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Defense Primer: Defense Working Capital Funds

A Department of Defense (DOD) working capital fund (DWCF) is a type of *revolving fund* used to finance operations that function like commercial business activities, (e.g., equipment maintenance, supply and storage activities, and transporting equipment and people). According to the DOD Financial Management Regulation 7000.14-R, *revolving fund* accounts finance a "continuing cycle of business-type operations" by incurring obligations and expenditures that generate receipts.

DWCFs are used throughout the department in an effort to efficiently provide services or industrial capabilities. Revolving funds are often considered to have several benefits. First, they operate without fiscal year limitations (i.e., amounts in a WCF do not expire). Second, they facilitate the aggregation of orders, allowing the government to leverage its purchasing power. Finally, they allow for the establishment of supply inventories that can lead to reduced delivery times.

How Do Working Capital Funds Work?

When establishing a WCF, Congress typically provides a direct appropriation to the fund (the initial appropriation and positive fund balance is often referred to as a *cash corpus*). Fund managers can use the cash corpus to buy parts and supplies in advance of an anticipated requirement (such as a depot overhaul of an aircraft), or to contract for services (such as commercial air transportation for a deploying military unit). A *customer*—such as an Air Force squadron—can then buy the good or service from the WCF-funded organization (e.g., a depot), using operation and maintenance funds appropriated to the squadron for that purpose. These WCF transactions move hundreds of billions of dollars within DOD accounts annually.

Rates

In general, DWCFs are expected to be self-sustaining after the initial appropriation. Fund managers establish rates charged by the fund, taking into account all costs associated with each anticipated transaction. The rates cover the commodity cost of materials as well as a surcharge, which includes overhead, operating expenses, and administrative requirements. Fund managers establish the rates 18-24 months ahead of schedule, and the rates are typically locked in for a specific fiscal year.

WCFs are typically organized by *budget activity* (a category within each fund that identifies the purposes, projects, or types of activities financed by the fund). In a supply-oriented budget activity, fund managers generally add a surcharge to all items provided in order to cover management and other overhead costs such as warehousing and shipping. Non-supply budget activities (such as those providing maintenance or information technology services) establish surcharge rates based on the unit cost of the service provided plus all overhead costs. Fund managers generally budget to recover all operating expenses, including

- **direct costs,** such as labor and materials;
- **indirect costs,** such as facilities operation and maintenance;
- **hardware costs,** such as acquisition and repair of equipment needed to support warehouse operations;
- **operations costs,** such as labor, travel, training, transportation of personnel; and
- **other general and administrative costs.**

Operating and Managing a WCF

DWCFs may realize gains or losses within each fiscal year. Gains may be returned to customers by setting lower rates for future fiscal years. Managers can recoup losses by establishing higher rates in later years or seeking additional appropriations from Congress. Regardless, DWCFs must maintain a positive cash balance at all times to avoid Anti-Deficiency Act violations.

DOD Financial Management Regulation (FMR) 7000.14-R governs DWCFs. The FMR directs DWCFs to operate on a *break-even* basis (revenue generated equals the cost associated with receiving the revenue). Fund managers track and report two main types of *operating results* in managing a WCF. The *net operating result* (NOR) is the net difference between expenses and funds received for a single fiscal year. The *accumulated operating result* (AOR) is the net difference between expenses and funds received since the inception of the fund. Managers typically use AOR in establishing the future rates to be charged to customers.

History of DOD Working Capital Funds

Section 2208 of Title 10 was codified in 1962 and provides the Secretary of Defense the authority to establish a variety of working capital funds to support DOD operations. In 1991, the Secretary of Defense combined five industrial funds, four stock funds, and multiple appropriated fund support activities that had been established by the services into the Defense Business Operations Fund (DBOF) to streamline management and oversight responsibilities. These operations included depot maintenance, transportation, supply management, and finance and accounting.

By 1996, the DOD recognized the difficulty in managing one large WCF and associated challenges in setting rates across the DOD. As a result, the Under Secretary of Defense (Comptroller) disestablished the DBOF in 1997 and established five DWCFs.

Air Force Working Capital Fund (AFWCF)

The AFWCF comprises three activities: two activity groups and the Transportation Working Capital Fund (TWCF). The Deputy Assistant Secretary for Budget (SAF/FMB) manages Consolidated Sustainment Activity Group and the Supply Management Activity Group Retail. SAF/FMB is also the Executive Agent for the TWCF, but U.S. Transportation Command (TRANSCOM) manages the operations. While TRANSCOM manages the TWCF, its three service component commands (Air Mobility Command, Military Sealift Command, and Military Surface Deployment and Distribution Command) utilize the funds. TWCF also includes the Defense Courier Division.

Navy Working Capital Fund (NWCF)

The Assistant Secretary of the Navy (Financial Management & Comptroller) manages five activity groups: Depot Maintenance, Base Support, Supply Management, Research and Development (all Naval Warfare Centers and the Naval Research Laboratory), and Transportation.

Army Working Capital Fund (AWCF)

The Assistant Secretary of the Army (Financial Management and Comptroller) manages two activity groups: Industrial Operations and Supply Management.

Defense-Wide Working Capital Fund (DWWCF)

The DWWCF comprises six activity groups managed by three agencies:

- Defense Logistics Agency (DLA)—DLA reports to the Assistant Secretary of Defense (Sustainment) and manages three activity groups: Consumable Supply Management, Energy Management, and Document Automation and Production.
- Defense Finance and Accounting Service (DFAS)—the Under Secretary of Defense (Comptroller) oversees DFAS. It is a service provider that directs, approves, and performs finance and accounting activities for the military services.
- Defense Information Systems Agency (DISA)—DISA falls under the DOD Chief Information Officer and manages two activity groups: Computing Services and Telecommunications/Enterprise Acquisition Services.

Defense Commissary Agency (DeCa)

DeCA operates a worldwide chain of commissaries providing groceries to military personnel, retirees, and their families. The DeCA WCF includes three activities: Resale Stocks, Commissary Operations, and the Surcharge Collections Trust Revolving Fund.

DOD WCF Challenges

DOD WCF managers experience a variety of challenges in maintaining operating costs and ensuring a stable cash corpus. The first of these is variability in customer orders. Customer requirements may change based on real-world operations, increased maintenance requirements, or a decreased ability to afford services based on higher than expected rates. Delays in appropriations (e.g., operating under continuing resolutions) can also affect customer orders.

Many commercial market factors directly affect DWCF operations. Customers pay a set *rate* (typically for that year) regardless of the market conditions. A difference in market price of an item and the set rate for that item results in either transactional *profit* or *loss*. Differences can accrue quickly due to the large scale of DOD operations. For example, a sharp increase in the price of fuel—like the 10% increase in two weeks in May 2009 —can quickly consume the cash in a DWCF that deals heavily in transportation services. Likewise, fuel prices may not increase as much as anticipated at the time the set *rate* was determined, leaving the DWCF with large amounts of excess cash at the end of the year.

DWCF funds do not expire. When excess cash accumulates in a DWCF, DOD officials or some in Congress may see that money as a funding source for other requirements. While there are budgetary procedures to enable the transfer or *reprogramming* of funds to other accounts, the transfer of funds may negatively affect future rates to customers, available funds for ongoing or future work, and daily operational risk if a major work interruption or shortfall occurs.

In addition to the day-to-day challenges associated with financial management of a DWCF, fund managers sometimes face challenges with performance or quality of services provided. If an activity funded by a DWCF is providing a poor-quality service or is not meeting a customer's schedule requirements, the customer may seek a different provider, which would result in the fund not making the *sale*. Often in this case, excess goods will remain in WCF-funded warehouses or contracted services will go unused. As a result, the fund will not earn the surcharge and its financial profile will begin to suffer.

DWCF Budgets

Budget information for DWCFs is publically available through the DOD Comptroller's website (http://comptroller.defense.gov/). The annual budget justification books provide a financial profile of each of the funds covering a three-year period (year of the request and two years prior). The profile generally includes an accounting of fund revenues, operating expenses, capital investments, and cash forecasts for the budget year. The NOR and AOR (actual and projected) can be found in these documents.

The budget justification books also depict and explain any anticipated rate/surcharge adjustments and provide detail to support requests for direct appropriations, if required. In addition, the budget justification books may provide information on fund operations to include performance metrics (such as customer wait times or supply quality assessments), management challenges and initiatives, and manpower trends.

Jason A. Purdy, jpurdy@crs.loc.gov, 7-5050
Lynn M. Williams, lmwilliams@crs.loc.gov, 7-0569

IF10852