

A DISCUSSION OF THE YARD FUND

1. PURPOSE. The purpose of this briefing paper is to provide a general description of the YARD's financial operations.

2. FUNDING SOURCES. Most Coast Guard funds are appropriated by Congress annually and administered by program managers at Coast Guard Headquarters through various field offices and units. As an example, all Coast Guard funds for ship maintenance are appropriated and allocated to AFC-45 and managed by the Assistant Commandant for Engineering and Logistics (CG-4). These funds are then provided to the Office of Naval Engineering (CG-45) as the Program Manager for this maintenance function. CG-45 buys products and services directly with these funds, or transfers portions of these AFC-45 funds to the Coast Guard Maintenance and Logistics Commands (MLCs), Engineering Logistics Center, or other government agencies to obtain necessary benefits to the Program. Likewise, most funds for new construction and major renovations of Coast Guard assets are provided as Acquisition, Construction, and Improvement (AC&I) funds to the Assistant Commandants for Acquisition (CG-9) or Integrated Deepwater Systems (CG-93) to acquire necessary new or improved assets. Similarly, funds targeted for telecommunications/electronics (AFC-42) are annually appropriated and allocated to the Assistant Commandant for Command, Control, Communications, Computers and Information Technology (CG-6). There are also small YARD projects funded by visiting ships' AFC-30 operating funds and funds from other government agencies for OGA work. These Programs represent the majority of the source of funds for this unique Coast Guard account called the Yard Fund.

3. YARD FUND DESCRIPTION. The Yard Fund is a revolving account, very similar in operation to your personal checking account. In other words, the Yard Fund started with no money, and if our ongoing work is completed with no new work coming in, it would have a zero balance. The YARD operates financially just like a business. Funding for the Yard Fund is obtained by charging customers for services or materials furnished in designing, documenting, repairing, altering, or constructing ships, small boats, and unique Coast Guard items. The work that the YARD performs is documented in the Naval and Electronics Supply Support System (NESSS). Estimated costs are built for each customer's order and a project order is established for that order on a time and materials basis. Charges to the customer for actual work performed are accounted for through a job order cost accounting system in NESSS. Direct labor charges are based on the actual employees' hourly rate of pay and a budgeted percentage rate applied for fringe benefits for those employees whose labor hours were charged to projects. A budgeted rate for overhead recovery (see Overhead in section 5) is applied to the direct labor to recover the YARD's full overhead costs. These estimates and charges are based on recovery of total YARD costs (labor, material, and overhead). The Yard Fund operates on a breakeven basis; the price charged the customer for a project equals the YARD's total cost to complete it and pay for its share of the YARD's overhead costs. However, in order to allow for budget and schedule fluctuations, Coast Guard policy allows the Yard Fund to accumulate a maximum plus or minus \$1M balance in its Retained Earnings at the end of each fiscal year. The Yard Fund obtains its working capital funds in the form of advanced payments or reimbursements from customers for services and products provided. Depending on the customer and type of work, the sources of funds for the Yard Fund are primarily AC&I, AFC-45, AFC-42, AFC-30, and funds from other government agencies. The FY07 revenue for the Yard Fund from these sources was \$88M.

4. BUDGETING. The YARD prepares an annual budget for the Yard Fund to establish the appropriate rates to charge customers. These rates are based on recovering the YARD's overhead and adjusting for any shortfalls/overages in past Retained Earnings, distributed over the expected workload for the upcoming fiscal year. An increase or a decrease to the YARD's industrial production cost rate may be the result of changes to the YARD's workload, overhead costs, hourly workers' rate of pay, or fringe benefits. For each dollar charged to the customer for production work during FY07, 57 cents paid for the direct labor and fringe benefits involved with producing that product and 43 cents paid for the overhead costs supporting that direct labor. Yard Fund revenue is used to pay for the majority of wages and benefits for YARD employees, materials purchases for waterfront projects, and overhead expenses discussed below. The YARD's average total budgeted industrial production cost rate for the first half of FY08 is \$66.96/manhour, and the average budgeted engineering production cost rate is \$91.21/manhour. The industrial production cost rate is charged for job orders within an industrial project requiring YARD trades/craftsmen (i.e., "blue collar") support, while the engineering production cost rate is charged for job orders within an industrial project that requires YARD engineering and other industrial staff support (e.g., ship superintendents). It is important to note that the actual labor costs for each worker for industrial and engineering production are charged to the customer; the budgeted rate is only used for estimation purposes and to determine the overhead recovery rate that will be attached to actual labor costs.

5. OVERHEAD. Normally, all labor and material costs associated with a particular project are charged directly to that project. However, there are also costs that cannot be associated directly with a specific project. These indirect costs are accounted for as overhead expenses. Overhead expenses include, but are not limited to: civilian and military labor (supervision, tool room mechanics, shop planners, clerical, administrative, etc.) and fringe benefits (leave, retirement, insurance, social security and etc.), shop materials and supplies, contractual services, training, and equipment depreciation. The YARD utilizes cost centers as a primary cost control unit used to budget, accumulate and control overhead expenses. A cost center generally relates to a shop or a department and the expenses within a cost center are further broken down by the type of expense. Each cost center administrator is responsible for the prudent expenditure of funds under his/her control. The amount charged to the customer for overhead recovery provides the YARD with funds to recover its cost center expenses.

6. REIMBURSEMENTS. The Yard Fund receives reimbursement from its tenants for certain "landlord" services and materials rendered. The basis for tenant reimbursements or in-kind services and support are documented in the Host-Tenant Agreement between the tenants and the YARD. Additionally, the YARD has the authority to sell scrap metals that are removed from a vessel and to receive the proceeds from the sale. These proceeds from scrap metal sales help to offset overhead expenses and totaled \$81K in FY07.

7. CAPITAL IMPROVEMENTS. YARD buildings, other structures/facilities, and capitalized general purpose equipment are procured using a variety of different Coast Guard funds. For example, the YARD's Machine Shop with its overhead cranes was paid for with AC&I funds, while the equipment inside the shop, such as lathes and drill presses, were bought with the Yard Fund. The dollar threshold for capitalizing YARD industrial equipment is \$50,000. Capitalized assets are paid for out of the Yard Fund cash balance at the time of acquisition, but the depreciation expense of the capitalized asset is spread out over the useful life of the asset as a monthly charge to overhead costs. This monthly depreciation expense is passed on to the customer through the overhead recovery rate. Major improvements and construction of buildings and structures are approved and funded under AC&I or AFC-43 (as allowed by policy) by Coast Guard Headquarters in the annual budget process.

8. MARKETING. The YARD is always seeking to retain current customers and attract new work in order to maintain its financial viability. Because the future workload for the YARD is not guaranteed, the YARD must maintain the highest standards for workmanship at the lowest cost possible, within the time constraints of each project. YARD management must assume a competitive attitude and proactively market its capabilities to any potential customer. Because of the stability brought about by the 270 foot and 210 foot Medium Endurance Cutter Mission Effectiveness Project (MEP), and the 110 foot Patrol Boat Mission Effectiveness Project (MEP), there has been a desirable full utilization of YARD resource capacity and a decreased marketing to non-Coast Guard (OGA) customers. In FY04, Coast Guard customers accounted for 90% of the YARD's revenues, which has increased to over 99% in FY07. The YARD's future depends on the ability to successfully market YARD services and products throughout the Coast Guard's ship/boat maintenance communities.