

August 2, 2005

WORKING CAPITAL FUND

FY 2005 Third Quarter Report: Summary

Introduction

The startup of the STARS accounting system during the third quarter of FY 2005 has created some challenges for financial reporting, and more system adjustments are needed before the accounting data can be used directly. However, in the interest of keeping the Board apprised of the progress of Fund businesses, the Manager and the business line officials have cooperated to provide as sound an assessment of fiscal status as possible.

In the following sections, earnings data are derived from the Fund's billing system, from which files are provided to STARS. Obligation data are derived from STARS reports for July 25, 2005, approximately the point at which third quarter results were provided to other agencies, and cost data derive from estimated prepared by the business line managers

Overall, we believe our conclusions based on these estimates to be reliable and there is no need to revise current pricing policies. We will advise the Board if any judgments based on these data appear to have been in error.

I. Relation of Earnings to Expenses

Based on our reviews, the Fund is on track for a break-even year in FY 2005. Earned revenue for the Fund has totaled slightly over \$73.4 million for the first three quarters, on track for an annual level of approximately \$100 million, as forecast in Table III of the June bill. Costs are harder to pinpoint, because of some difficulty experienced in posting expenditure accruals in the new STARS system and related difficulties in capturing costs incurred through DOE field locations, notably NETL, which administers parts of the CHRIS and PMCDP programs. The STARS system recorded \$60 million in costs as of June 30, 2005, suggesting a \$13 million profit, but we are certain that is not the case. We went through the records on a business-by-business basis, as indicated in Table I below, and concluded that business expenditures for the first three quarters of FY 2005 were approximately \$71.8 million, leaving net earnings for three quarters of \$ 1.6 million. The \$ 12 million upward adjustment we made to costs for three quarters compares to \$16.3 million we made for the mid-year report to the Board, so it is not out of line with expected delays in invoicing and cost recording..

Each business is expected to achieve a balance between annual 'earnings' (billings to customers pursuant to Board-approved pricing policies) and 'expenses' (accrued contractual costs adjusted for depreciation, inventory changes, and related business-type costs). Quarterly analyses are intended primarily to identify emerging annual issues that may warrant changes in Board pricing policies. Unless otherwise noted, all financial data are cumulative for the first three quarters of FY 2005.

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FY 2005 Third Quarter Cumulative Business Results (in Millions)			
TABLE I			
<u>Business Line</u>	Third Quarter Earnings	Third Quarter Business Expenses	Third Quarter Net
Supplies	\$2.2	\$2.2	\$0.0
Mail	\$1.5	\$1.5	\$0.0
Copying	\$1.7	\$1.5	\$0.2
Printing/Graphics	\$2.7	\$2.6	\$0.0 ¹
Building Occupancy	\$48.4	\$47.8	\$0.6
Telephones	\$6.5	\$5.9	\$0.6
Desktop	\$0.7	\$0.7	\$0.0
Network	\$4.5	\$4.2	\$0.3
Procurement Services	\$0.7	\$0.7	\$0.0
Payroll Processing	\$1.5	\$1.4	\$0.1
CHRIS	\$1.6	\$1.5	\$0.1
Corp Training Services	\$0.5	\$0.5	\$0.0
PMCDP	\$0.9	\$1.3	\$(0.4)
TOTAL ²	\$75.3	\$71.8	\$1.6

With few exceptions, the net earnings by business line are consistent with a longer-term breakeven position. For example, historical building profits that were due to unfinished projects are being offset as projects are completed, and Telephone capital accumulation is an offset to the equipment write-off that resulted in large losses in FY 2003. The Copy business has recovered from losses in the first half that were due to information missing from the billing system. PMCDP implementation is catching up to draw down balances accumulated in the first year. Specific differences in excess of \$50,000 are as follows:

- Copy Business Line reported net earnings of \$175,328 through the Third Quarter due to recording revenues earned during the first two quarters of FY 2005, but not billed until the third quarter.
- The Building Occupancy Business Line had net earnings of \$629,463 through the Third Quarter due to delays in completing projects where revenue has been counted as earned. Since the affected projects are proceeding, there will be further costs associated with these earned revenues, so they are not “profits” in an economic sense.

¹ Rounding issue. Net earnings were \$6,320

² When converting from whole dollars to tens of millions total amounts do not always add due to rounding.

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- The Telephone Business Line had net earnings of \$596,324 through the Third Quarter due primarily to collection of revenues for depreciation without any actual depreciation cost. This adds to funds that could be available to support the infrastructure upgrades once a plan is presented to the Board.
- The Network Business Line had net earnings of \$239,267 through the Third Quarter, basically on track for the accumulation of capital authorized by the Board in the late 2003 pricing policy changes.
- Payroll processing had estimated net earnings of \$150,484 through the Third Quarter,. This is an estimate, because no invoices have been received from DFAS for FY 2005. We have received word informally that DFAS may be making a reduction in its annual charges to DOE, but we are not in a position to propose adjustments in future year requirements at this time.
- CHRIS had net earnings of \$127,500 due to deferring capital equipment purchases within the year. A large capital purchase is planned for later in FY 2005, likely to be reflected as depreciation expenses in ensuing years.
- PMCDP costs are estimated to be in excess of earnings, primarily due to the drawdown in balances obligated in the initial FY 2004 year; however, no change in pricing policy is needed. In the coming months, there will be cost and revenue growth due to the full implementation of bilateral course scheduling agreements between the Fund and NE and EM.

Both earnings and expenses reported above have been adjusted from the STARS accounting to present the Fund's financial results with the most accurate and latest information. Specifically, we have adjusted earnings downward by \$3.2 million because certain business line have revenue segments that, while charged annually, should be reflected as earned in quarterly reports in 25% increments. Telephone results have also been adjusted to offset the reverse billing for August/September usage billed in October/November. Due to STARS implementation, there were uneven cost accruals for the Third Quarter. For that reason, we have adjusted expenses to simulate the effect of full accruals. This net cost adjustment was \$12 million, which is equivalent to approximately 1.5 months of spending; it is consistent with the adjustments we made at mid-year when the decision was taken not to record accruals during the transition from DISCAS to STARS.

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II. Relation of Customer Payments to Anticipated Customer Billings

Obligation authority for Fund businesses is derived from customer advance payments for services. The Board has adopted procedures calling for customers to make full-year advance payments into the Fund once appropriations are available. By June, 2005 we had collected \$105 million compared to the estimated \$100 million in FY 2005 annual revenues (Table II), and since the end of June, some organizations have made further advances. The Fund Manager is working with customers to fully fund their WCF requirements as soon as possible.

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FY 2005 Third Quarter Cumulative Business Results (in Thousands)			
TABLE II			
<u>Program Customer</u>	Annual Estimate	Customer Advances³	Difference
Secretary of Energy Advisory Board	\$ 218	\$ 258	\$ 41
Board of Contract Appeals	101	110	9
Bonneville Power Administration	192	N/A	N/A
Congressional & Intergovtl Affairs	705	717	12
Counterintelligence	1,125	1,247	122
DOE Representative to the DNFSB	134	137	3
Economic Impact and Diversity	681	839	158
Energy Efficiency	6,335	6,292	-43
Environment, Safety, and Health	4,156	6,429	2273
Energy Information Administration	7,013	8,415	1,402
Environmental Management	7,496	7,268	-228
Fossil Energy	3,718	3,957	240
General Counsel	3,124	2,965	-159
Hearings and Appeals	703	702	-1

³ Customer advances include prior year customer advances. (see Table III).

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FY 2005 Third Quarter Cumulative Business Results (in Thousands)			
TABLE II (continued)			
<u>Program Customer</u>	Annual Estimate	Customer Advances	Difference
Inspector General	1,607	1,587	-20
Chief Information Officer	4,875	4,755	-120
Intelligence	4,866	5,211	345
Legacy Management	584	578	-6
Management Budget and Evaluation	14,888	16981	2,093
NNSA	17,770	17,057	-714
Nuclear Energy	2,574	2,248	-325
Naval Reactors	214	648	434
Oversight & Performance Assurance	806	816	10
Public Affairs	819	803	-16
Policy and International Affairs	1,709	1,643	-66
CRWM	1,562	1,660	98
Office of the Secretary	1,005	1,053	48
Science	4,632	4,877	245
Security	4,746	4,872	126
Electric Trans & Distribution (OE)	693	860	166
WAPA/SWPA/SEPA	952	N/A	N/A
Field Offices	21	N/A	N/A
Total, Working Capital Fund	\$100,026	\$104,989	\$ 4,963

The difference between Total Available for Obligation (Table III) and Customer Advances (Table II) is net equity held in business line accounts (**\$3.5 million**).

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III. Relation of Payments to Obligations by Business Line

- There have been no violations of administrative control of funds procedures by WCF business lines. However, the initial set-up of the STARS system did not reinstitute the electronic controls that were in DISCAS on obligations at the business line level. Therefore, the Fund Manager withdrew all obligation authority in June from the business lines and instituted a “paper” control system whereby every obligation instrument required signoff by the Fund Manager before it could be processed. This system is far from ideal, because many very small transactions have had to be processed. However, business officials have been very cooperative, and the paper-based system has worked thus far.
- As shown in Table III, funds available exceeded obligations by an estimated \$ 40.9 million by the end of the Third Quarter.

WORKING CAPITAL FUND					
FY 2005 Third Quarter Business Results (in Millions)					
TABLE III					
<u>Business Line</u>	Unobligated Balance ⁴ 10/05	Current Year Customer Advances	Total available for Obligation ⁵	Third Quarter Obligations	Advances Remaining to be Obligated
Supplies	\$ 1.6	2.5	3.1	\$1.7	1.4
Mail	1.3	2.3	3.6	\$1.7	1.9
Copying	0.5	1.7	2.2	\$1.6	0.6
Printing/Graphics	0.7	3.1	3.8	\$2.9	0.9
Building Occupancy	7.2	59.4	66.6	\$48.2	18.4
Telephones	2.9	6.7	9.6	\$3.8	5.8
Desktop	0.2	0.8	1.0	\$0.6	0.4
Network	1.0	5.6	6.6	\$2.5	4.1
Procurement Services	0.4	1.0	1.4	\$0.0	1.4
Payroll Processing	2.2	2.3	4.5	\$0.7	3.8
CHRIS	0.0	2.5	2.5	\$1.8	0.7
Corp Training Services	0.5	0.8	1.3	\$0.4	0.9
PMCDP	1.2	1.0	2.2	\$1.6	0.6

⁴ The unobligated balances are made up of earned and unearned customer advances from the prior fiscal year. These funds often act as working capital during the early weeks of a new fiscal year.

⁵ In the STARS, the availability of funds for obligation was reduced by \$20 million during the quarter due to an error, and it is expected that such funds will be restored to provide full availability this fiscal year.

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TOTAL	\$ 19.7	89.7	108.4	\$67.5	40.9
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For reasons that were explained in the STARS/IDW message on incorrect transaction dates, the obligation levels shown in Table II reflect downward adjustments of slightly over \$14 million, to correct for errors in the recording of RSIS transactions in the three CIO business lines. The reductions taken from the June general ledger reports were made during the month of July, and the Fund Manager is confident of the estimates numbers above.

IV. Changes in Budget Estimates by Business Line and Customer

The \$3.4 million increase from the December 2004 to the June 2005 estimate for FY 2005 was the result of \$2.5 million in building alterations ordered during FY 2005 and the annualized impacts of the corrections made in Copying billing systems (\$0.6 million). Building alterations cannot be predicted in the budget and therefore result in an increase in spending during budget execution. Otherwise the FY 2005 billing estimates are reasonably aligned with prior estimates. The remainder was due to bilateral arrangements between the Fund and NE and EM for incremental PMCDP services.

FY 2005 Budget Estimates for WCF Businesses		
Date	Process	FY 2005 Billing Estimate (\$Millions)
May 2003	FY 2005 Corporate Review	\$94.9
December 2003	FY 2005 Congressional Budget	\$97.2
May 2004	FY 2006 Corporate Review	\$97.2
December 2004	FY 2006 Congressional Budget	\$96.6
June 2005	June Bill	\$100.0

V. Anticipated Need to Change Pricing Policies or Make Substantial Changes in Operating Levels.

Based on the Third quarter reviews with the businesses the Fund Manager foresees no immediate need to change pricing policies in any businesses. However, businesses are reviewing future funding needs, and the Board has formed working groups to analyze potential investment requirements in Network. It is also possible that the STARS business line will request FY 2007 changes due to newly identified

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needs, but this matter remains under review.

VI. Financial Management Systems Progress Working Capital Fund Billing System

- The WCF billing system continued to successfully produce timely and accurate monthly bills. The chart below indicates the billing performance related to transferring customer-billing information to DISCAS/STARS by the second working day of the month (a decrease of two working days). This allows the Fund staff, with the cooperation of EFASC officials, to have the billings entered into STARS each month before the accounts are closed. A minus two (-2) indicates that billing was forwarded two days before the deadline. This standard provides customers with costs reported in DISCAS in the same month they occur. The time between the end of the month and the issuance of the bill is extremely consistent.
- The Fund Manager recently completed upgrading the billing system to automate and enhance customer reporting. The complete assessment can be located on our web site at www.wcf.doe.gov under Billing System Assessment. It is our assessment that the system is stable and has the flexibility to accept changes as needed. We also conducted a review of information processing flows on feeder systems to identify areas which would warrant special attention to ensure data continuity. We solicit ideas from our customer and business working groups for the next generation of enhancements.
- As noted earlier, we have encountered some problems associated with the implementation of the STARS accounting system and have alerted STARS management to these issues. The major WCF vulnerabilities of the system as currently in place are as follows:
 - Obligation control levels were established not at the business line level, as under DISCAS, but at the Fund level, resulting in too many entities being able to obligate funds against a single target. Since Fund business lines do not report administratively to the Fund Manager, but rather to elements of the OMBE and CIO organizations, the Fund Manager had to withdraw obligation authority from businesses and institute a rather old-fashioned signature log system whereby the Manager approves every obligation. Some obligations were already “in the pipeline” before this emergency control system was put in place, creating potential Anti-Deficiency Act problems. We are working with STARS management to correct this control deficiency for FY 2006.
 - Inter-entity transactions are difficult to see and monitor in STARS and IDW reports. Since some businesses rely on procurement functions at field sites, notably NETL, it is imperative that the Fund Manager get timely access to accurate reporting on the use of Fund resources at such locations.
 - Definition of the availability of WCF funds for obligation has become problematic, as accounting entries were made without our knowledge to withdraw the equivalent of nearly three months of

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obligation authority when only four months remained in the fiscal year. It will be important to reestablish the chain of custody for customer letters of obligation to the Fund.

- Accrual procedures were made more difficult by the manner in which accrual forms were transmitted and by the lack of legacy values that would permit routing forms to the appropriate officials.

The Fund Manager has been working with the I-MANAGE staff on these issues, and we will continue to do so.

During the Third Quarter the Fund Manager examined source data and systems that feed billing information to the billing system in order to document their characteristics, to identify and mitigate potential risks, to identify best practices, and to develop opportunities for improvement. Recommendations included: billing subsystems should be better documented and business-line staff should be cross trained in billing tasks; all billing systems should be backed up each month; and in specific businesses, further analysis is needed to further evaluate potential errors due to various factors. A complete discussion of this analysis is available on www.wcf.doe.gov.

WCF Billing Performance

