REVIEWING UNCOSTED BALANCES

A Self-Study Course for reviewing
and analyzing Uncosted Balances

U.S. Department of Energy

Prepared for the
Chief Financial Officer

Financial Management
Development Program

Reviewing Uncosted Balances - A Self Study Course

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Reviewing Uncosted Balances - A Self Study Course

INTRODUCTION:

Purpose

This is a Financial Management Development Program self study course on reviewing and analyzing uncosted balances.

This course is intended to provide the reader with an understanding of the following processes:

- Analyzing uncosted balances during budget formulation.
- Analyzing uncosted balances during budget execution.
- Analyzing uncosted balances at yearend and fulfilling Headquarters reporting requirements.

Target Audience

The target audience is accountants, budget analysts, program analysts, or other personnel in the Chief Financial Officer's (CFO) organization that have responsibility for tracking, monitoring, and reporting uncosted balances.

It could also benefit program or project managers who are called upon to explain certain uncosted balances.

BACKGROUND ON UNCOSTED BALANCES:

The General Accounting Office (GAO) testified to Congress in 1992 that Department of Energy (DOE's) uncosted obligations were growing and that the Department did not have an effective system for analyzing these uncosted obligations. They reported that without a systematic analysis the Department could not adequately determine the extent to which uncosted obligations could be used to reduce DOE's current budget requests.

The Energy Policy Act of 1992, (P.L. 102-486), created a legal requirement that the Department submit an annual report to Congress on the status of it's uncosted obligations. Section 2307 of this Act stipulates that the report will identify the level of uncosted obligations at the end of each fiscal year, the purpose for which such funds are intended, and the impact of these balances on the Department's annual budget request.

In April 1996, the GAO reported to the Secretary of Energy that DOE needed further improvements in its analysis of uncosted or carryover balances. The GAO reported that DOE did not have a standard, effective approach for identifying excess carryover balances that could be available to offset future budget requests. In response, the Department issued a policy for reviewing uncosted balances. In addition, the CFO issues an annual call for the analysis of uncosted balances at the end of each fiscal year.

REFERENCES:

- Public Law 102-486, Energy Policy Act of 1992, Section 2307
- April 1996 United States General Accounting Office Report to the Secretary of Energy, "DOE Management: DOE Needs to Improve Its Analysis of Carryover Balances"
- Chief Financial Officer's Call for Analysis of FY 2000 Uncosted Balances
- Report to Congress on FY 1999 carryover balances, submitted April 2000

UNCOSTED BALANCES DEFINED:

Uncosted obligations or uncosted balances are commonly used synonymous terms that should not be confused with unobligated balances. Unobligated balances are appropriated funds that have not yet been legally promised or obligated to a third party. Information on unobligated balances is also requested annually, but is not the topic of this course. Uncosted obligations represent obligations that have been made less costs that have been incurred or accrued to date. These uncosted obligations or uncosted balances are the topic of this course.

Uncosted balances are generally needed to meet remaining legal obligations incurred for goods or services, which have not yet been received and to allow operations to continue smoothly between fiscal years.

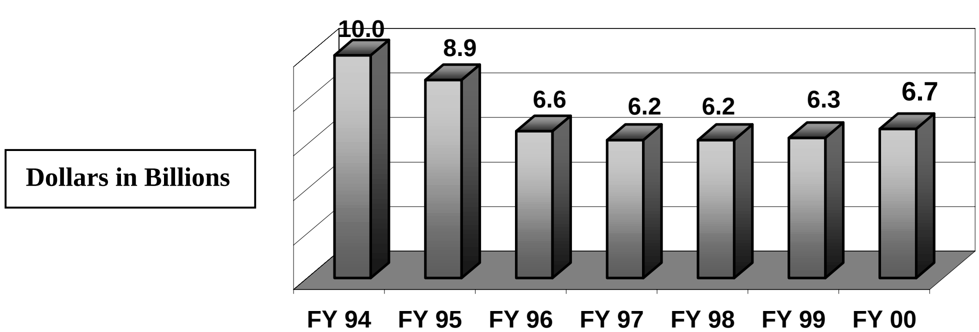
The vast majority of uncosted balances are legal liabilities with third parties. In other words, uncosted balances represent a promise from the Department to pay a third party for a specific scope of work that has yet to be performed. This can take the form of contracts, purchase orders, travel orders, etc. For management and operating (M&O) or management and integrating (M&I) contractors, a large portion of their uncosted balances are often tied up on subcontracts or purchase orders that they have awarded.

Capital projects typically exhibit large uncosted balances, especially early in the life cycle of the project. This is usually the result of long-lead procurement actions that occur early in project that must be funded upfront.

An analysis of uncosted balances is an integral part of the budgeting process. Budget requests should consider the amount of uncosted balances that are anticipated to be available and the amount needed to cover legal liabilities. It is evident that this kind of analysis has had an effect on budget requests based on the change in uncosted balances since FY 1994. Table 1 shows the change in uncosted balances for DOE's appropriations since FY 1994.

Table 1

DOE'S UNCOSTED BALANCES BY FISCAL YEAR
(Excludes Bonneville Power Administration)



In summary, uncosted balances are a normal and legitimate part of funds management. However, a strong funds management process is needed to monitor and evaluate uncosted balances to avoid arbitrary increases or reductions to uncosted balances.

POLICY:

The various types of obligating instruments, the nature of the expenditures, or the types of entities involved increases the complexity of analyzing uncosted balances. Because of this, DOE's approach for a systematic analysis of uncosted balances is based on the establishment of thresholds. These thresholds are stated in percentages of total funds available to cost and provide an objective baseline for evaluating uncosted balances for different types of financial and contractual arrangements.

Percentage thresholds allow an objective evaluation because they define a baseline against which greater scrutiny and analysis is required, based on the variance between the target threshold and the actual balance.

If uncosted balances exceed the established threshold, it does not mean that the balance is necessarily inappropriate. It does mean that such balances will become subject to more review and require more detailed justification to accurately determine their appropriateness

In order to focus analysis on those areas where the Department can exercise the most control, costs and uncosted balances are segregated into discrete categories that display similar and predictable costing rates. The following table outlines the various uncosted categories and their respective thresholds. It is taken from the CFO's call for analysis of FY 1999 uncosted balances issued September 1999. Each year's call should be checked to see if any of the categories or thresholds have changed.

Table 2 - Uncosted balance categories and thresholds

CATEGORY	THRESHOLD
Contractor operating costs: This category includes costs incurred by major contractors that manage Departmental sites.	**13 percent of the Total Funds Available to Cost (TAC) for operating activities for the fiscal year just ended.**
Capital Equipment, GPP, & AIP: Capital equipment meets the accounting criteria for capitalization. General Plant Projects and Accelerator Improvement Projects are grouped in this category because they share similar costing patterns.	**50 percent of the TAC for capital equipment, GPP, and AIP respectively for the fiscal year just ended.**
Non-Integrated Operating & Prime Contract Costs: Costs for other than major contractors.	**17 percent of the TAC for non-integrated activities for the fiscal year just ended.**
• **Line Item Construction** • **Grants** • **CRADA's and other Cooperative Agreements** • **Reimbursable Work**	• **Not subject to a Specific Threshold. These Costs should be reported and evaluated on a case-by-case basis throughout the life of the contractual instruments.**

ANALYSIS OF UNCOSTED BALANCES:

<u>During Budget Formulation:</u>

Budget formulation begins in the field with the operations offices' planning of the work scope that will be done in the budget year. This occurs two years ahead of the current execution year. This planning process usually begins in the late fall/early winter timeframe in order to meet the field budget submission to Headquarters date of mid-April. The estimated cost to perform this planned work becomes the starting point for determining the budget request.

The field budget requests to Headquarters are based on the need for new Budget Authority (BA), or the amount of funding needed to meet the obligation needs of the budget year for the planned work scope. In order to determine the amount of new BA required by the field in the formulation year, an analysis of uncosted balances is needed to convert the estimate of the cost to perform the planned work into the amount of BA needed. This is done by adding the projected ending uncosted balance for the budget year to the estimated cost of the planned work and then subtracting the projected beginning uncosted balance for the budget year. The resulting amount represents the new BA needed for the budget year. This formula is stated as follows:

Projected ending uncosted balance + estimated cost - projected beginning uncosted balance = new Budget Authority request.

It should be noted that the beginning uncosted balance amount used in the above formula is a projected amount. This is because the budget year is up to two years ahead of the current execution fiscal year. Therefore, one has to project what the uncosted balance will be at the beginning of the budget fiscal year. This amount won't necessarily be the uncosted balance amount that is eventually available for the current execution fiscal year.

The ending uncosted balance amount is also a projection. This amount should be estimated based on the legal liabilities that are expected at yearend. This estimate can be determined by looking at the planned work scope, the schedule for accomplishing the work and how the work will be contracted.

Example:

Program A has a beginning uncosted balance of $10 million and appropriated funding of $50 million in the current year (CY). The projected ending uncosted balance for the CY is $12 million. Therefore, this Program expects to cost $48 million in the current year ($10M + $50M - $12M = $48M).

The President's Budget request for Program A, CY+1, contains a new BA request of $55 million. The projected ending uncosted balance for the CY+1 is $14 million.

The expected cost of work planned in this fiscal year (CY+1) is $53 million ($12M +$55M - $14M = $53M)

The expected cost of work planned for the budget year (CY+2) is \$58 million. The contractor is expecting to continue subcontracting more of the work in the budget year and is projecting the ending uncosted balance for CY+2 to be \$15 million.

The amount of new BA needed in CY+2 is calculated as follows:
\$15 million (projected ending uncosted balance for CY+2) + \$58 million (cost estimate for planned work) - \$14 million (projected beginning uncosted balance for CY+2) = \$59 million

Note that the new BA request is more than the estimate of cost for the work. This is because additional funding is needed at the end of the budget year to cover yearend legal liabilities that are higher than what was needed for yearend legal liabilities at the end of the previous fiscal year.

When the ending uncosted balance is projected to be less than the beginning uncosted balance, the new BA request will be less than the estimate of cost to perform the planned work. This is because a portion of the beginning uncosted balance that is not needed to cover yearend legal liabilities can be used to fund some of the work to be performed.

During Budget Execution:

During the budget execution fiscal year, the operations offices execute work plans and spend funds that have been appropriated by Congress, apportioned by the Office of Management and Budget (OMB), and allocated by Headquarters. The operations offices should estimate at the beginning of the execution fiscal year, the funds needed to cover legal liabilities expected at yearend. This is the amount of total available funds to cost that should be remaining at the end of the execution year as uncosted balances

The amount of uncosted balances, which will be available at yearend to cover legal liabilities, should be forecasted periodically by the operations office. This forecast is used to verify that adequate uncosted balances will be available to cover estimated yearend legal liabilities, as well as, alert management if uncosted balances are projected to exceed what is needed at yearend. You should review projected ending uncosted balances throughout the fiscal year.

There are several ways to analytically assess what the uncosted balance will be at yearend. Two of the most common methods used are: 1) a straight-line projection of costs incurred to date, and 2) an estimate of the costs to complete the work that can be realistically done by the end of the year. An example of each follows:

Example of Straight Line Projection:

Program D began the execution year with \$16 million of uncosted balances. The program was appropriated \$155 million of new BA. The total funds available for Program D are \$171 million for the execution year. At the beginning of the fiscal year, \$14 million was forecast to be needed at yearend for legal liabilities.

Costs incurred through the first 7 months of the execution year totaled \$91 million. This equates to an average costing rate of \$13 million per month. Projecting this costing rate over the next 5 months would equate to an additional \$65 million of costs.

This would bring total costs for the year to $156 million, which would leave $15 million ($171 million total available funds less $156 million total costs) as an uncosted balance at yearend. This is in line with the projected uncosted balance needed at yearend.

While this straight-line projection is simple and easy to use, it may not model actual costing patterns. It is not uncommon for costs in the first half of the year to be different and, in most cases, less than costs in the second half of the year. This is because work is not accomplished linearly and because of funding constraints usually experienced at the beginning of a fiscal year, such as continuing resolutions.

Because of this, many operations office financial and program managers prefer to use an estimate of the costs to complete the work planned to predict what the uncosted balance will be at fiscal yearend. This is best illustrated with the following example.

Example of Estimate to Complete Method:

Program D began the execution year with $12 million of uncosted balances. The program was appropriated $150 million of new BA. Therefore, the total funds available for Program D is $162 million for the execution year. At the beginning of the fiscal year, $12 million was forecast as the amount of funds needed at yearend to cover legal liabilities.

Costs incurred through the first 6 months of the execution year totaled $66 million. This equates to an average costing rate of $11 million per month. The estimated cost to complete the work that can be accomplished for the remainder of the fiscal year is $84 million. This equates to an average costing rate of $14 million per month. This would bring total costs for the year to $150 million, which would leave $12 million ($162 million total available funds less $150 million total costs) as an uncosted balance at yearend.

Another method that can be used to check the reasonableness of a projected uncosted balance is to determine the remaining monthly costing rate needed to achieve a specified uncosted balance. This costing rate can then be compared to historical costing rates or to the estimated cost to complete to determine its reasonableness.

Example of Checking Reasonableness of Remaining Costing Rate:

Program X starts the fiscal year with an uncosted balance of $30 million. The program received an appropriation of $450 million. Therefore, the total funds available for Program X are $480 million for the fiscal year.

At the end of the first six months, the M&O contractor had costed $168 million for an average cost per month of $28 million. The threshold percentages in Table 2 could be used as a reference point for determining a reasonable ending uncosted balance. The Table 2 threshold for M&O contractors is 13 percent. Multiplying this times the total funds available of $480 million would produce an ending uncosted balance threshold of $62 million.

> Subtracting the costs for the first half of the fiscal year of $168 million and the ending uncosted balance threshold of $62 million, from the total funds available of $480 million, leaves $250 million that would have to be costed over the next 6 months. This equates to a monthly average of $42 million. This could then be checked against the average monthly costing rate for the last 6 months of the prior fiscal years or against the average monthly costing rate for the estimate to complete.

Sometimes these analyses will show that the projected ending uncosted balance is going to be substantially less than the amount needed to cover yearend legal liabilities if cost trends continue unchanged. This could result from higher then expected costs, or from more work being accomplished than was originally planned. In either case, it may become necessary to adjust annual work plans to ensure that adequate funding will be available to cover yearend legal liabilities.

On the other hand, these analyses may show that the projected ending uncosted balance will exceed the amount needed at yearend. This could result from lower than expected costs or from less work being accomplished than was originally planned. When excess funds are projected, it is wise to consult with your Program Manager and your Headquarters sponsor so that the best usage of funding can be determined.

At Yearend:

The previous two sections discussed analysis that operations offices perform of uncosted balances during budget formulation and execution. An analysis of future year uncosted balances is necessary during budget formulation to gauge the amount of new BA that the operations office must request. An analysis of uncosted balances is necessary during the execution year to determine if resources could be redeployed to higher priority work requirements.

> Formal analysis and reporting of uncosted balances to Headquarters begins at the end of the fiscal year. Headquarters develops control reports for each reporting entity's uncosted balances from the official DOE accounting system (MARS) after yearend closing is completed. Headquarters provides the control reports to the operations/field offices in late October to early November. The operations/field offices have until the end of November to complete their analysis and report the results back to Headquarters. See CFO's Call for Analyses of FY 2000 Uncosted Balances for an example of these control reports.

The control reports developed by Headquarters contain the uncosted balances and costs reported in the official DOE accounting system for the fiscal year ended at the four digit Budget and Reporting (B&R) level, or higher if the B&R control level is higher. These control reports are done for each field office and individual major contractors. The non-integrated contractor data is combined into one control report for each field office.

The field offices are to break out the uncosted balance and cost control totals for each B&R and contractor into the various categories identified in Table 2. An uncosted balance percentage of total available funds is then calculated for each category, and compared to the threshold for that category in Table 2. If the threshold is exceeded and the uncosted balance is greater than $1 million, a written explanation of the major drivers for the entire uncosted balance and a justification for the retention of the uncosted balances is required.

The DOE accounting system calculates the uncosted balance by subtracting the costs reported in the accounting system from the total funds available (the beginning uncosted balance plus new obligational authority as recorded in the accounting system). An uncosted balance percentage is calculated by dividing the uncosted balance by the total funds available. These computations can be expressed in the following formulas:

Total Funds Available to Cost = Beginning Uncosted Balance + New Obligation Authority

Ending Uncosted Balance = Total Funds Available to Cost – Current Year Costs

Uncosted Balance Percentage = Ending Uncosted Balance/Total Funds Available to Cost

The Headquarters control reports provide the uncosted balances and costs for each B&R level from the DOE accounting system. The uncosted balance percentage formula above needs the total funds available in order to calculate the percentage. This can be computed by adding the ending uncosted balance and the costs for the fiscal year. This is the same as adding the beginning uncosted balances and the obligations recorded during the year. The spreadsheets provided by Headquarters automatically perform these calculations.

All totals for costs and ending uncosted balances for each operations/field office, contractor, and B&R should tie to the control totals provided in the Headquarters control reports.

Example of Yearend Analysis:

Headquarters developed the following control report using official DOE accounting system data after yearend closing is completed. The data is for operations office ABC, integrated contractor XYZ, and four digit B&R XX02.

Assistant Secretary = XX
Uncosted balance = $50M
Total Costs = $300M

Operations office ABC breaks out the control totals into the following threshold categories identified in Table 2:

	Contractor Operating Costs	Line Items	Other Capital CE/GPP/AIP	Reimbursable Work	Total
Uncosted balance	$ 30M	$10M	$ 7M	$ 3M	$ 50M
Total costs	$185M	$85M	$10M	$20M	$300M
TOTAL FUNDS	$215M	$95M	$17M	$23M	$350M

The uncosted balance percentage is then calculated for the contractor operating costs and other capital items as follows:

Contractor Operating Costs Percentage = \$30M/\$215M = 14%
Other Capital Items = \$7M/\$17M = 41%

The calculated percentages are then compared to the threshold percentages for each category in Table 2. The contractor operating costs uncosted balance percentage of 14 percent is higher than the Table 2 threshold percentage of 13 percent. A written explanation of the major drivers for the entire uncosted balance and a justification for the retention of the uncosted balance should be provided. The other capital items uncosted balance percentage of 41 percent is less than the Table 2 threshold of 50 percent, and no explanation is necessary.

Uncosted balances percentages are calculated for the contractor operating costs and other capital items (CE/GPP/AIP) only because these are the only categories that have an assigned threshold percentage. The uncosted balances and total costs for the Line Items and Reimbursable Work are shown, but no percentage is required. These items are not subject to a specific threshold because of the unique longer-term nature of this work. The uncosted balances for these items should be evaluated on a case-by-case basis throughout the life of each project.

In December, the CFO and Program Offices at Headquarters review the uncosted balances and the reports from the operations/field offices to determine if uncosted balances should be reallocated to higher priority requirements or withdrawn. In early February, Headquarters submits a report to Congress on the uncosted balances, which Congress uses when considering the Department's budget request.

REPORTING UNCOSTED BALANCES:

The previous section addressed the formal analysis of uncosted balances that is required at the end of each fiscal year. This analysis is reported to Headquarters by the end of November of the following fiscal year.

The reporting process begins with the issuance of an annual Call of uncosted balances by the CFO. This call is usually issued in late September. The Call provides guidelines and the schedule for analyzing and reporting ending uncosted balances. It also provides the categories and thresholds for analyzing and reporting the uncosted balances.

The CFO then issues control reports that were cited in the previous section. These reports are usually available in late October or early November after yearend closing is completed and are provided in electronic format.

Each field office, in conjunction with its major contractors, completes its analysis and fills out their analysis spreadsheets. These data are submitted to the CFO by the end of November. The submission should include: 1) a transmittal memorandum, 2) all analysis spreadsheets and related justifications for its contractors and field office, and 3) a summary spreadsheet for the field office.

The transmittal memorandum should highlight any funds that were identified during the analysis that could be used to offset the Department's pending budget request at OMB.

The submission should be sent to the CFO, the CFO Office of Internal Review (CF-1.2) and each Headquarters Assistant Secretary who provides funding to the field office. A hard copy and an electronic copy of the report should be submitted.

REVIEW TESTS

Budget Formulation Test:

Operations office A has a beginning uncosted balance of $20 million for Program Z and new obligational authority of $120 million in the current execution fiscal year, FY 2000. The projected ending uncosted balance for FY 2000 is expected to be $20 million. The President's Budget request for FY 2001 contains a new BA request of $125 million. The projected ending uncosted balance for FY 2001 is expected to be $22 million. The estimate for the work planned for the budget year, FY 2002, is estimated to cost $115 million. The amount needed for legal liabilities at the end of FY 2002 is estimated to be $18 million.

What is the amount of new Obligational Authority that operations office A needs to request for Program Z in FY 2002?

REVIEW TESTS

Budget Execution Test:

Operations office A starts the execution year with an uncosted balance of $55 million in Program E. The program receives $325 million of new obligational authority. The M&O contractor incurred costs of $176 million for the first 7 months of the fiscal year. The historical average monthly costing rate for the last 5 months of the fiscal year is $30 million.

What are the total funds available to cost for the fiscal year for this Program at operations office A?

Using Table 2, calculate what the threshold ending uncosted balance should be.

What is the average monthly costing rate for the remainder of the fiscal year to achieve the threshold ending uncosted balance?

Compare this to the historical costing rate.

REVIEW TESTS

Yearend Test:

Headquarters developed the following control report using official DOE accounting system data after yearend closing is completed. The data is for operations office XYZ that does not have a major contractor and for B&R AB02.

Assistant Secretary = HH
Uncosted balance = $35M
Total Costs = $150M

Operations office XYZ breaks out the control totals into the following threshold categories identified in Table 2:

	Nonintergated Operating and Prime Contractor Costs	Capital Items CE/GPP/AIP	Reimbursable Work	Line Items	Total
Uncosted balance	$25M	$5M	$1M	$4M	$35M
Total costs	$99M	$4M	$3M	$44M	$150M

Calculate the uncosted balance percentage required in Table 2.

Compare the calculated percentages to the threshold percentages for each category in Table 2. State which categories require a written explanation of the major drivers for the uncosted balances and a justification for retaining the balances.

REVIEW TESTS ANSWERS

<u>Budget Formulation Test:</u>

What is the amount of new Budget Authority that operations office A needs to request for Program Z in FY 2002?

Answer: $111M

$18M (projected ending uncosted balance for FY 2002) + $115M (cost estimate for planned work) - $22M (projected beginning uncosted balance for FY 2002) = $111M

<u>Budget Execution Test:</u>

What are the total funds available to cost for the fiscal year for Program E at operations office A?

Answer: $380M ($55 million of beginning uncosted balances + $325 million of new obligational authority)

Using Table 2, calculate what the threshold ending uncosted balance should be.

Answer: $380M times 13% = $49M

What is the average monthly costing rate for the remainder of the fiscal year to achieve the threshold ending uncosted balance?

Answer: $380M less $176M less $49M = $155M divided by 5 = $31M.

Compare this to the historical costing rate.

Answer: This compares favorably with a historical costing rate of $30 million over the last five months of the fiscal year. Since it is slightly above average, it should be watched closely over the remaining months. An estimate to complete should also be obtained and the average monthly costing rate checked. As a final step, the threshold uncosted balance should be checked to ensure that it is adequate to cover yearend legal liabilities.

<u>Yearend Test</u>

Calculate the uncosted balance percentages required in Table 2.

Answer: Prime and Operating Activities Percentage = $25M/($25M + 99M) = 20%
Capital Items = $5M/($5M + $4M) = 55%

Uncosted balances percentages are not calculated for the Reimbursable Work and Line Items categories because they are not subject to a specific threshold. The uncosted balances for these items should be evaluated on a case-by-case basis throughout the life of each project.

Compare the calculated percentages to the threshold percentages for each category in Table 2. State which categories require a written explanation of the major drivers for the uncosted balances and a justification for retaining the balances.

Answer: Prime and Operating Activities calculated percentage of 20 percent is higher than the threshold of 17 percent for nonintegrated contractors and requires a written explanation and justification.

Capital Items (GPP, CE, AIP) calculated percentage of 55 percent is higher than the threshold of 50 percent and requires a written explanation and justification.