despite changes to the exchange rate. Adjusting this policy would avoid the need to select updated obligation rates, reprogram FCFD into OMMC, and track adjustments to consolidated SDNs. However, this change would require an investigation into acquisitions procedures to determine its feasibility and implementation, but this report focused only on financial management of FC transactions and ways to improve under that scope.

Although, this change may cause unintended consequences in the form of increased economic costs. A vendor who has customarily had the U.S. assume exchange rate risk, will only bear it themselves if they can mitigate it. Thus, DOD could expect vendors to bid higher prices to ensure compensation for assuming, or sharing, this risk. Essentially, the cost of reduced exchange rate uncertainty may be higher prices. However, this policy change may still be economically beneficial if higher prices cost less than the savings from reduced FCF accounting and administration.

B. IMPROVING OBLIGATION EXCHANGE RATE ACCURACY

When a DOD component reaches a lawful agreement with a vendor, they establish an obligation. DOD obligations use the budget rate, established several months in advance. GAO pointed out that an improvement in the obligating exchange rate can reduce realized fluctuations (Russell, 2018). A shift in policies could allow for obligation incurrence at a more recent rate, conceivably reducing the possibility of fluctuations upon liquidation. Instead of committing to a vendor with an established budget rate that changes only annually, contracting officers would require reliable access to the ITS system or OUSD(C)'s reports to determine the exchange rate at which they will write a contract. Incurring an obligation at a current rate, as opposed to the outdated budget rate, may reduce FCF uncertainty. This subsection addresses two recommended options for obtaining updated rates.

- **ITS Rates**

RFF policy to select the ITS system's 3-day rate for liquidations is appropriate because it is one of the cheaper rates that still allows for adequate time to process payments. Obligations could use this same system to determine current exchange rates, more in line with the market than the previously set budget rates. Most importantly, obligations can be incurred using the more immediate, and cheaper, 2-day spot rates, since establishing an obligation does not require the additional processing time involved in disbursement.

- **OUSD(C) Monthly Adjusting Rates**

OUSD(C) releases adjusting rates with its monthly FCF Report. As with the ITS rates, these adjusting rates are more aligned with current market rates than the established budget rates. Using these monthly rates reverses the variances calculated in Figure 5 as obligations no longer rely on the outdated budget rates.

C. FUNDS FLOW

1. Obtaining External Funding

Foreign currency fluctuations have proven difficult to predict and budget, as they depend on myriad global factors. As Congress established the defense-wide FCFD transfer

appropriation for this purpose, funding should come from OUSD(C). This research recommends front-loading appropriations for FCF; however, establishing a time threshold for reimbursement is acceptable, pending fiscal law determinations. Moreover, RFE should include anticipated FCF effects to prior year appropriations when requesting reimbursement, as those active transactions still fluctuate and may require additional OUSD(C) funding.

Front-loading funds ensures that RFE would have an available balance to cover any anticipated FCF. In order to properly fund an FCF loss, the appropriation must have an unobligated balance enough to cover the difference. Given the numerous FC adjustments, transfers from OUSD(C) to RFE for every individual loss would be cumbersome and impossible to maintain in an accurate, timely manner. Transferring the amounts from FCFD into the applicable OMMC appropriation further alleviates any concerns of fiscal law purpose violations.

If unbiased fiscal law investigations permit the use of OMMC appropriations toward FCF expenses, then establishing periodic reimbursement of RFE's consolidated SDNs accomplishes the goal of obtaining external funding. RFE would continue using their *FC* SDNs to cover losses as they occur, and then request reimbursement from OUSD(C) at agreed upon deadlines.

Changes to how RFE obtains FCFD funding will affect fiscal law implications. Using the FCFD appropriation, reprogrammed into OMMC, will ensure RFE abides by the necessary expense rule.

Whether funding in advance or through periodic reimbursements, P&R and OUSD(C) should draft a memorandum of agreement or understanding. This memorandum should include specific deadlines and dollar thresholds to ensure both entities understand and adhere to an established policy.

2. Ensuring Auditability

RFE needs to establish a policy to ensure auditability of their FCF processes. Using consolidated SDNs loses transparency, as the FCF charge is no longer associated with its

original transaction. In order to guarantee the traceability of these transaction, RFE could establish a format for the memo item that mandates inclusion of the original document's SDN. Investigations into *DX0* adjustments to the consolidated SDNs would then reliably trace back to the original document.

Moreover, when MCICOM or other subordinate commands make these adjustments, they should provide supporting documentation to RFE. This supporting documentation would include the contract, amendments, and receipts. RFE could then maintain files for their consolidated SDNs that contain this documentation, available to inquiring auditors at a moment's notice.

VI. CONCLUSION

After researching scholarly articles, government documents, accounting data, and budget reports, this project determined that the processes to address foreign currency fluctuations in the Marine Corps and the Department of Defense are not well-established, understood, or adequate. The secondary research questions helped divide the substantial processes into distinct areas for analysis.

A. SECONDARY RESEARCH QUESTIONS

1. What are the Marine Corps processes to obligate funding on transactions with foreign vendors and can they be improved?

DOD obligations use the foreign currency's budget rate, established several months in advance by OUSD(C). Updating these processes may reduce FCF risks. By including an exchange rate as a negotiable term in the contract, DOD can share the burden of exchange rate fluctuation with the foreign vendor. Even if the KO still assumes all risk in this agreement, the fiscal uncertainty is alleviated. DOD is no longer concerned with FCF affecting the payment, as they are guaranteed to pay a specific amount.

However, if the DOD continues to assume all risk by contracting in the foreign vendor's currency, then improvements can still be made to the obligation policy. KOs establish obligations using OUSD(C) annual exchange rates, set months prior to the budgeting of the current fiscal year. Updating this policy to utilize rates from the ITS system or OUSD(C)'s monthly FCF reports would subvert accumulated variances to the exchange rates. Incurring obligations at more recent rates, closer to the actual market rate, would reduce realized gains or losses due to FCF.

2. What are the Marine Corps policies for considering the fluctuations of foreign currency exchange rates to manage gains and losses of disbursements?

HQMC P&R RFF standardized selection of the 3-day rate from ITS in Financial Instruction Manual guidance. This policy selects a relatively inexpensive advanced rate,

while still allowing for enough time to process payment disbursement. This project recommends no improvements to this effective policy of selecting exchange rates for disbursement.

3. What accounting practices does the Marine Corps use to track transactions of foreign currency fluctuations?

RFE and RFI centrally manage FCF adjustments in their respective appropriations by consolidating subordinate expenses into SDNs using a DTC of *FC* as well as designated serial numbers corresponding to currencies and purposes. Upon anticipation of FCF, a subordinate command would liquidate the original transaction, and then conduct a *DX0* adjustment to the P&R branch's corresponding consolidated SDN.

This method simplifies consolidation of FC transactions for SMARTS reports but leads to auditability issues when tracing FCF expenses. On occasion, a SABRS user includes a memo with their *DX0* transaction that cites the original SDN; however, there is no policy in place to mandate a link between the original FC transaction to the consolidated SDN. These P&R branches should implement controls to track FCF adjustments and supporting documentation. At a minimum, the *DX0* adjustment should cite the original transaction requiring FCF funding. Additionally, the commands should provide the contract, amendments, and receipts to P&R for filing and providing to auditors upon request.

4. How does the Marine Corps obtain external funding to pay for unbudgeted foreign currency fluctuations?

At the beginning of a fiscal year, FMB-231 tasks RFI to estimate their expected FCF requirements for that year's FHOPS appropriation. RFI averages past year fluctuations and requests DON funding. FMB-231 typically transfers the requested authority to RFI. RFI then has this balance available in advance of any FCF expenses for that appropriation.

On the other hand, near the end of the fiscal year, RFE provides to OUSD(C) its accumulated total of FCF expenses, consolidated into their SDNs. If under OUSD(C)'s ad hoc \$1 million threshold, they do not receive reimbursement. In response, RFE pushes

MCICOM to finalize its transactions with foreign vendors in order to realize FCF expenses prior to FY closeout. Weeks later, RFE submits another reimbursement request to OUSD(C), who then responds that they missed the uncommunicated deadline for reprogramming. RFE typically fails to obtain FCFD reimbursement from OUSD(C) due to an inability to meet an informal dollar threshold or deadline.

RFE and OUSD(C) should improve communication to determine the best way to uphold congressional intent of the FCFD appropriation and then establish a memorandum of understanding or agreement to ensure compliance. Front-loading FCFD into RFE's OMMC budget authority would best guarantee that RFE has funding to pay for fluctuations. On the other hand, setting a time threshold in which RFE receives their requested reimbursement, no matter the amount if they meet the deadline, could be suitable. Moreover, RFE should calculate prior year FCF requirements for open transactions to also request reimbursement. However, this method of reimbursement—as well as the status quo—could violate fiscal law, as RFE continues using their OMMC appropriation to pay for expenses more appropriate under FCFD.

B. OBJECTIVES

Answering the secondary research questions helped to tackle the objectives of this project.

1. Address the flow of funding to increase transparency and thus auditability, to guarantee that all spending complies with congressional intent, and to ensure that the USMC Operations and Maintenance (O&M) appropriation yields the greatest benefit to the readiness of the Corps.

The current process of funding fluctuations with OMMC funding may be a violation of the purpose statute of fiscal law. FCFD exists with the specific purpose of funding FCF expenses. Using the general appropriation OMMC goes against congressional intent for FCFD and violates the necessary expense rule. This can be corrected through reprogramming FCFD into OMMC budget authority in advance to ensure it covers expenses for which it was created.

Moreover, the loss of visibility in the consolidation of FCF expenses hinders Marine Corps auditability and transaction tracing. Establishing and enforcing accounting procedures to mandate inclusion of the original transaction and source documentation corrects this deficiency. Additionally, through increased transparency, P&R can better support their requests to OUSD(C) for reimbursement.

Through these changes, P&R can obtain FCFD funding for FCF expenses and reallocate OMMC to other requirements essential to the USMC mission.

2. Improve the accuracy of selected exchange rates when contracting to minimize the realized gains and losses of FCF.

Incurring obligations at budget rates that are already several months old simply adds onto projected exchange rate uncertainty. Adjusting the policy to instead obligate with rates more in line with the market may reduce future fluctuations. The ITS system and OUSD(C) adjusting rate reports are available to provide spot and monthly rates, respectively. Selecting either of these rates increases accuracy of the exchange rate used when drafting a contract. If a KO can incur an obligation at an accurate rate, relative to the market, then the eventual liquidation may have less variance, realizing a reduced gain or loss.

3. Reduce overall fiscal uncertainty of FCF transactions for operational units and HQMC.

Further investigation from an acquisitions perspective is needed into the option of locking an exchange rate in a contract,. Sharing the burden of rate fluctuation may cause the unintended consequence of increased prices, but its benefit may still outweigh the cost of reactive accounting to consolidate, track, and cover FCF. This change could ultimately aid in alleviating the DOD of fiscal uncertainty due to foreign currency fluctuations.

C. CONCLUSION

Analyzing the secondary questions helps to answer the primary research questions of this project. Major weaknesses of Marine Corps processes for managing foreign currency fluctuations include the exchange rate used when obligating transactions with

foreign vendors, obtaining FCFD funding to finance these expenses, and tying the adjustment transactions back to the original contract. The USMC can improve these processes through determining agreeable policies with OUSD(C), establishing memorandums of agreement or understanding, and enforcing these changes.

Establishing new policies and updating those few policies in place will help to reduce fiscal uncertainty due to foreign currency fluctuation. However, once explicit policies are put in place, they should be disseminated and enforced to ensure widespread understanding and compliance. Through this, the Marine Corps may find itself with an additional several million dollars available in its annual appropriations.

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APPENDIX A. FCF OBLIGATION AND LIQUIDATION RECORDING MEMORANDUM – FY19



DEPARTMENT OF THE NAVY
HEADQUARTERS UNITED STATES MARINE CORPS
3000 MARINE CORPS PENTAGON
WASHINGTON, DC 20350-3000

IN REPLY REFER TO:

7000
RFE

September 26, 2018

MEMORANDUM

From: Head, Budget Execution Branch, Budget and Execution Division,
Programs and Resources Department, Headquarters U.S. Marine
Corps

To: Distribution List

Subj: USMC FY19 FOREIGN CURRENCY FLUCTUATION (FCF) OBLIGATION AND
LIQUIDATION RECORDING

Ref: DoD FMR Vol 6, Chapter 7

1. In accordance with the reference, this memorandum provides the
Line of Accounting (LOA) to support the Marine Corps' FY19 FCF offset
gains and losses.

2. The following LOAs shall be used to record FY19 FCF obligations
and liquidations associated with contract purchases containing FCF.
Each SDN is associated with one of the below listed foreign currency
denominations which the Marine Corps incurs charges against.

a. The FY19 OMMC/1106 FCF SDNs and LOAs for Contracts are
(excludes Family Housing):

- (1) (Japan - Base Operating Support) YEN = SDN:
M0008519FC9YEN1
LOA: 17 9 1106 BSS1 252 00027 067443 2D M00085
M40085199EN1
- (2) (Korea - Base Operating Support) WON = SDN:
M0008519FC9WON1
LOA: 17 9 1106 BSS1 252 00027 067443 2D M00085
M4008519WON1
- (3) (European Union - Base Operating Support) EURO = SDN:
M0008519FC9EURO
LOA: 17 9 1106 BSS1 252 00027 067443 2D M00085
M4008519EURO
- (4) (Japan - Operating Forces Support) YEN = SDN:
M0008519FC9JAPN
LOA: 17 9 1106 1A1A 252 00027 067443 2D M00085
M4008519JAPN

Subj: USMC FY19 FOREIGN CURRENCY FLUCTUATION (FCF) OBLIGATION AND
LIQUIDATION RECORDING

- (5) (Korea - Operating Forces Support) WON = SDN:
M0008519FC9KORE
LOA: 17 9 1106 1A1A 252 00027 067443 2D M00085
M4008519KORE
- (6) (European Union - Operating Forces Support) EURO = SDN:
M0008519FC9EURN
LOA: 17 9 1106 1A1A 252 00027 067443 2D M00085
M4008519EURN
- (7) (Norwegian - Operating Forces Support) KRONE = SDN:
M0008519FC9KRON
LOA: 17 9 1106 1A1A 252 00027 067443 2D M00085
M4008519KRON
- (8) (Norwegian - MPF) KRONE = SDN:
M0008519FC9KRNE
LOA: 17 9 1106 1B1B 252 00027 067443 2D M00085
M4008519KRNE

2. Foreign Currency Fluctuation will not be utilized on Government Commercial Purchase Card (GCPC) point of sale transactions for Fiscal Year 2019. Ensure that all Prior Year (PY) Direct Cite GCPC Lines of Accounting are deleted from Citi Direct.

3. The point of contact in this matter is the Head Quarters Marine Corps Execution Branch (RFE) is Kim Devoto at e-mail kim.devoto@usmc.mil or phone (703)692-5868 or the RFE Organizational Mailbox (OMB) at P&R Execution RFE@usmc.mil. If a command requires support for a foreign currency not listed on the Fiscal Year 2019 memorandum, please contact the Kim Devoto



D. B. MATTIES

Distribution:
CG, Marine Forces Pacific, Comptroller
CG, Marine Forces Command, Comptroller
CG, Marine Forces Europe, Comptroller
CG, Marine Forces Africa, Comptroller
CG, Marine Forces South, Comptroller

Subj: USMC FY19 FOREIGN CURRENCY FLUCTUATION (FCF) OBLIGATION AND
LIQUIDATION RECORDING

CG, Marine Forces Central Command, Comptroller
CG, Marine Corps Installations Command Comptroller

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APPENDIX B. TRANSFER TO FCFD MEMORANDUM – FY19



COMPTROLLER

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

(Program/Budget)

AUG 09 2019

MEMORANDUM FOR: SEE DISTRIBUTION

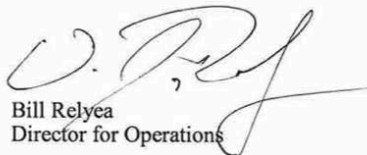
SUBJECT: Transfer of Expired Unobligated Balances to the Foreign Currency Fluctuations, Defense (FCF,D) Appropriation

The Department must restore the Foreign Currency Fluctuations, Defense (FCF,D) appropriation to cover losses that may be realized due to declining value of the U.S. dollar in the world market. The Department has congressional authority to replenish the FCF,D appropriation by transferring prior year unobligated balances and net realized gains into the account.

Addressees should review their current unobligated balances for all Fiscal Year (FY) 2017 and Fiscal Year (FY) 2018 Operation and Maintenance and Military Personnel appropriations, including the National Guard and Reserve accounts, and determine the availability of those funds for transfer.

It is particularly important to review expired FY 2017 unobligated balances since these balances can not be transferred to the FCF,D appropriation after September 30, 2019. If you report that you have no expired FY 2017 and FY 2018 unobligated balances available to transfer, and accounting reports show otherwise, provide specific written justification to explain the non-availability of these funds.

Please use the format provided in the attached template to submit your input to Sherrin Christensen no later than **August 16, 2019**. Ms. Christensen may be contacted at (703) 697-3103 or sherrin.d.christensen.civ@mail.mil. Negative replies are required.


Bill Relyea
Director for Operations

Attachment:
As stated

DISTRIBUTION:

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DIRECTOR FOR RESOURCE MANAGEMENT, DEFENSE PRISONER OF
WAR/MISSING PERSONS OFFICE
BUDGET OFFICER, DEFENSE HUMAN RESOURCES ACTIVITY
COMPTROLLER, NATIONAL DEFENSE UNIVERSITY

**Foreign Currency Fluctuations, Defense (FCF,D) Appropriation
Transfer of Expired Unobligated Balances**

Component/Agency: _____
POC and phone number: _____
E-mail: _____

The following amounts are available for transfer to the FCF,D account:

	<u>(Dollars in Thousands)</u>			
	<u>FY 2017</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2018</u>
<u>Unobligated Balances</u>	<u>Reported</u>	<u>1002/SF133</u>	<u>Reported</u>	<u>1002/SF133</u>

<i>Example: Military Personnel, Air Force</i>	-	-	100,000	100,000
---	---	---	---------	---------

Explanation: N/A

Note 1: Differences between the amounts reported as available to turn in and the unobligated balances showing on the DFAS 1002 or SF-133 Budget Execution accounting reports must be explained. If you are reporting that there are no unobligated balances available to turn in, include that statement and an explanation herein.

Note 2: All unobligated balances that are reported must be reflected as available on the current DFAS 1002 report (**June 2019**). This is particularly important for FY 2017.

Note 3: If you are reporting funds available from a Defense-Wide appropriation, do not make those funds available in PBAS until notified by this office.

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APPENDIX C. OUSD(C) FOREIGN CURRENCY REPORT – SEPTEMBER 2020

ADJUSTING RATES OF EXCHANGE FOR "FOREIGN CURRENCY FLUCTUATIONS, DEFENSE," "FOREIGN CURRENCY FLUCTUATIONS, CONSTRUCTION" AND "DEFENSE MILITARY CONSTRUCTION AND FAMILY HOUSING" For Month Ended 9/30/2020

COUNTRY	MONETARY UNIT	O&M (DOD) FY 2020 BUDGET RATE		MILCON & FH FY 2020 BUDGET RATE		ADJUSTING RATE	
		U.S. DOLLARS FOR ONE UNIT OF FOREIGN CURRENCY	UNITS OF FOREIGN CURRENCY FOR ONE U.S. DOLLAR	U.S. DOLLARS FOR ONE FOREIGN CURRENCY	UNITS OF FOREIGN CURRENCY FOR ONE U.S. DOLLAR	ADJUSTING RATE (IN U.S. DOLLARS)	ADJUSTING RATE (IN FOREIGN CURRENCY)
DENMARK	KRONE	0.1562354	6.4006	0.1562354	6.4006	0.1572327	6.3600
EUROPEAN UNION*	EURO	1.1645511	0.8587	1.1645511	0.8587	1.1709602	0.8540
ICELAND	KRONA	0.0091885	108.8315	0.0091885	108.8315	0.0072254	138.4000
JAPAN	YEN	0.0089965	111.1542	0.0089965	111.1542	0.0094607	105.7000
NORWAY	KRONE	0.1220390	8.1941	0.1220390	8.1941	0.1055075	9.4780
SINGAPORE	DOLLAR	0.7342144	1.3620	0.7342144	1.3620	0.7299270	1.3700
SOUTH KOREA	WON	0.0008991	1112.2819	0.0008991	1112.2819	0.0008552	1169.2800
TURKEY	LIRA	0.1868391	5.3522	0.1868391	5.3522	0.1287333	7.7680
UNITED KINGDOM	POUND	1.3133701	0.7614	1.3133701	0.7614	1.2820513	0.7800

*On January 1, 1999, the euro became the official currency of 11 member states of the European Union with a fixed conversion rate against their national currencies. The euro was adopted by Greece on January 1, 2001. The value of the euro fluctuates according to market conditions against the dollar and all other currencies. Euro notes and coins were introduced to replace national notes and coins on January 1, 2002.

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