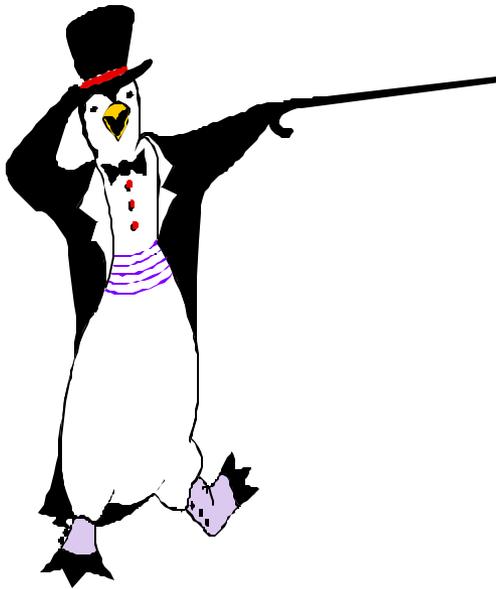


Programming and Budget Policies for Acquisition Programs



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Topics



- **Appropriations**
- **Funding Policies**
- **Funding Policy Exceptions**
- **Escalation**
- **Working Capital Funds**

Major Appropriation Categories

APPN CAT	SCOPE OF WORK EFFORT	FUNDING POLICY	OBLIGATION PERIOD
RDT & E	RDT&E Activities & Exp, AIS E/SW @ R&D Facilities, Minor Const	Incremental	2 Years
PROC (SCN)	Production Labor/HW, Initial Spares, AIS E/SW >=\$250K	Full	3 Years 5 Years - SCN
O&M	Replenishment Spares, Civilian Salaries, Travel, Fuel, Supplies, Minor Const <\$750K, AIS E/SW <\$250K	Annual	1 Year
MILPERS	Military Pay & Allowances, PCS Moves, Retired Pay Accrual	Annual	1 Year
MILCON	Major Construction Projects >\$750K	Full	5 Years

Annual Funding Policy

Operations & Maintenance and Military Personnel

Annual budget request will be limited to budget authority necessary to cover all expenses during the 12 month budget period (fiscal year).

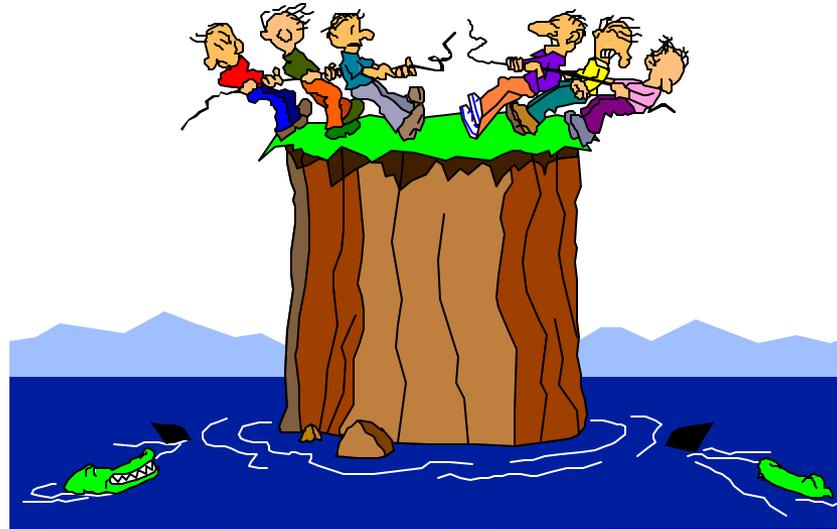


Annual Funding Policy

	FY 00	FY 01	FY 02	FY 03
Task 1 \$20M	\$5M	\$5M	\$5M	\$5M
Task 2 \$350M	\$50M	\$100M	\$100M	\$100M
Task 3 \$15M		<u>12 Month Effort</u> \$10M	\$5M	
O&M Budget Authority	\$55M	\$120M	\$105M	\$105M

Severable Services

- **May enter into a contract for severable services that begins in one fiscal year and ends in the next fiscal year if the contract period does not exceed one year**
- **Funds made available for a fiscal year may be obligated for the total amount of the contract**



Multi-Year Service Contracts

Operations & Maintenance - Authority

- Continuing requirement for the services
- Furnishing of services will require a substantial initial investment in plant or equipment, or incurring substantial contingent liabilities for the assembly, training, or transportation of a specialized work force
- The use of such a contract will promote the best interest of the U.S. by encouraging effective competition and promoting economies of operation.



Multi-Year Service Contracts

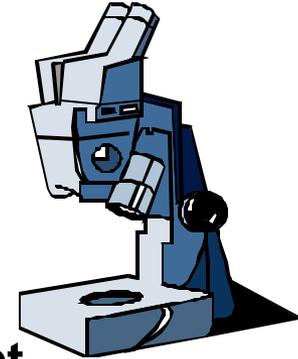
Operations & Maintenance - Covered Services

- Operation, maintenance and support of facilities and installations
- Maintenance or modification of aircraft, ships, vehicles, and other highly complex military equipment
- Specialized training necessitating high quality instructor skills (eg. Pilot and aircrew members; foreign language training)
- Base services (eg. Ground maintenance; plane refueling; bus transportation; refuse collection and disposal.)

Chapter 137 of title 10, United States Code, Sec 2306C, Multiyear Services Contracts. (Originated in 2000 Authorization language).

Incremental Funding Policy

Research, Development, Test & Evaluation



Annual budget request will be limited to budget authority necessary to cover all costs expected to be incurred during that fiscal year.

Incremental Funding Policy provides flexibility to the government in the uncertain environment of RDT&E



Incremental Funding Policy - RDT&E

	FY 00	FY 01	FY 02	FY 03
TASK 1 \$20M	\$5M	\$5M	\$5M	\$5M
TASK 2 \$400M	\$50M	\$100M	\$100M	\$150M
TASK 3 \$15M	\$10M	\$5M		
RDT & E Budget Authority	\$70M	\$105M	\$105M	\$155M

18 Month Exception

RDT&E - 18 Month Exception

- There are requirements in which there is no logical way to divide the work, it is clearly unfeasible to limit the contract to a shorter period; or the planned technical effort is such that no responsible contractor can be found who will accept a contract for a less than completion increment. For these type of efforts that take longer than 12 months, but less than 18 months, the Service or Defense Agency Comptroller may approve financing the total requirement in one fiscal year.



Full Funding Policy

Procurement and Military Construction

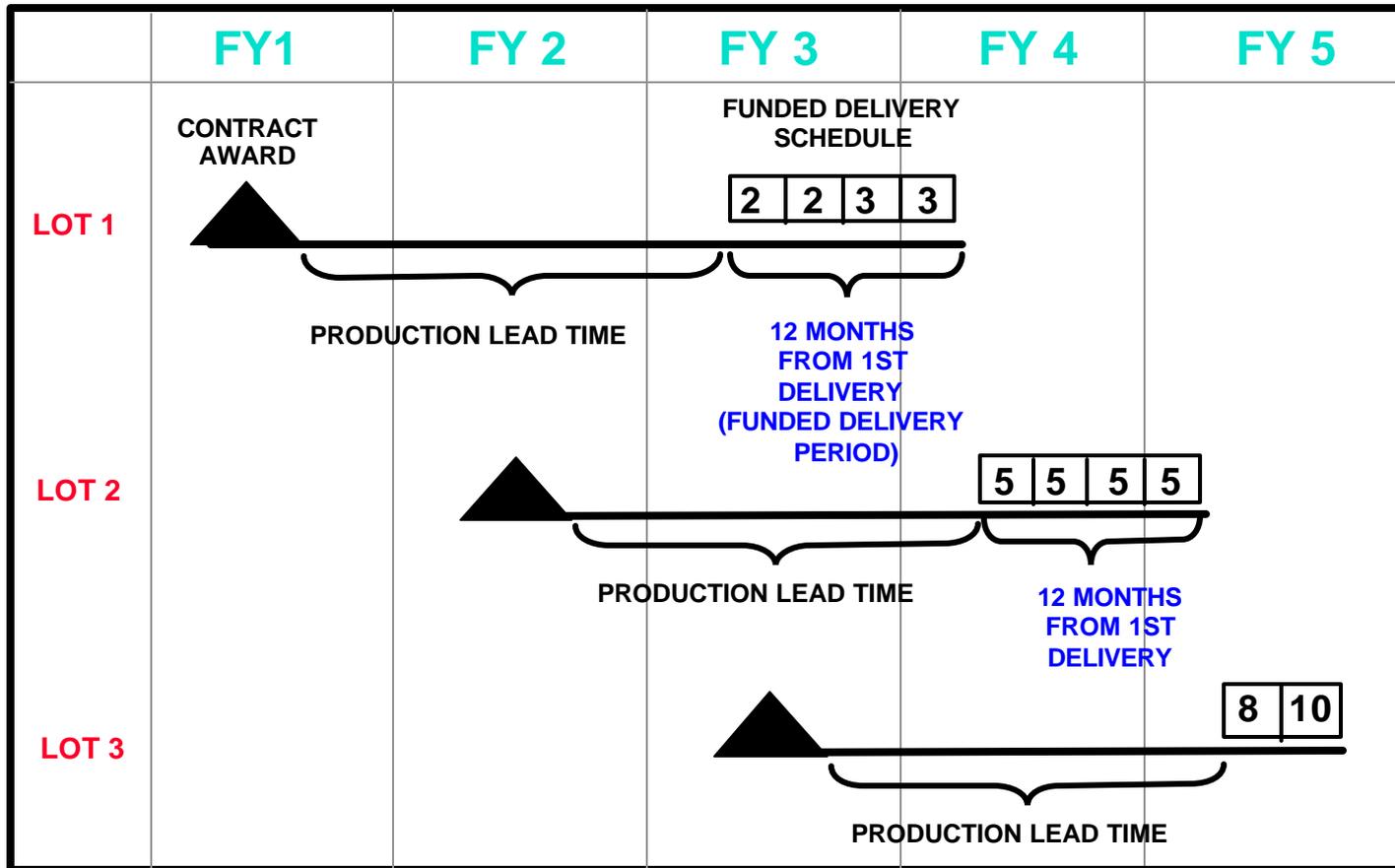
Annual budget request must cover the total cost to deliver a given quantity of complete, militarily usable end items in a 12 month funded delivery period.



Governing Concepts

- *Usable End Items* - No piecemeal procurement of systems is permitted.
- *Funded Delivery Period* - 12 month period starting with delivery of first item.

Funded Delivery Period



Full Funding Policy

	FY 1	FY 2	FY 3	FY 4
LOT 1 10 ITEMS				
Start Up Costs:	\$40K	\$0K	\$0K	\$0K
Production Costs:	\$30K	\$140K	\$140K	\$50K
	\$70K	\$140K	\$140K	\$50K
Budget Request:	\$400K			

Full Funding Policy

	FY1	FY 2	FY 3	FY4	FY 5
\$ 400 K LOT 1 10 Items	\$70K 	\$140K	\$140K 2 2 3 3	\$50K	
\$ 600 K LOT 2 20 Items		\$120K 	\$200K	\$200K 5 5 5 5	\$80K
\$ 500 K LOT 3 18 Items			\$90K 	\$230K	\$180K 8 10
Budget Request	\$ 400 K	\$ 600 K	\$ 500 K	\$	\$

Advance Procurement / Long Lead Items

- **Exception to Full Funding Policy**
 - Must be in Acquisition Strategy
 - Approved by Milestone Decision Authority
 - Separate Initial Contract
- **Finances Long Lead (Recurring) Components**
 - To protect production schedule
 - To maintain a critical skill in the work force
- **Generally, Budget Authority requested / granted one Fiscal Year in advance of the related end item**
- **Shown as a separate line item on the budget request**



Advance Procurement

	FY 1	FY 2	FY 3	FY 4				
LOT 2 20 ITEMS Less Advance Procurement: Budget Request System: Budget Request Adv Proc:		▲	<table border="1" style="display: inline-table;"> <tr> <td>5</td> <td>5</td> <td>5</td> <td>5</td> </tr> </table>	5	5	5	5	
	5	5	5	5				
			\$100M	\$300M	\$200M			
			\$600M					
		▲	-\$50M					
	\$50M	\$550M						

Advance Procurement (cont.)

	FY 1	FY 2	FY 3	FY 4	FY5
LOT 2 20 Items Less Advance Procurement:		 \$600M ↓ -\$50M	5 5 5 5 <hr/>  \$900M ↓ -\$75M	8 10 10 12 <hr/> \$825M	
LOT 3 40 Items Less Advance Procurement:		\$550M \$75M	\$825M		
Budget Request System: Budget Request Adv Proc (PY):	\$50M				

Multiyear Procurement (MYP)

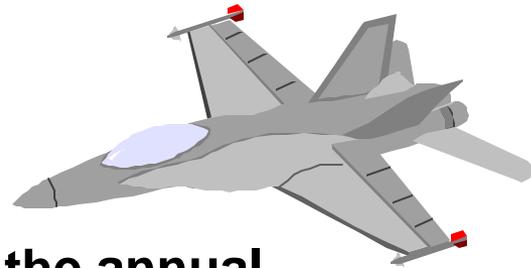
Exception to Full Funding Policy

Commitment to buy a specific quantity of useable end items of a weapon system over a specified number of years (normally, maximum of five years)

Annual Appropriation by Congress for same specified number of years

Purpose:

- To reduce program cost growth
- To counteract adverse effects of the annual budget and procurement process
- To bring stability to acquisition process



Multiyear Procurement (cont.)

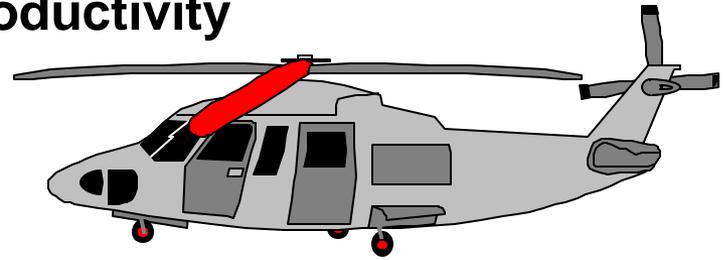
Benefits:

Provides assurance to Contractor of future years procurement

Encourages Contractor investment

Facilitates economic order quantities

Increases Contractor productivity



Potential problems

Government liable for a penalty (decreasing amount) for early cancellation of contract

Can't budget for termination liability

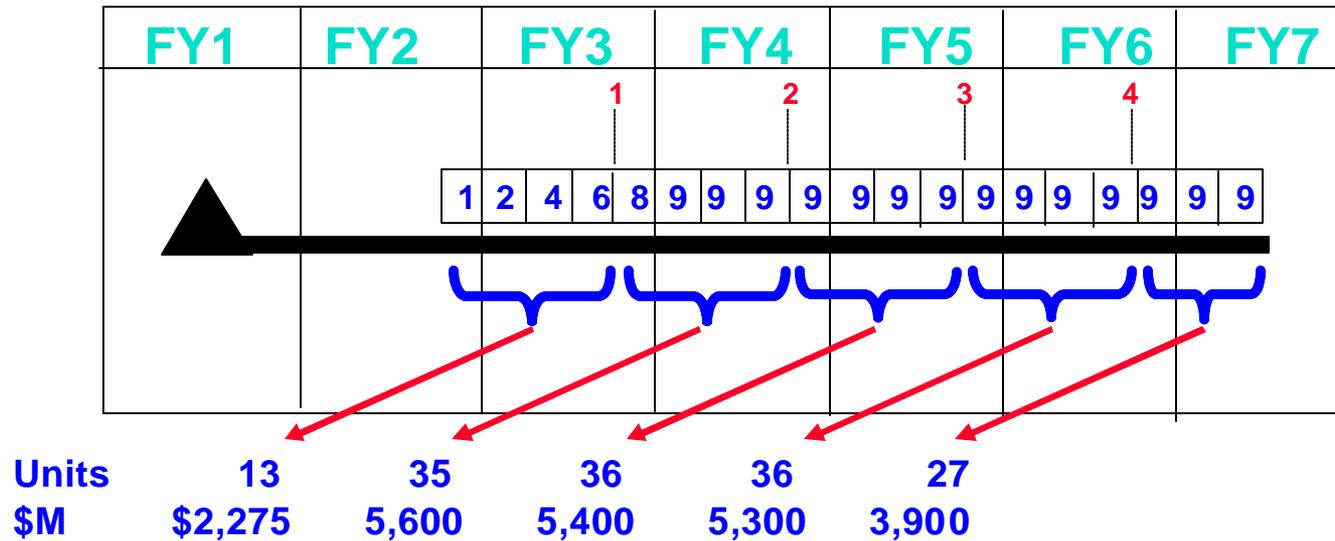
Controversial concept (both in Congress & OSD)

Multiyear Procurement Criteria

- Significant savings compared to annual buys
- Stable requirements
- Stable design
- Confidence in cost estimates
- Confidence in contractor's ability to produce
- Commitment to funding by Service, OSD and Congress for current and out-years

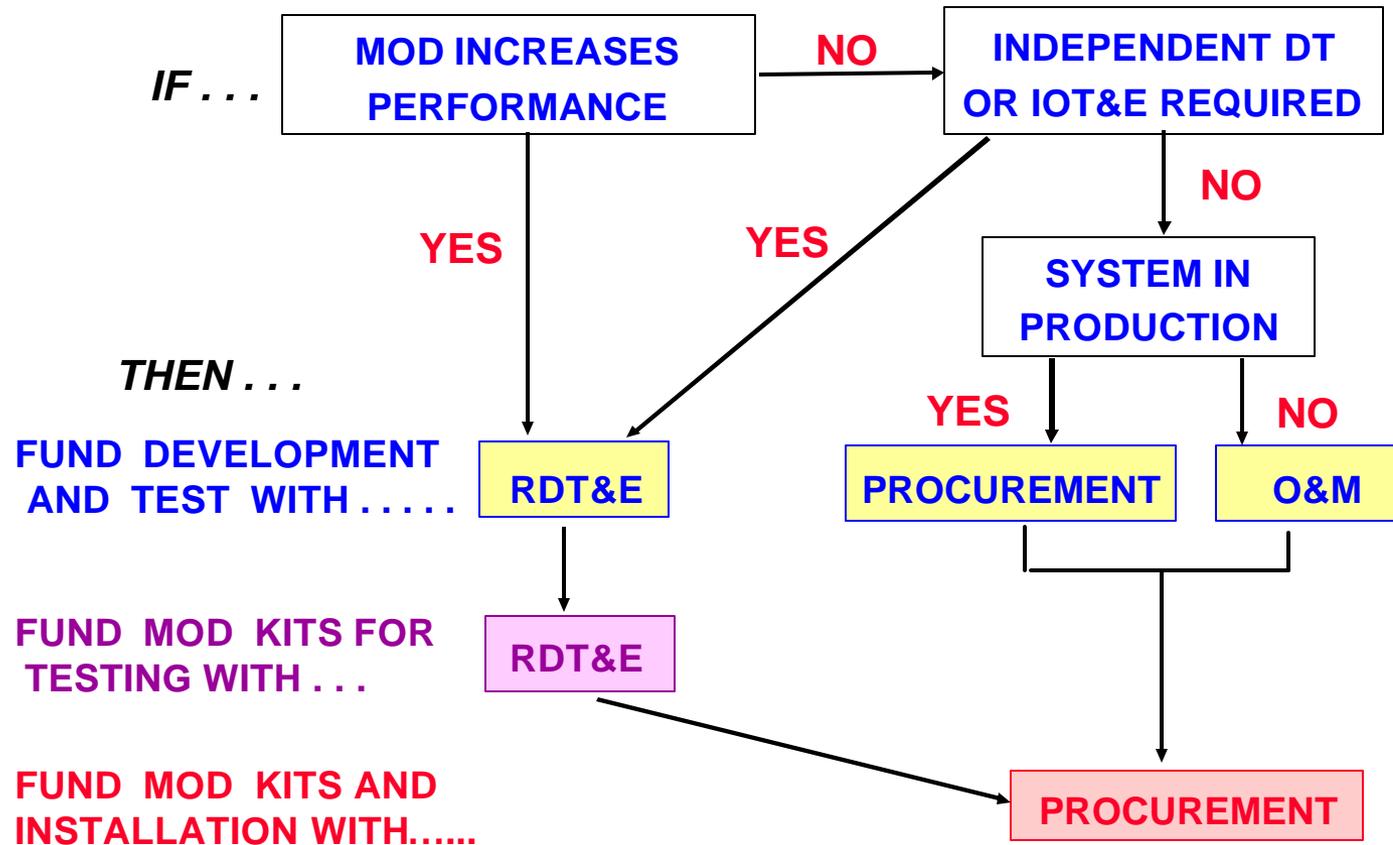


Multi-Year Procurement (cont.)



**Funded the same way
as Full Funding**

Product Improvement



Funding Rules for Communications & Information Systems

Procurement - Investment

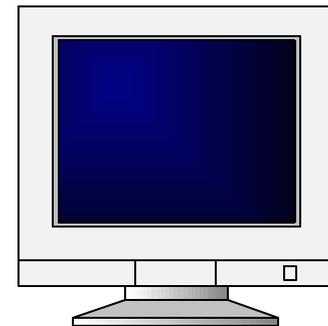
- New Equipment / SW > \$250K
- Upgrades / Replacement Equipment > \$250K

O&M - Expenses

- New Equipment / SW < \$250K
- Upgrades/Replacement Equipment < \$250K
- Routine maintenance, Lease

RDT&E

- Development, test and evaluation costs
- Development of major upgrades
- Hardware/Software for RDT&E Facilities



LRIP

According to FMR - Designed to be flexible

Article Use

DT or OT

Operational Use

Testing subsequent to
acceptance

Modification of Test Articles

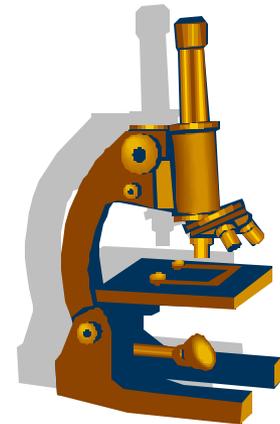
Appropriation

RDT&E

Procurement

Procurement

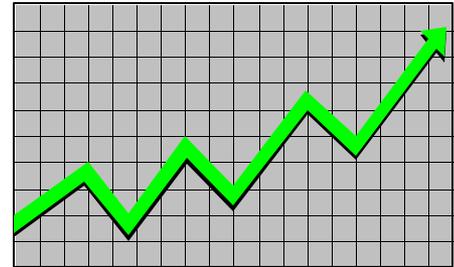
Procurement



Escalation

- **Constant / Base Dollars**

- Tied to Specific year, No Inflation
- Used for Cost Estimates
- Allows comparison of program costs between years



- **Current / Then Year Dollars**

- Includes Inflation and Outlay Rates
- Inflation - general price level increases over time
- Outlay rates - not all dollars are expended in year obtained
- Used for Budget Estimates (POM, BES, PB, FYDP)

Escalation Terms

- **Raw (Compound) Index**
 - Simple annual compounding of inflation rates
 - Used to convert constant dollars to another year constant dollars
- **Weighted (Composite) Index**
 - Combines inflation (compound index) with outlay rates. Unique for each appropriation
 - Used to turn constant dollars (cost estimate) into then-year dollars (budget estimate)

Constant Dollars x Weighted Index = Then-Year Dollars

- OSD provides annual inflation rates and outlay rates
- Services compute raw and weighted indices to use for POM, BES and PB



Raw Index

Effects of Compounding Inflation

Base Year: Mid - FY03
Aircraft Procurement, Navy

Fiscal Year	Annual inflation rate	Raw (Compound) inflation rate <hr/> % Increase over FY 03 Base Year	Raw (Compound) Index FY 03 Base Year
2002	1.7%	98.52%	0.9852
2003	1.3%	100.00%	1.0000
2004	1.7%	101.70%	1.0170
2005	1.8%	103.53%	1.0353
2006	1.9%	105.50%	1.0550
2007	1.9%	107.50%	1.0750
2008	1.9%	109.54%	1.0954
2009	1.9%	111.63%	1.1163

Constant Dollars

Converting FY 2003 Constant \$ to FY 2005 Constant \$ (\$ Millions)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
FY 2003 Constant \$	50.000	60.000	70.000	70.000	60.000	50.000	40.000
FY 2005 Raw Index Inflation Factor	1.0353	1.0353	1.0353	1.0353	1.0353	1.0353	1.0353
FY 2005 Constant \$	51.765	62.118	72.471	72.471	62.118	51.765	41.412

Examples Of Historical Outlay Rates

(As a Percentage of First Year Budget Authority)

<u>APPROPRIATION</u>	EXECUTION YEAR (Percentages)						
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>
<u>ARMY</u>							
AIRCRAFT PROC	24.60	42.00	29.40	02.00	02.00		
MISSILES	09.50	36.10	38.00	12.70	03.70		
RDT&E	41.97	45.60	07.32	02.49	02.62		
<u>AIR FORCE</u>							
AIRCRAFT PROC	12.40	37.60	28.90	14.00	03.50	03.60	
MISSILES PROC	24.10	30.90	23.80	10.90	03.70	06.60	
RDT&E	57.20	34.66	05.53	01.46	01.15		
<u>NAVY</u>							
AIRCRAFT PROC	16.00	39.50	32.20	05.90	04.10	02.30	
SCN	07.29	17.88	22.51	19.42	13.25	09.83	09.82
RDT&E	52.33	38.19	06.13	01.50	01.85		

Escalation Methodology

Aircraft Procurement

(\$ Millions)	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08
Aircraft Procurement, Navy Cost Estimate expressed in Constant Year Dollars	\$100.00					
Outlay Rates for Aircraft Procurement, Navy	.1600	.3950	.3220	.0590	.0410	.0230
	X					
Compound Index (Procurement Appn Index)	1.0000	1.0170	1.0353	1.0550	1.0750	1.0954
Price Escalated Outlays	= .1600	.4016	.3333	.0622	.0440	.0251
Composite (Weighted) Index Sum of Price Escalated Outlays	1.0262					
Budget Entry for FY 03 Expressed in Current / Then Year Dollars	\$102.62					
	←	Constant Year Estimate multiplied by FY 03 Composite Index Factor \$100 x 1.0262				

Escalation Composite Index

Aircraft Procurement Navy
Base Year: Mid - FY 2003

<u>Fiscal Year</u>	<u>Inflation Rate %</u>	<u>Compound Index</u>	<u>Composite Index</u>
2002	1.70	0.9872	1.0091
2003	1.30	1.0000	1.0262
2004	1.70	1.0170	1.0449
2005	1.80	1.0353	1.0646
2006	1.90	1.0550	1.0849
2007	1.90	1.0750	1.1055
2008	1.90	1.0954	1.1265
2009	1.90	1.1163	1.1479

Then-Year Dollars

Converting FY 2003 Constant \$ to Then-Year \$ (\$ Millions)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
FY 2003 Constant \$	50.000	60.000	70.000	70.000	60.000	50.000	40.000
Weighted Index Inflation Factor	1.0091	1.0262	1.0449	1.0646	1.0849	1.1055	1.1265
FY 2005 Constant \$	50.455	61.572	73.143	74.522	65.094	55.275	45.060

Working Capital Funds

Definition: Revolving funds or Working Capital Funds are used to finance operations from the time that specific work is begun until payment is received from the customer

Statutory Basis: Title 10, U.S. Code (Section 2208), the SECDEF may direct establishment of working capital funds within DoD

Purposes:

- Finance inventories of parts & supplies
- Provide working capital for industrial-type activities and commercial-type activities that provide common services within or among military departments and DoD agencies

Defense Business Operations Fund (DBOF)

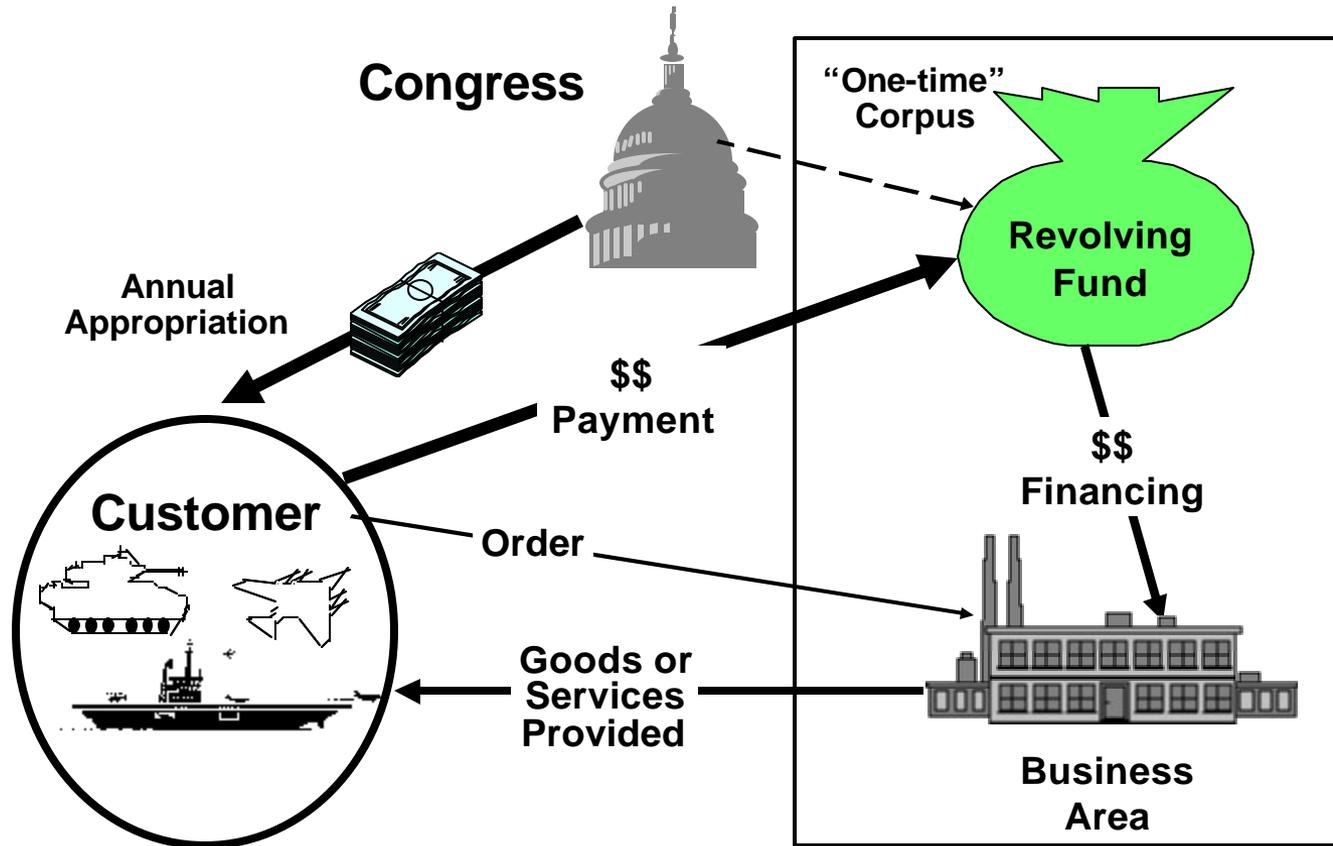
- Congress established DBOF as a revolving fund in 1991
- DBOF was initially created to consolidate nine stock and industrial funds
- Reasons
 - Improvements in business practices
 - Full cost visibility
 - Stabilized rates
 - Application of standard policies across business functions



Working Capital Funds

- **The FY 1997 Defense Authorization Act directed DoD to conduct a comprehensive study of working capital funds and present the study findings and proposed improvement plan to Congress for approval**
- **DoD initiated some of the needed changes, creating four working capital funds:**
 - **Army Working Capital Fund**
 - **Navy Working Capital Fund**
 - **Air Force Working Capital Fund**
 - **Defense - Wide Working Capital Fund**
 - **Defense Commissary Agency Working Capital Fund**

Working Capital Funds



How Does It Work?

- **Individual Business Areas**
- **Business Areas operate as a business with “break even” budgets**
- **Stabilized rates and prices established to cover full cost of operating and overhead costs**
- **Rates remain unchanged in year of execution**
- **Rates adjusted in following year to account for any shortfalls or profits**

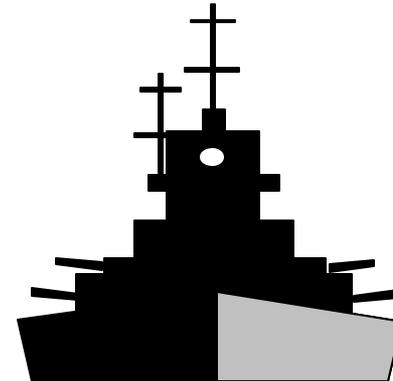
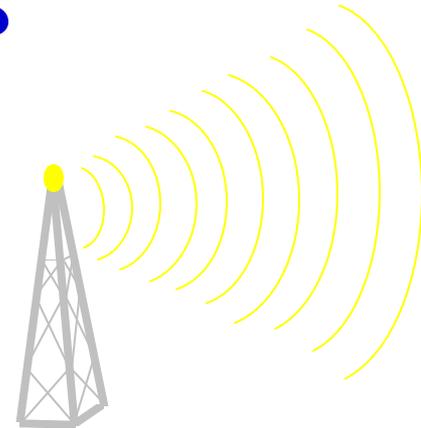
Working Capital Funds & Functions

Army Working Capital Fund

Depot Maintenance
Information Services
Ordnance
Supply Management

Navy Working Capital Fund

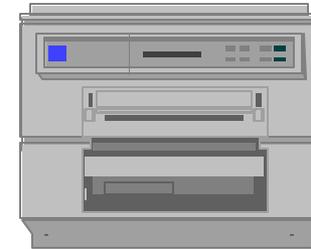
Base Support
Depot Maintenance - Aircraft
Depot Maintenance - Marine Corps
Depot Maintenance - Ships
Information Services
Ordnance
Research and Development
Supply Management
Transportation



Working Capital Funds & Functions

Air Force Working Capital Fund

Depot Maintenance
Information Services
Supply Management
Transportation



USTRANSCOM

Defense - Wide Working Capital Fund

Defense Printing	DAPS
Distribution Depots	DLA
Financial Operations	DFAS
Information Services	DFAS, DISA, DLA
Logistics Systems	JLSC
Reutilization & Marketing	DLA
Supply Management	DLA
Commissary Operations	

Service Appropriation Codes

<u>Appropriation</u>	<u>Army</u>	<u>Navy</u>	<u>USMC</u>	<u>Air Force</u>
RDT&E	2040	1319		3600
Procurement				
Aircraft	2031	1506		3010
Missiles	2032			3020
Weapons		1507		
W & TCV	2033			
SCN		1611		
Ammunition	2034	1508		3011
USMC			1109	
Other	2035	1810		3080
MILPERS	2010	1453	1105	3500
O & M	2020	1804	1106	3400
MILCON	2050	1205		3300