IMPROVING NAVY WORKING CAPITAL FUND CASH MANAGEMENT

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Background:

By statutory authority[1], working capital fund (WCF) activities have a buyer-seller relationship and operate under a breakeven concept. Providers recoup the costs of conducting business by charging customers a rate.[2] Profits are returned to customers by rate decreases and customers absorb losses in rate increases. WCF entities maintain a cycle of business operations similar to private and public sector enterprises with profit and loss or surplus and deficit life cycles. Today's business-like activities evolved from the original industrial and stock funds of the last century created to provide work and services related to ammunition, ordnance, ship and aircraft refurbishment and repair, as well as replenishment material and supplies for military equipment. Some of these functions continue under the WCF concept today, others transitioned to mission funding when a viable customer base ceased to exist.

The Department of the Navy (DON) is the most diverse of the Department of Defense (DOD) WCFs. Tables 1 and 2 list the DOD WCF business areas by Component.

Table 1:

Navy Working Capital Fund Business Areas				
Supply	Depot Maintenance	Research & Development	Transportation	Base Support
– Navy – Marine Corps	– Ships – Aircraft – Marine Corps	– Air Warfare Center – Surface Warfare Center – Undersea Warfare Center – SPAWAR Systems Center – Naval Research Laboratory	– Military Sealift Command	– Public Works Centers – Naval Facilities Engineering Service Centers

Table 2:

Army Business Areas	Air Force Business Areas	DOD Component Business Areas			
		Defense Finance & Accounting Service	Defense Information Systems Agency	Defense Logistics Agency	Defense Commissary Agency
– Industrial Operations – Supply	– Depot – Supply – Information Services – Transportation WCF[3]	– Financial Operations – Information Services	– Computing Services – Telecommunications/Enterprise Acquisition Services	– Supply – Distribution Depots – Reutilization & Marketing Services – Document Automation & Production Services	– Commissary Resale Stocks – Commissary Operations

During operations, planned and actual operating results are used to evaluate the fiscal wellbeing of WCF activities. In its simplest form:

Revenue – Expenses = Operating Results

Similar to any business entity the WCF is allowed to apply depreciation expenses to the basic operating result.

Operating Results + Depreciation = Net Operating Results (NOR)

NOR can be positive or negative recognizing a gain or loss from business activities. The cumulative effect of NOR is the Accumulated Operating Result (AOR), which must be zero in the budget year.

Cumulative Net Operating Results = Accumulated Operating Results

Cash Initiative:

One indicator of WCF solvency is maintaining sufficient cash to meet financial obligations. In 2005, the DON embarked on an ambitious initiative to determine the optimum amount of cash required, and the amount of cash required for each business area.[4] By agreement between the Congress and the Department of Defense, the annual cash balance requirement is seven days of operational requirements and six months of capital expenditures.[5]

If a negative balance is anticipated at anytime during the fiscal year, action must be taken by the Department and/or activity to avoid such. Insufficient cash to meet current expenditures is an Anti-Deficiency Act Violation[6], which is reported to the Congress and the President.

Unlike private concerns, WCF entities cannot borrow or sell receivables to maintain cash flow, but raise cash internally through advance billing and cash surcharges. Advance billing[7] is the process of accelerating the payment of future accounts receivables prior to completing the work or services and earning revenue. Under Title 10 United States Code 2208, the DOD has $1 billion in advance billing authority currently shared among the Army, Navy, Air Force and Defense. DOD must notify the Congress within 30 days of using advance billing authority. Notification to the Appropriations and Armed Services Committees of both chambers must include the reason, the amount, the time period, and actions planned to correct the shortfall. The Director, Revolving Funds, manages this process as delegated by the Secretary of Defense to the Office of the Under Secretary of Defense (Comptroller).

Although advance billing does not impact readiness or operations, its effects may exasperate cash solvency in a later period by interrupting the normal collections and disbursements cycle. Conversely, cash surcharges increase customer rates with the potential to impact funds earmarked for readiness and operations.

In a normal business cycle collections should generate sufficient cash to fund disbursements. A linear relationship should exist between the disbursement and collection cycle and the recognition of revenue and expenses in most of the non-supply[8] business areas. If, during the normal course of business, the cash cycle cannot maintain positive cash flow, a cash surcharge[9] may be warranted.

Historically, the Congress has perceived high cash balances within the DOD as potential assets to finance burgeoning requirements. To avoid Congressional reductions, several DOD Components have used various budgetary presentations, such as decreasing the cash balance through lower customer rates and credits to the general fund accounts, in an effort to control who benefits from the perceived asset. Unfortunately, neither strategy provides a credible analysis of the underlying cash flow or business practices.

The first set of challenges is to map the “as is” cash flow process, develop a standardize cash flow process, and to transition from the “as is” to the standard process. The DON began this initiative by tracking the billing and collection of labor costs, which is the largest single expenditure within the WCF. In the Federal sector, the Treasury actually disburses the payroll prior to receiving funds from an activity. This creates a float of three to five days. If the float crosses the end of the accounting period[10] (one month), the disbursement is reflected in the subsequent month. As a consequence, all Navy WCF activities are required to bill customers at least twice a month to reflect all labor billings in the appropriate accounting period. Each category of cost within the WCF will be similarly analyzed. A contactor has been selected to map the cash flow processes and assist the DON in adopting standardized processes.

The second challenge is to identify the tools required to ensure sufficient real time financial accounting data is available to support the managerial decision-making process. Weekly Flash Cash reports have proven insufficient as inter-

Service and non-DOD transactions are omitted. Further, current monthly reports do not provide consistent insight into the aging of payments nor the status of accrued liabilities and accrued expenses.

The DON partnering with the Defense Finance and Accounting Service-Cleveland has incorporated the correction of systems deficiencies into the Department's Financial Improvement Plan (FIP)[11], since the inability to predict cash balances is directly related to the reliability and timeliness of systems data. Resolution of systemic issues will provide processes and procedures compliant with various internal control and financial statutes and regulations.

The final challenge is corrective action. The DOD and other Components share the DON's concern and are interested in leveraging study findings throughout DOD.

[1] Title 10 United States Code 2208. The Department of Defense authority for the establishment and operation of working capital fund entities.
[2] Working Capital Fund rates are usually set annually to recover all costs of operations. This means prices are set to achieve an Accumulated Operating Result (AOR) in the budget year of zero. Accordingly, prices in the budget year are set to either make up loses or return gains. See DOD FMR Vol. 2B, Chapter 9, for a full explanation of rate setting policies.
[3] US Transportation Command manages TWCF operations, but cash management is provided by the Air Force.

[4] Management Initiative Decision (MID) 903 of December 2002 requires the DOD Components to manage WCF cash by business area.
[5] DOD FMR Vol. 2A, Chapter 9, para. 090103.
[6] A zero or negative cash balance creates an Anti-Deficiency Act violation (Title 31 United States Code 1341(a)(1)(A).
[7] Advance billing is not the same as an advance payment, which occurs when the Department accepts work from non-DOD and/or non-government sources, or a pre-paid item such as rent or a lease.
[8] The Supply Management business area has authority to finance short and long-term inventory, which changes the timing between expense and the receipt of revenue.
[9] A cash surcharge is collected along with the rate from the customers of one or more business areas to rebuild the cash balance to the appropriate amount.
[10] DOD FMR Vol. 1, defines an accounting period as one month.
[11] The FIP is an event driven plan to attain an unqualified opinion on the Component’s Annual Chief Financial Officer report.