

DEPARTMENT OF THE NAVY  
NAVY WORKING CAPITAL FUND  
ACTIVITY GROUPS:  
NAVY SUPPLY MANAGEMENT  
MARINE CORPS SUPPLY MANAGEMENT  
FY2005 BUDGET ESTIMATES

Activity Group Functions:

The Supply Management Activity Groups performs inventory management functions that result in the sale of aviation, shipboard, and ground components as well as fuel, ships store stock, and general use consumables to a wide variety of customers. Major customers include Department of the Navy commands afloat and ashore, Department of the Army, Department of the Air Force, Defense Agencies, and other government agencies and foreign governments. All costs associated with supplying this material to our customers are recouped through stabilized rates which include cost recovery elements that cover expenses relating to inventory management, receipt and issuing of DON managed material, Department owned retail material at distribution depots, as well as depreciation of capital assets.

Activity Group Composition:

Operations costs for the following activities are funded in the Navy Supply Management Activity Group:

Naval Inventory Control Point, Mechanicsburg/Philadelphia, PA

Commander, Fleet and Industrial Support Centers:

Fleet and Industrial Supply Center, San Diego, CA

Fleet and Industrial Supply Center, Norfolk, VA

Fleet and Industrial Supply Center, Puget Sound, WA

Fleet and Industrial Supply Center, Jacksonville, FL

Fleet and Industrial Supply Center, Pearl Harbor, HI

Fleet and Industrial Supply Center, Yokosuka, JP

Navy Supply Information Systems Activity, Mechanicsburg, PA

Operations costs for the following activities are funded in Marine Corps Supply Management Activity Group:

Materiel Management Center, Albany, GA

Direct Support Stock Control, Albany, GA

Direct Support Stock Control, Barstow, CA

Business Logistics Support Department, Camp Lejeune, NC  
Direct Support Stock Control, Parris Island, SC  
Direct Support Stock Control, Quantico, VA  
Direct Support Stock Control, Twenty-nine Palms, CA  
Consolidated Material and Service Center, Camp Pendleton, CA  
Direct Support Stock Control, Camp Butler, JA

Executive Summary / Significant Changes in the Activity Groups:

Within the Supply Management areas, the Department continues to focus on delivering combat capability through optimum logistics support. Ensuring the right material is provided at the proper place, time, and cost is paramount to sustaining our warfighting units whether at peace or at war. To this end, the Department continues to pursue initiatives that will control costs and improve readiness. While we continue to address our aging weapon systems through modifications and new procurement, our older weapon systems combined with increased utilization rates have increased the cost of our spare parts. This is one of the reasons why the Department's request for material obligations remains high. In this regard, it is important to realize that since spare parts, in the aggregate, are but a single element within a complex and intricately balanced system necessary to keep weapon systems safe and operating at their optimal capability, the Department must also look at other contributing elements that influence cost. To attain data in other integrated logistics support elements, such as training and maintenance, more robust information systems are required. Accordingly, the Department continues to fund initiatives such as Enterprise Resource Planning. This initiative will provide the Department better tools to assess program growth and implement cost reducing procedures where appropriate. We are optimistic that these continuing efforts along with reducing weapon system age will stem the tide of spare part cost growth and allow the Department to provide our warfighters improved logistics support at a lower cost. One of the Department's readiness initiatives that will improve our ability to respond logistically to impending threats is the capitalization of spare aircraft engines. The NWCF is an account that provides the Department the ability to react quickly to changing (or projected) customer demand patterns. By enabling the NWCF to order spare aircraft engines, while still using procurement funds to buy the asset off the shelf when available, the Department gains efficiencies and improves our readiness posture. Accordingly, this submission includes \$59 million in FY 2005 to order spare aircraft engines using the NWCF. Lastly, this budget submission reflects a continuation of the Department's inventory

augmentation efforts. Inventory augmentation finances the procurement of wholesale system stock necessary to support new, modified or increasing numbers of weapons systems entering the Department's arsenal. It is this wholesale inventory upon which Fleet customers rely to meet afloat/ashore logistics response times planned in retail allowance models. Ensuring sufficient wholesale material is on hand is an essential element of the readiness equation. Additionally, financing the inventory augmentation via a direct appropriation is considered the most effective funding method since it does not excessively burden the customer rates and it allows the Department to capture total ownership more effectively since the funds are clearly tied to the support of the weapon system rather than being accounted for in the cost of operating the system. As a result of the lead times associated with ordering and delivering inventory augmentation material, the direct appropriation is normally required within two years after ordering; although in some case the lead times may be slightly longer. Accordingly, a direct appropriation to the NWCF of \$65.4 million is requested in FY 2005 as the last installment for material ordered over the FY 2002-2003 timeframe. As a continuation of the inventory augmentation initiative, obligation authority of \$114.7 million and \$86.0 million has been requested in FY 2004 and FY2005 respectively and a direct appropriation funding line has been programmed in the outyears to liquidate this expense as the material is delivered.

FY04 Annual Price Change (APC): This submission reflects an increase to both the Navy and the Marine Corps prices. While growth is still occurring for Navy items, it is important to note that the rate is beginning to subside. The Navy composite APC for FY 2005 is 2.4% with an overall cost recovery rate (CRR) of 15.7%. The Marine Corps composite APC for FY 2005 is 5.9% with an overall cost recovery rate (CRR) of 33.5%.

Material Cost and Rates:

<u>Navy</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
Purchase Inflation	0.8%	1.5%	1.5%
Customer Rate Changes	9.6%	6.1%	2.4%
Composite Cost Recovery Rate	20.2%	17.1%	15.7%
Cost of Matl Sold (\$M)	3,400.7	3,734.9	3,844.6

<u>Marine Corps</u>	FY 2003	FY 2004	FY 2005
Purchase Inflation	0.8%	1.5%	1.5%
Customer Rate Changes	31.3%	-18.2%	5.9%
Composite Cost Recovery Rate	61.8%	29.5%	33.5%
Cost of Matl Sold (\$M)	24.6	23.4	19.1

### Financial Profile:

(Dollars in Millions)

<u>Navy</u>	FY 2003	FY 2004	FY 2005
Revenue	6553.4	5826.1	5585.1
Expenses	6612.3	5830.0	5597.9
Capital Surcharge	18.1	4.5	-24.7
Other Changes Affecting NOR	7.7	0.0	-49.1
Net Operating Result	-69.2	-8.4	-37.3
Other Changes Affecting AOR	0.0	0.0	0.0
Accumulated Operating Result	45.7	37.3	0.0

(Dollars in Millions)

<u>Marine Corps</u>	FY 2003	FY 2004	FY 2005
Revenue	225.0	147.9	141.4
Expenses	201.2	204.6	172.5
Other Changes Affecting NOR	8.4	35.1	4.5
Net Operating Result	32.2	-21.6	-26.6
Other Changes Affecting AOR			
Accumulated Operating Result	48.2	26.6	0.0

Revenue: Corporate revenue decreased mainly as a result of transferring fuel accounting to DESC.

Expense: Corporate expenses decreased commensurate with revenue.

### Cash Forecast

Cash solvency across the budget horizon continues to remain a primary consideration. This budget carefully balances cash with Chief of Naval

Operations' and the Commandant of the Marine Corps' priorities of current and future readiness.

(Dollars in Millions)

<u>Navy</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
Collections	6721.8	6003.2	5694.3
Disbursements	6876.7	6491.6	5783.7
Net Outlays*	154.9	488.4	89.4

\* Cash transfers associated with the Inventory Augmentation initiative are not included.

(Dollars in Millions)

<u>Marine Corps</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
Collections	251.6	182.1	146.0
Disbursements	185.4	168.7	162.0
Net Outlays	-66.2	-13.4	16.0

### Inventory Augmentation

Inventory augmentation finances the procurement of wholesale system stock necessary to support new, modified or increasing numbers of weapons systems entering the Department's arsenal. It is this wholesale inventory upon which Fleet customers rely to meet afloat/ashore logistics response times planned in retail allowance models. Ensuring sufficient wholesale material is on hand is an essential element of the readiness equation. Additionally, financing the inventory augmentation via a direct appropriation is considered the most effective funding method since it does not excessively burden the customer rates and it allows the Department to capture total ownership more effectively since the funds are clearly tied to the support of the weapon system rather than being accounted for in the cost of operating the system. As a result of the lead times associated with ordering and delivering inventory augmentation material, the direct appropriation is normally required within two years after ordering; although in some case the lead times may be slightly longer. Accordingly, a direct appropriation to the NWCF of \$65.4 million is requested in FY 2005 as the last installment for material ordered over the FY 2002-2003 timeframe, as depicted below:

(Dollars in Millions)

<u>Navy</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
Obligation Authority	98.5	137.5		
Direct Appropriation to the NWCF		40.2	130.4	65.4

As a continuation of the inventory augmentation initiative, obligation authority of \$114.7 million and \$86.0 million has been requested in FY 2004 and FY2005 respectively and a direct appropriation funding line has been programmed in the outyears to liquidate this expense as the material is delivered.

War Reserve Material Obligations

(Dollars in Millions)

Marine Corps	FY 2003	FY 2004	FY 2005
Retail	24.3	1.3	0.4
Wholesale	10.8	3.2	4.5
Total WRM	35.1	4.5	4.9

The above chart reflects WRM authority budgeted to meet projected Marine Corps deficits and funding levels required for initial mobilization.

Obligation Authority:

(Dollars in Millions)

Navy Obligations	FY 2003	FY 2004	FY 2005
Wholesale	4,278.9	3,884.7	4,054.5
Retail	1,488.7	1,050.1	891.8
Operating	1,386.7	1,229.2	1,150.3
Total	7,154.3	6,164.0	6,096.6

(Dollars in Millions)

Marine Corps Obligations	FY 2003	FY 2004	FY 2005
Wholesale**	115.3	70.1	67.1
Retail**	137.5	79.9	85.0
Operating	12.3	11.2	11.0
Total	265.1	161.2	163.1

\*\* WRM obligations are included.

Wholesale: Focuses on a continued emphasis to align customer funding and demand to NWCF wholesale production and repair investments. Proposed in FY05 is the capitalization of aircraft engines. Accordingly, \$59M has been budgeted in FY05 and procurement account resources have been aligned in FY07 to pay for the engines when they are available.

Retail: Reflects the Department's ongoing effort to reduce the retail footprint. Naval Supply Systems Command completed the transfer of fuel aboard Navy oilers to DESC in FY 2003 and is scheduled to complete transfer of fuel from remaining force level ships in FY 2004. As a result, this budget submission reflects minimal obligation authority to support fuel operations in FY 2004 and contains no Navy obligation authority to support fuel operations beginning in FY 2005. However, a minimal amount of commitment authority has been budgeted in case this effort is delayed.

Operations (BPP91): The operations budget reflects a decline in obligations. This decline is primarily attributable to continued efficiencies, Strategic Sourcing Initiatives and NAVSUP's Transformation Initiative.

Workload:

(Dollars in Millions)

Navy Gross Sales	FY 2003	FY 2004	FY 2005
Wholesale	4,821.1	4,544.1	4,449.8
Retail	1,456.8	1,072.3	910.9
Total	6,277.9	5,616.4	5,360.7

(Dollars in Millions)

Marine Corps Gross Sales	FY 2003	FY 2004	FY 2005
Wholesale	119.8	73.8	64.3
Retail	111.3	77.8	80.8
Total	231.1	151.6	145.1

Wholesale: Sales are directly tied to customer funding and the Department's ability to fill orders.

Retail: This submission continues to reflect the Department's efforts to reduce its retail footprint. By the end of FY 2004, all Navy fuel is expected to be transferred to DESC.

Unit Cost:

Navy	FY 2003	FY 2004	FY 2005
Wholesale	1.060	.986	1.043
Retail	1.026	.994	.997

Marine Corps	FY 2003	FY 2004	FY 2005
Wholesale	1.024	1.106	1.199
Retail	1.018	1.013	1.048

### Performance Metrics

The availability of spare parts is an essential performance metric to our warfighting customers. Accordingly, goals are established and results are monitored continuously so that corrective action can be taken, when necessary, to maximize performance outputs.

Navy	FY 2003	FY 2004 Goal	FY 2005 Goal
Supply Material Availability	77.5%	85%	85%

Marine Corps	FY 2003	FY 2004 Goal	FY 2005 Goal
Supply Chain Channel Performance	77.5%	85%	85%

### Staffing:

Navy	FY 2003	FY 2004	FY 2005
Civilian End Strength	5,672	5,477	5,477
Civilian Work Years	6,061	5,756	5,477
Military End Strength	426	421	383
Military Work Years	428	423	402

Marine Corps	FY 2003	FY 2004	FY 2005
Civilian End Strength	47	26	24
Civilian Work Years	47	26	24

Civilian Personnel: FY 2003 numbers reflect actual end strength and work year levels. The decrease in FY 2004 and FY 2005 is a continuation of our strategic sourcing and workload validation efforts to gain efficiencies throughout the supply management business area.

### Capital Budget Authority:

(Dollars in Millions)

Navy	FY 2003	FY2004	FY 2005
Equipment Non-ADPE/Telecom	1.429	1.999	1.822
ADPE/Telecom Equipment	2.250	2.306	1.786

Software Development	66.595	43.284	9.231
Minor Construction	1.238	2.259	2.328
Total	71.512	49.848	15.167

Cost of Goods Sold Breakout:

This budget continues to reflect the methodology applied in previous years for recovering costs associated with transportation, depot washout, obsolescence, LECP management, testing and NADEP Transformation. These costs, which are directly associated with material, are now being recovered through material cost of goods. The following breakout applies:

(Dollars in Millions)

FY 2003	Transportation	Obsolescence	Depot Washout	LECP NRE	Testing	SNT	
BP 34	13.7	3.4			5.3		
BP 81P	11.7	4.1		1.0			
BP 81R	10.0		18.5				
BP 85P	34.5	27.7			1.8		
BP 85R	68.2		231.5	14.2		25.1	
Total	138.1	35.2	250.0	15.2	7.1	25.1	
FY 2004	Transportation	Obsolescence	Depot Washout	LECP NRE	Testing	SNT	NADEP Transf
BP 34	15.2	9.3			5.7		
BP 81P	17.6	4.9		1.0			
BP 81R	12.7		23.4				
BP 85P	32.6	6.0			2.4		
BP 85R	107.7		254.1	9.5		15.1	-17.7
Total	185.8	20.2	277.5	10.5	8.1	15.1	-17.7
FY 2005	Transportation	Obsolescence	Depot Washout	LECP NRE	Testing	NADEP Transf	
BP 34	17.1	8.3			5.7		
BP 81P	15.5	4.7		1.0			
BP 81R	15.1		37.2				
BP 85P	21.5	19.2			2.5		
BP 85R	97.2		284.4	11.0		-20.4	
Total	166.4	32.2	321.6	12.0	8.2	-20.4	

In conclusion, the budget presented herein maintains NWCF-SM at a funding level that meets the Department of the Navy's readiness requirements over the budget horizon.