

122686 2653

REPORT BY THE U.S.

RELEASED

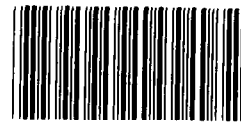
General Accounting Office

Uranium Enrichment Deferral Charges And The Customer Payment Period

A Department of Energy (DOE) Office of the Inspector General report entitled Dollar Impact of Financial Management Decisions in the Uranium Enrichment Program includes two recommendations which, if implemented, would (1) change the interest rate DOE uses to compute its charges to customers deferring delivery of uranium enrichment services and (2) reduce the 30-day interest-free period customers are allowed for making payment on DOE-provided enrichment services.

GAO believes that an interest rate based on the current market yield on Treasury borrowings with maturities comparable to the period of deferrals (current-market-yield rate) better reflects the cost of Treasury borrowings and is therefore more appropriate than either the rate DOE currently uses or the rate recommended by DOE's Inspector General. DOE agrees and plans to use the current-market-yield rate in any deferral under future contracts.

GAO also believes reducing the customer payment period has merit from a cash management standpoint. However, the effect of such an action on DOE's competitive position among foreign suppliers of enrichment services needs to be considered before any such reduction is made.



122686

GAO/RCED-84-13
OCTOBER 21, 1983

526973

Request for copies of GAO reports should be sent to:

**U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760**

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are \$3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are \$1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY
AND ECONOMIC DEVELOPMENT
DIVISION

B-203787

The Honorable Marilyn Lloyd
Chairman, Subcommittee on Energy
Research and Production
Committee on Science and Technology
House of Representatives

Dear Madam Chairman:

In your letter of September 22, 1982, you requested that we evaluate two recommendations contained in an August 13, 1982, Department of Energy (DOE) Office of Inspector General (IG) report entitled Dollar Impact of Financial Management Decisions in the Uranium Enrichment Program (DOE/IG-0186). The results of our evaluation and the full text of the request letter are included as appendixes I and II, respectively.

As you know, uranium enrichment is the process by which uranium is converted into a richer mixture suitable for use as a fuel in nuclear powerplants. About 200 powerplants throughout the world are fueled with uranium enriched by DOE. Customers provide the unenriched uranium, which DOE enriches to specified levels. Based on the amount of processing required, DOE charges its customers for enrichment costs. In its report, the IG stated that using the current-value-of-funds rate¹ rather than the average-marketable-securities rate² to compute schedule

¹The current-value-of-funds rate is the interest rate paid by commercial banks to the Department of the Treasury for deposits in tax and loan accounts. Monies are usually held in the account for a period of 2 to 8 days. This rate is a quarter of a percentage point less than the interest rate commercial banks charge each other for overnight borrowings.

²The average-marketable-securities rate is a weighted average of the interest rate paid by the Treasury on all marketable securities that are in the form of bonds, bills, and notes. Thus, this is the rate of interest paid by the Treasury on all of its currently outstanding marketable securities.

adjustment charges³ would more accurately account for the cost of customers deferring deliveries of enriched uranium and equitably allocate those costs among DOE's enrichment customers. Further, the IG noted that reducing the 30-day period from the date of invoice that customers are allowed to make payment would improve the program's cash management practices. Accordingly, the IG recommended that DOE's Assistant Secretary for Nuclear Energy consider (1) using the current-value-of-funds rate in computing future schedule adjustment charges and (2) reducing the 30-day customer payment period.

The Assistant Secretary disagreed with both of these IG recommendations. More specifically, the Assistant Secretary said that the average-marketable-securities interest rate is appropriate because it is used throughout the uranium enrichment program to represent the government's cost of funds and that reducing the 30-day customer payment period may weaken the program's competitive position in world markets.

The Assistant Secretary also stated that the enrichment program is operated on a full-cost recovery basis and the government would gain no long-term benefit from implementing either of the IG recommendations. We agree. DOE is required by law to recover all costs associated with enriching uranium. The law's intent is for DOE to break even on its costs of providing enrichment services. Since DOE's program is operated on a full-cost recovery basis, any costs incurred which are not recovered through specific charges, such as the schedule adjustment charge, will be recovered through the price DOE charges its customers for providing uranium enrichment services. Further, in recovering its costs, DOE includes imputed interest⁴ on the government's investment in the program. Any revenues from

³A schedule adjustment charge is an amount DOE assesses customers that defer deliveries of contracted uranium enrichment services. This charge does not represent DOE's cost of enriching uranium. Instead, it represents only the additional interest cost to the government resulting from the deferral. In computing schedule adjustment charges DOE uses the annual average-marketable-securities rate for the prior fiscal year. The applicable annual average-marketable-securities rate at the time of the deferrals that the IG examined was 6.4 percent and the current-value-of-funds rate was 11.3 percent. As of July 1983, the applicable average-marketable-securities rate was 12.3 percent and the current-value-of-funds rate was 11 percent.

⁴Imputed interest is an established interest cost assigned to a particular in-house government investment alternative, even though actual interest expenditures may not be incurred by the individual agency undertaking the activity.

charges for deferrals of scheduled enriched uranium deliveries, to the extent they are not offset by outlays, will decrease the government's investment in the program. Conversely, any costs, such as the cost of allowing customers 30 days to make payment, not recovered would increase the government's investment. Therefore, imputed interest on the government's investment compensates for the time value of any short-run over- or under-collection of costs from schedule adjustment charges or the length of the customer payment period. This, of course, assumes that DOE is using an appropriate interest rate for imputing interest on the government's investment.

Choosing the appropriate interest rate for computing schedule adjustment charges and establishing the appropriate customer payment period are largely judgmental matters that are subject to differing points of view. In this regard, we favor neither the IG-recommended current-value-of-funds rate nor the average-marketable-securities rate being used by DOE. In our opinion, another rate, the current-market-yield interest rate on Treasury borrowings having a maturity period comparable to the 1- to 5-year period of the deferrals (current-market-yield rate)⁵ is appropriate. This rate more closely approximates the cost of Treasury borrowings and more equitably allocates the cost of deferrals among DOE's customers. In commenting on a draft of this report, Treasury agreed that the current-market-yield rate is appropriate.

DOE agreed that choosing an appropriate interest rate for computing schedule adjustment charges is largely a judgmental matter subject to differing points of view. Although DOE considered our conclusions to be fair, it pointed out that the viewpoints of the IG and the Assistant Secretary could be presented with better balance. We have accordingly revised our report to better reflect the IG's and the Assistant Secretary's positions on the issues. DOE also pointed out that an agreement within DOE on the appropriate interest rate for computing schedule adjustment charges has not been reached and its audit review council may consider this issue, including information from our draft report. Subsequently, while this report was in final processing, DOE agreed that the current-market-yield rate is appropriate for computing schedule adjustment charges and said

⁵The current-market-yield rate is the current yield on the Treasury's outstanding marketable securities of comparable maturities. This yield usually approximates the Treasury's current cost of borrowing because new offerings will have to carry about the equivalent return to investors that is available to them by investing in outstanding marketable securities of the Treasury.

that it will use that rate for any deferrals under future contracts. DOE does not intend to apply the current-market-yield rate to existing contracts due to interrelated contractual complications and the lack of economic benefit to the government. We did not examine these complications and thus cannot comment on the appropriateness of applying the current-market-yield rate to existing contracts.

We believe IG's recommendation to reduce the customer payment period has merit. However, the effect on DOE's position in the competitive uranium enrichment market needs to be considered before any adjustment is made.

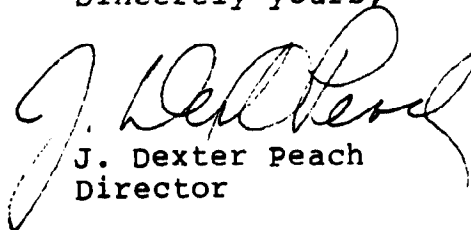
Treasury generally concurred with the position we take in this report in regard to the customer payment period. DOE pointed out that the customer payment period cannot be reduced unless customers agree because 30 days are provided in present contracts. In addition, DOE commented on several specific technical points. In finalizing this report, we considered the comments provided and made changes where deemed appropriate.

Our audit was performed in accordance with generally accepted government auditing standards. We conducted our examination from October 1982 to June 1983. Appendix I presents our detailed response to your request, including a brief perspective on the uranium enrichment program; our objectives, scope, and methodology; the circumstances surrounding, and our evaluation of, the IG's recommendations; and agency comments and our evaluation of those comments. The full text of Treasury's and DOE's comments are included in appendixes III and IV.

- - - -

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 3 days from the date it is issued. At that time, we will send copies to the Director, Office of Management and Budget; the Secretaries of Energy and the Treasury; and interested committees and Members of Congress. Copies will also be made available to others upon request.

Sincerely yours,



J. Dexter Peach
Director

C o n t e n t s

APPENDIX		<u>Page</u>
I	EVALUATION OF URANIUM ENRICHMENT DEFERRAL CHARGES AND THE CUSTOMER PAYMENT PERIOD	1
	A perspective on the uranium enrichment program	1
	Objectives, scope, and methodology	3
	Appropriate interest rate for calculating future schedule adjustment charges	4
	Appropriateness of the 30-day interest-free payment period	9
	Agency comments and our evaluation	12
II	LETTER DATED SEPTEMBER 22, 1982, FROM THE CHAIRMAN, SUBCOMMITTEE ON ENERGY RESEARCH AND PRODUCTION, HOUSE COMMITTEE ON SCIENCE AND TECHNOLOGY	15
III	LETTER DATED JUNE 8, 1983, FROM THE ACTING ASSISTANT SECRETARY (DOMESTIC FINANCE), DEPARTMENT OF THE TREASURY	17
IV	LETTER DATED JUNE 27, 1983, FROM THE ASSISTANT SECRETARY FOR MANAGEMENT AND ADMINISTRATION, DEPARTMENT OF ENERGY	19

ABBREVIATIONS

AEC	Atomic Energy Commission
DARC	Department of Energy Audit Review Council
DOE	Department of Energy
ERDA	Energy Research and Development Administration
FY	fiscal year
GAO	General Accounting Office
IG	Office of the Inspector General, Department of Energy
NE	Office of Nuclear Energy, Department of Energy
OMB	Office of Management and Budget
SAC	schedule adjustment charges

.....

.....

EVALUATION OF URANIUM ENRICHMENT DEFERRALCHARGES AND THE CUSTOMER PAYMENT PERIODA PERSPECTIVE ON THE URANIUM
ENRICHMENT PROGRAM

Since 1969, the federal government--through the former Atomic Energy Commission (AEC), the former Energy Research and Development Administration (ERDA), and now the Department of Energy (DOE)¹--has been enriching uranium for domestic and foreign utility customers. Today, 72 nuclear powerplants in the United States and about 130 foreign powerplants are fueled with uranium enriched by DOE. Foreign and domestic customers provide the unenriched uranium, which DOE converts to a richer mixture suitable for fueling nuclear powerplants. DOE charges its customers for this enrichment service based on the amount of processing required to enrich the uranium to specified levels.

DOE sets its prices using a formula that is designed to recover all of the government's costs within a reasonable period of time, as required by Section 161(v) of the Atomic Energy Act of 1954, as amended (42 U.S.C. 2201(v)). The law's intent is for the government to break even on the services provided to commercial customers.

During fiscal year 1982, DOE received nearly \$2.2 billion in revenues² under its uranium enrichment program, and program costs amounted to about \$1.9 billion. Since the program is operated on a full-cost recovery basis, a revenue gain has the effect of reducing future prices in DOE's pricing formula. Thus, the program's net revenue gain of \$300 million for fiscal year 1982, in effect, will be returned to DOE's customers unless, of course, such gains merely offset losses incurred in prior periods. Further, in recovering its costs, DOE includes imputed interest on the government's investment in the program. Any revenues received, to the extent they are not offset by expenditures, will decrease the government's investment in the program. Accordingly, no gain or loss would result to the government over the long run.

During the Arab oil embargo of 1973-74, customers envisioned a rapid expansion of nuclear power, and domestic and foreign

¹AEC was abolished on January 19, 1975, and its uranium enrichment activities were transferred to ERDA. On October 1, 1977, ERDA was abolished and its enrichment activities were transferred to DOE.

²Included in fiscal year 1982 revenues was \$10.4 million for deferring scheduled deliveries of enriched uranium.

orders for enrichment services soared. Shortly after the contracts were signed, congressional and public concern over nuclear proliferation and safety, combined with reduced consumer demand for electricity, slowed the growth of nuclear power. As a result, DOE's foreign and domestic customers were committed to take billions of dollars worth of enrichment services that were no longer needed within the contracted time frame.

In 1978, to grant its customers relief, DOE decided to allow them to convert their existing contracts to contracts which allow uranium enrichment deliveries to be deferred up to 5 years upon payment of schedule adjustment charges. According to a DOE program official, such charges were intended to allocate the resulting increased costs incurred by DOE specifically to those customers asking for deferrals. Generally, DOE calculated the charges by determining the difference between the present value of the gross revenues DOE was contracted to receive³ and the present value of those revenues deferred to a later year. In determining the present value of those revenues, DOE uses the average-marketable-securities interest rate which is the rate it uses for all aspects of the program. Revenues obtained from schedule adjustment charges are included in the program's revenue accounts. To the extent such revenues are not offset by program costs, the revenues are, in effect, returned to all enrichment customers in the form of reduced prices for subsequent enrichment services.

Since the program began selling enrichment services in 1969, DOE and its predecessor agencies have generally allowed customers 30 days from the date of invoice to make payment on uranium enrichment services provided. This practice was considered appropriate at the time because of delays occasionally experienced when conducting business activities through the mails, particularly where such activities involved foreign countries. As other entities entered into competition with DOE, they also adopted this practice. Currently, three other entities are selling uranium enrichment services--the Soviet Union and two European consortia, EURODIF⁴ and URENCO.⁵ According to DOE, Australia, Brazil, South Africa, and Japan have plans to build enrichment facilities and may also enter

³Present value represents the value today of a future payment, or stream of future payments. Thus, future payments are discounted, using an interest rate which is to represent the cost of capital.

⁴EURODIF is a consortium incorporated in 1973. Its members include French, Spanish, Belgian, and Italian utilities.

⁵URENCO is a consortium formed in 1970. Its members include the United Kingdom, West Germany, and the Netherlands utilities.

into competition. These additional foreign enrichers are expected to provide their customers with payment terms at least as lenient as DOE's. Hence, DOE believes that if the 30-day payment period is reduced, foreign and U.S. utilities may be more apt to obtain their enriched uranium from other world suppliers.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objective was to evaluate the IG's two recommendations and DOE's Assistant Secretary for Nuclear Energy's responses to those recommendations. The IG had recommended that the Assistant Secretary consider (1) using the current-value-of-funds rate rather than the average-marketable-securities rate in computing future schedule adjustment charges to customers deferring delivery of enriched uranium and (2) reducing the 30-day period from the date of invoice that customers are allowed to make payment. The Assistant Secretary disagreed with both of these recommendations.

We reviewed the IG report and supporting workpapers to determine the rationale for the recommendations; obtained the Assistant Secretary's official comments on a draft of the IG report; and discussed those comments with IG and DOE uranium enrichment officials at the program's headquarters in Germantown, Maryland. Since DOE's Oak Ridge Operations Office, located in Oak Ridge, Tennessee, conducts the day-to-day accounting functions for the program, we also discussed with that office's chief accountant for the uranium enrichment program the effect of the IG's recommendations on (1) the government's revenues, (2) the program's costs, and (3) the pricing of uranium enrichment services under the full-cost recovery formula. Furthermore, we contacted representatives from the Office of Management and Budget's (OMB's) Cash Management Project⁶ and the Department of the Treasury, Washington, D.C., to obtain a government-wide perspective on issues surrounding the interest cost to the government and their opinions on the IG's two recommendations.

To further evaluate the IG's first recommendation, we examined the standard provisions of DOE's uranium enrichment contracts to identify possible legal or contractual constraints that may affect the specific interest rate to be used. We also researched the interest rates we recommend federal agencies to

⁶On November 1, 1982, OMB established the Cash Management Project. This project's charter is to improve federal cash management practices. It is run by a task force comprised of representatives from OMB and other federal agencies.

use in general⁷ and our past position on the interest rate DOE is using in the program.⁸

Even though DOE uses the average-marketable-securities rate throughout the program, we did not specifically examine the appropriateness of this interest rate in the other aspects of the uranium enrichment program. These aspects include the pricing of enrichment services, imputed interest on the government's investment in the uranium enrichment program, and interest on customers' advanced payments for future deliveries. For purposes of evaluating the effects of the two IG recommendations on the government's revenues, we assumed that the average-marketable-securities rate was appropriate for imputing interest. During our review, IG was conducting a broad review of the interest rates DOE uses relative to these program aspects.

In addition to discussing with officials mentioned above the appropriateness of the IG's recommendation on reducing the 30-day customer payment period, we examined the Assistant Secretary's response to the IG's recommendation by exploring the effect a reduction would have on the Treasury and DOE's customers. With respect to the enrichment program's competitive position in world markets, we examined our past position on the importance of price and other market factors.⁹

Our audit was performed in accordance with generally accepted government auditing standards. We conducted our examination from October 1982 to June 1983.

APPROPRIATE INTEREST RATE FOR CALCULATING FUTURE SCHEDULE ADJUSTMENT CHARGES

The IG believed the current-value-of-funds rate more accurately estimates the value of deferred revenues and recommended that the Assistant Secretary consider using this rate to calculate future schedule adjustment charges. If the current-value-of-funds rate was used, the IG estimated that an additional \$90 million in revenues from schedule adjustment charges could have been realized in fiscal year 1980. The IG's report stated

⁷Accounting Principles and Standards for Federal Agencies, Comptroller General of the United States, 1978.

⁸Letter report to the Chairman, Atomic Energy Commission, on accounting, theories, and methods used for uranium enrichment financial statements (B-159687, Mar. 31, 1972).

⁹Evaluation of Selected Features of U.S. Nuclear Non-Proliferation Law and Policy (EMD-81-9, Nov. 18, 1980), and Issues Concerning the Department of Energy's Justification for Building the Gas Centrifuge Enrichment Plant (GAO/EMD-82-88, May 25, 1982).

that both Treasury and OMB supported the current-value-of-funds rate because this interest rate represents the government's cost of money associated with the deferral of revenues due to the Treasury. According to the IG, the undercollection of revenues from using a lower than appropriate interest rate will eventually be collected by the program through the pricing formula. They pointed out, however, that this would result in an inequitable allocation of cost among DOE's customers. Further, the IG said that the Treasury will have to bear added interest cost on the deferred revenues during the period of the deferral because Treasury could have reduced its borrowings by the amount of the undercollection. The IG stated that Treasury's additional borrowing cost from using a lower than appropriate interest rate during the period of the deferred revenues will not be recovered through the uranium enrichment pricing formula. This assumes that the rate used to impute interest is also lower than appropriate.

The Assistant Secretary defended the use of the average-marketable-securities rate because this interest rate is used throughout the enrichment program to represent the government's cost of funds. Besides being used for schedule adjustment charges, the average-marketable-securities rate is used by the enrichment program to determine prices, impute interest on the government's investment in the program, and calculate interest on customers' advanced payments. The Assistant Secretary stated that present uranium enrichment contracts require that the interest rate used to calculate the schedule adjustment charges be the same as the rate paid to customers for advanced payments.¹⁰

The current-market-yield rate
is more appropriate

Generally, when interest costs are a factor in determining revenues, such as schedule adjustment charges, federal agencies should use a rate that reasonably reflects the current-market-yield interest rate on Treasury borrowings for a comparable period. For example, if DOE grants deferrals for a 5-year period, the cost of the deferrals should be based on the current-market-yield rate on Treasury securities with a 5-year maturity period. In this regard, the Treasury computes the current-market-yield rate on its borrowings of various lengths of maturity each month. In July 1983, the Treasury reported the current-market-yield rates shown on the following page.

¹⁰Our review showed that the existing uranium enrichment contracts do contain such a requirement. In fiscal year 1982, DOE paid its customers \$48 million in interest on advanced payments.

<u>Length of maturity</u>	<u>Rate for July 1983</u>
	(in percentages)
1 year	9-1/2
5 years	10-1/2
10 to 12 years	10-3/4
15 years	10-7/8
20 years	11

Source: U.S. Treasury.

Administrations, for the last 2 decades, have supported the use of current-market-yield rates as the most effective and equitable way to estimate Treasury borrowing costs for a wide variety of federal lending, borrowing, and investment decisions. This rate was first recommended as a general standard by the 1963 Presidential Committee on Federal Credit Programs; promulgated in 1965 by OMB Circular No. A-70, which pertains to federal credit program standards; and adopted by subsequent administrations. We have similarly recommended the use of the current-market-yield rate for cost analyses of federal activities in general.¹¹

In discussing this issue with DOE program officials, we were told that the average-marketable-securities rate and the current-market-yield rate should average out over time. Even if this is not the case, these officials pointed out that DOE's pricing formula for recovering all of the government's costs would adjust for any differences. For example, they pointed out that if additional revenues are gained from using an interest rate for schedule adjustment charges that is higher than the rate of Treasury borrowing resulting from the deferrals, the gains would simply be returned to customers in the form of lower prices. Accordingly, program officials believe that regardless of which interest rate is used for schedule adjustment charges, the government will receive no revenue gain or loss in the long run.

Although we favor the use of current-market-yield rates, DOE has a basis for using the average-marketable-securities interest rate to compute schedule adjustment charges. In March 1972, we reported to the Chairman of AEC that (1) the average-marketable-securities rate, if consistently applied,

¹¹Change Proposed in Interest Rate Criteria for Determining Financing Cost of Federal Power Program (B-167712, Jan. 13, 1970), and Legislation Needed to Revise the Interest Rate Criteria for Determining the Financing Cost of Water Resource Projects (B-167712, Aug. 11, 1972).

would, in the long term, reasonably reflect the government's cost of investing in the program and (2) using the average-marketable-securities rate, instead of the current-market-yield rates, for imputing interest could satisfy the requirement of the Atomic Energy Act of 1954 to recover the government's costs over a reasonable period of time.

However, the deferrals of enriched uranium deliveries and schedule adjustment charges present a new situation which has occurred since our 1972 report. Since costs resulting from deferred deliveries are for specific time periods--1 to 5 years--they can be more closely matched to current-market-yield rates. Therefore, deviations in the average-marketable-securities rate and the current-market-yield rate will not average out for any specific deferral. For example, the average-marketable-securities rate used by DOE during fiscal year 1983 was 12.3 percent, while the current-market-yield rate for July 1983 for a 5-year period was 10.5 percent, or nearly 2 percent lower. Hence, if in July 1983, a customer had deferred a delivery for 5 years, DOE would have charged that customer on the basis of the 12.3-percent rate. Even if the average-marketable-securities rate subsequently decreased, that customer would not recover the nearly 2-percent difference because only a one-time charge is applied to each deferral. Instead, to the extent that an overcharge would reduce future prices, other DOE enrichment customers would benefit. Although customers did not defer scheduled deliveries in fiscal year 1983, using the current-market-yield rate in fiscal year 1982 for computing schedule adjustment charges would have tended to reduce future prices per unit of enrichment by about 1 cent. Since DOE in practice rounds up to the nearest 5 cents, a 1-cent reduction might not result in any change in the price charged to enrichment customers. Nonetheless, we believe the current-market-yield rate is more appropriate for computing schedule adjustment charges than the average-marketable-securities rate because it more closely reflects the Treasury's cost of borrowings and its use assures equitable allocation of those costs among DOE's enrichment customers.

We also believe the current-market-yield rate is more appropriate than the IG-recommended current-value-of-funds rate for determining amounts to charge customers deferring delivery of uranium enrichment services. The current-value-of-funds rate represents the interest earned by the Treasury on short-term deposits in accounts with commercial banks. Thus, this rate reflects the interest revenues (sometimes referred to as "opportunity cost") that the Treasury would have received if deliveries had not been deferred. According to Treasury and OMB officials, this rate is appropriate for imputing the value of

cash management improvements, such as debt collection,¹² but this rate bears no relationship to Treasury's borrowing cost. Since the program is operated on a cost-recovery basis, we believe the cost of Treasury borrowings is a more appropriate basis than lost opportunity cost for computing the schedule adjustment charges. Furthermore, the current-value-of-funds rate is associated with short-term deposits into Treasury tax and loan accounts for periods of about 2 to 8 days, while past deferrals of enrichment services have been for 1 to 5 years. As of July 1983, the annual average current-value-of-funds rate was 11 percent, whereas the cost of Treasury borrowings, as represented by the current-market-yield rate, was 10.5 percent.

With respect to the conflicting positions between IG and the Assistant Secretary on whether the Treasury's cost is being recovered, we noted that both the IG's and the Assistant Secretary's positions are correct; however, both are based on different underlying assumptions on the appropriateness of using the average-marketable-securities rate for imputing interest on the government's investment in the program. The Assistant Secretary believes that the average-marketable-securities rate is appropriate for use throughout the program, including imputing interest on the government's investment. Under this assumption, we agree with the Assistant Secretary that it does not matter what interest rate DOE uses to compute schedule adjustment charges. This is because any underrecovery of those charges would be offset by an additional amount of imputed interest DOE charges its customers. Conversely, an overrecovery of schedule adjustment charges would be offset by a lower amount of imputed interest on the government's investment in the program. Contrary to the Assistant Secretary's position, IG's position assumes that the average-marketable-securities rate is not appropriate for imputing interest costs. The IG believed that the current-value-of-funds rate better reflected the government's cost of investing in the program. At the time of its review, the current-value-of-funds rate was higher than the average-marketable-securities rate, and the IG concluded that the program will not recover the Treasury's costs. One should note, however, that the average-marketable-securities rate has become the higher rate and, under the IG's assumption, the program may be now recovering more than Treasury's cost. Thus, at the heart of this debate is whether the interest rate used in the program for imputing interest on the government's investment is appropriate. As noted earlier, the IG was doing follow-on

¹²Section 11 of the Debt Collection Act of 1982 (31 U.S.C.A. 3717) requires that the current-value-of-funds rate be charged for late payments. By its terms, this act does not apply to deferrals made under any existing DOE uranium enrichment contract executed before, and in effect, on October 25, 1982.

work including an examination of interest rates used throughout the program.¹³

While our report was in final processing, DOE's Audit Review Council, on September 1, 1983, reviewed the issue of which interest rate would be appropriate for computing schedule adjustment charges. In reviewing this issue, the council considered information from the IG report and a draft of this report. During the council's review, DOE agreed to use the current-market-yield rate for any deferrals under future uranium enrichment services contracts. Due to interrelated complications in existing contracts and the lack of economic benefit to the government, DOE does not intend to use the current-market-yield rate in existing contracts. We did not examine these interrelated complications and thus did not comment on the appropriateness of using this rate in existing contracts.

APPROPRIATENESS OF THE 30-DAY
INTEREST-FREE PAYMENT PERIOD

The IG recommended that the Assistant Secretary consider reducing the 30-day interest-free customer payment period in future uranium enrichment contracts because each day in the 30-day billing cycle was costing the government an estimated \$417,000. If the 30-day payment terms were reduced to cash terms, the IG stated that the government could save about \$12.5 million annually (30 x \$417,000). Recognizing that 30-day interest-free terms may be common trade practice in businesses such as retailing, the IG stated that the trend is toward shorter payment periods as most businesses are becoming increasingly aware of the time value of money. The IG also reported that domestic and foreign banks are increasing the use of electronic fund transfers to move monies from bank to bank, thereby making shorter payment periods feasible. Consequently, the IG questioned whether the uranium enrichment program's practice of providing 30-day interest-free payment periods is appropriate for transactions involving millions of dollars.

The Assistant Secretary is opposed to the recommendation because no economic benefit would result to the government, and reducing the payment period could adversely affect the program's competitive position. Concerning the absence of economic benefit, the Assistant Secretary explained that any benefit to the Treasury from reducing the customer payment period would be offset by lower program revenues due to the reduced imputed interest which DOE would include in its price. This is because the amount of outstanding accounts receivable would be reduced

¹³On June 21, 1983, the IG issued its report, Uranium Enrichment Pricing Policies (DOE/IG-0196).

and therefore the government's investment on which imputed interest is based would be lower. With respect to the program's competitive position, the Assistant Secretary said that since 1974, DOE's share of the foreign enrichment market has decreased from 100 percent to 30 percent in March 1983. A program official told us that, in light of the extremely price competitive enrichment market, and the recent loss of customers to international competitors, the possible effect on the program's competitive position needs to be known before the customer payment period is shortened.

In responding to the Assistant Secretary's concern that a reduced payment period could weaken the program's competitive position, the IG asserted that other factors such as supply diversification (having multiple suppliers available), supply assurance, national goals, and international politics are more important considerations to customers than payment periods in deciding on an enrichment supplier. Accordingly, the IG contended that any shortening of the payment period would have a relatively minor effect on the program's competitive position.

In this regard, when we evaluated the Nuclear Non-Proliferation Act of 1978, we found that potential foreign enrichment customers were more interested in diversifying their sources of enrichment services than in obtaining the lowest enrichment prices. In our May 1982 report (GAO/EMD-82-88), we further pointed out that this desire to diversify had been borne out as a major factor behind a customer's selection of an enrichment supplier. We noted in the latter report that despite a vigorous marketing effort and one of the lowest prices available since 1978, DOE was not able to sign any new foreign enrichment contracts until May 1982.

The effect on the program's competitive position is uncertain

From a cash-management point of view, the IG's recommendation has merit because sound business practice would require collecting revenues as promptly as possible. However, there are no cost savings to the government from reducing the customer payment period. The time value to the Treasury of receiving payments earlier would be accounted for by the interest DOE imputes on the government's investment. Reducing the customer payment period would reduce the amount of outstanding accounts receivable and the government's investment and therefore reduce the amount of imputed interest included in the price paid by DOE's customers. Whether the resulting price decrease would help DOE's competitive position is uncertain.

Although the 30-day interest-free customer payment period meets Treasury guidelines, a shorter payment period is desirable from a cash-management point of view. Chapter 8000 of Part 6

(section 8020.10) of the Treasury Fiscal Requirements Manual requires federal agencies to establish payment due dates that are not more than 30 days from the date of an invoice. According to Treasury, the 30-day payment period is based on standard industry practice. Nonetheless, revenues, when in the form of receivables, generally do not earn interest and cannot be used to accelerate the reduction of the federal deficit with a consequent savings in interest cost. In an effort to reduce the government's interest cost, OMB's Cash Management Project is currently reviewing federal cash management practices. One of the issues OMB is examining is the time it takes federal agencies to collect money owed to the government. Thus, little doubt exists that reducing the customer payment period is desirable from a cash-management point of view.

As noted earlier, any costs associated with the 30-day payment period are recovered through the prices charged for enrichment services. Accordingly, the issue is not whether reducing the interest-free payment period is desirable from an economic point of view but whether the change will weaken DOE's competitive position. DOE believes that it will.

During March 2, 1983, hearings before the Subcommittee on Energy and Water Development, House Committee on Appropriations, the Assistant Secretary testified that the United States no longer enjoys a \$30 to \$50 per unit of enrichment price advantage it enjoyed over its competitors from 1978 to 1981. In March 1983, uranium enrichment program officials estimated that prices offered by one competitor are \$20 per unit of enrichment less than DOE's. Uranium enrichment program officials further told us that five U.S. utilities have already cancelled contracted enrichment services from DOE to purchase cheaper enriched uranium from foreign suppliers.

While reducing the 30-day interest-free customer payment period should enable the program to offer lower prices, such reduced prices would be made possible by customers paying for uranium enrichment services earlier. According to the program's chief accountant, over 90 percent of the customers take full advantage of the 30-day payment period. To the extent that customers would have to borrow funds to make earlier payments for uranium enrichment services, a reduced payment period would likely be more costly to those customers. Generally, this situation would occur because such customers' borrowings entail greater risk than government borrowings and therefore bear a higher rate of interest. Accordingly, the interest cost to the customer probably would be higher than the price decrease resulting from a reduced payment period. Consequently, we believe the interest-free customer payment period should be reduced only after fully considering the effect such an action will have on the program's competitive position.

AGENCY COMMENTS AND OUR EVALUATION

Treasury and DOE provided written comments on a draft of this report. The full text of Treasury's and DOE's comments are contained in appendixes III and IV.

Treasury concurred with our conclusions on using the current-market-yield rate for calculating future schedule adjustment charges. Treasury said that as a matter of long-term policy, it has recommended the current-market-yield rate as the best measure of the federal government's cost of financing an activity. With regard to reducing the customer payment period, Treasury said that 30 days apparently is the industry standard, and it is providing no further comments on this issue.

Overall, DOE agreed that choosing an appropriate interest rate to compute schedule adjustment charges and establishing an appropriate customer payment period are largely judgmental matters. Although DOE believed our positions to be fair, it pointed out that the viewpoints of the IG and the Assistant Secretary could be presented with better balance. As a result, we made changes to better present their respective positions. For example, we added the underlying assumptions for the IG's and the Assistant Secretary's different positions on the effect of the recommendations on the Treasury's revenues. Regarding reducing the customer payment period, both IG and the Assistant Secretary agreed the payment period should be reduced only after full consideration of the program's competitive position. Further, DOE also pointed out that its Office of the Controller supports the use of the average-marketable-securities rate and that the payment period cannot be reduced unless customers agree because 30 days are provided in present contracts.

With respect to a need to better present its position, the IG commented that it recommended that the current-value-of-funds rate be used because it would (1) more accurately reflect the present value of the revenues deferred and (2) in addition to affecting the Treasury's revenues, result in DOE's customers being more equitably treated. We added these points to better present the IG's position.

In addition, the IG pointed out that it reported that an additional \$755 million in schedule adjustment charges should have been collected and estimated that this undercollection resulted in \$270 million of additional interest costs to the Treasury. However, the IG report states that only \$90 million of the \$755 million was attributable to the program's use of the average-marketable-securities rate in lieu of the current-value-of-funds rate. The IG attributed the balance of the \$755 million, or \$665 million, to other factors including an understatement of the price of enrichment services, an incomplete accounting of the enrichment services deferred, and an erroneous estimate of when customers were to make payment. We did not review these other factors.

Instead, our review focused on the appropriate interest rate to compute schedule adjustment charges. Therefore, we reported only on the undercollection of \$90 million that the IG attributed to the use of the average-marketable-securities rate.

The IG disagreed with a statement in our report citing DOE program officials' belief that the average-marketable-securities rate and the current-market-yield rate will average out over time. Instead, IG believes the two rates measure different things, and outside of coincidence, there is no assurance the two rates would in fact average out. We agree that whether or not the rates average out in the long run is a matter of conjecture. In regard to schedule adjustment charges, our report points out that deferrals are not a long-term matter and that the rates would not average out for a specific deferral.

The IG took issue with our assumption that the interest rate DOE uses for imputing costs is appropriate. Under the program's full-cost recovery pricing formula, the inclusion of imputed interest in the price of enrichment services compensates the Treasury for the time value of any deferred revenues. Thus, we point out that regardless of the interest rate DOE uses to compute schedule adjustment charges, no gain or loss of revenues would result to the Treasury. However, if imputed interest does not accurately reflect the Treasury's borrowing costs, the Treasury will not be appropriately compensated. Accordingly, we recognized in this report that the IG was assuming that the rate for imputing interest was not appropriate. Nevertheless, we focused our review on schedule adjustment charges to isolate its effect on the Treasury's revenues. Thus, we assumed all other factors, including the rate used for imputing interest, were appropriate.

The IG stated that our report presented a convincing case for using the current-market-yield rate but does not unequivocally state that this rate should be used for computing schedule adjustment charges. We believe our preference for using the current-market-yield has been clearly stated. Although we did not recommend the rate be used, program officials advised us that if deferrals are made under any future contracts, the program will use the current-market-yield rate.

In making specific comments on our draft report, the Assistant Secretary pointed out that a 1972 GAO report approved the average-marketable-securities rate which has long been viewed by the program and its customers to be an equitable rate. However, in a September 1, 1983, audit review council session, DOE agreed to use the current-market-yield interest rate in all future contracts to calculate charges to customers who defer delivery of uranium enrichment services. We believe the current-market-yield rate is more appropriate for computing schedule adjustment charges even though we previously reported that the average-marketable-securities rate would reasonably reflect the Treasury's long-term costs for the program. As noted earlier in this report,

our 1972 report did not address schedule adjustment charges which were introduced 6 years after that report was issued. As such, schedule adjustment charges present a new situation that has occurred since our 1972 report.

The Assistant Secretary said the draft failed to recognize that present uranium enrichment contracts require that interest on customers' advanced payments be accrued using the same interest rate used to compute schedule adjustment charges. While a footnote to page 5 of this appendix notes this contract requirement, we did not examine the appropriateness of using the current-market-yield rate on customers' advanced payments. If another rate is more appropriate for advanced payments, the Assistant Secretary could decide not to tie in the interest rate for schedule adjustment charges with customers' advanced payments in future contracts.

The Assistant Secretary pointed out that the effect of using the current-market-yield interest rate on the price of enrichment services is insignificant. If the current-market-yield rate had been used for schedule adjustment charges in fiscal year 1982, prices should have been reduced by about 1 cent, but in practice, prices might not be affected at all because the program rounds its prices upward to the nearest 5 cents. We agree that the effect of using the average-marketable-securities rate was small in fiscal year 1982 and noted it in this report. However, the lack of a significant effect is due primarily to the relatively small amount of deferrals that occurred in fiscal year 1982. If more deliveries are deferred in the future, the inequity between customers could be greater. The Assistant Secretary does not anticipate any significant deferral in the near future, but as a matter of prudent policy, using the current-market-yield rate would better assure that the cost of the deferred revenues is equitably distributed.

Finally, the Assistant Secretary agreed that diversity of supply was more important than price to foreign customers in the late 1970's but believed that price has been the most important factor in recent years. We believe the report adequately disclosed the Assistant Secretary's belief concerning this point.

DON FURBA, FLA., CHAIRMAN
 ROBERT A. BOE, N.J.
 GEORGE E. BROWN, JR., CALIF.
 JAMES H. BOHNER, N.Y.
 RICHARD L. OTTINGER, N.Y.
 TOM HARKIN, INDIA
 MARILYN LLOYD BOLSHARD, TENN.
 JAMES J. BLANCHARD, MICH.
 DEAN WALSHORN, PA.
 RONNIE G. FLIPPO, ALA.
 DAN GLICKMAN, KANS.
 ALBERT GOEPE, JR., TENN.
 ROBERT A. YERNS, MD.
 RICHARD C. WHITE, IOWA
 HAROLD L. VOLKMER, MD.
 HOWARD WOLFE, MICH.
 BILL NELSON, FLA.
 STANLEY M. LINDBERG, N.Y.
 ALLEN E. BENTEL, PA.
 BEN SHAWANSKY, OHIO
 RALPH M. HALL, TENN.
 DAVE MCCURDY, OKLA.
 MERVYN M. SPIGALLI, CALIF.
 LARRY WISH, JR., KANS.
 BARRY M. GOLDWATER, JR., CALIF.
 HAMILTON FISH, JR., N.Y.
 MARGIE LUJAN, JR., N. MEX.
 HAROLD G. HOLLZBERG, N.J.
 ROBERT S. WALKER, PA.
 EDWIN S. FORSYTHE, N.J.
 WILLIAM CARNEY, N.Y.
 MARGARET M. HEGGNER, MASS.
 F. JAMES SCHNEIDERMAN, WIS.
 VIN WEBER, MINN.
 JUDG BRIDGES N.H.
 RAYMOND J. MCGONATH, N.Y.
 JOE GREEN, N. DAK.
 CLAUDINE SCHNEIDER, S.C.
 JIM DUNN, MICH.
 BILL LOWERY, CALIF.

HAROLD P. HANSON
 EXECUTIVE DIRECTOR
 ROBERT C. KEYOHAM
 REBEKA A. DAVIS
 MARTHA BRIDGES
 GEORGE S. KOPP
 JOHN V. DURBAH, JR.
 THOMAS R. KRAMER
 DANIEL R. BRANSCOME
 ANTHONY C. TAYLOR
 ROBERT B. NICHOLAS
 DAVID S. JEFFERY
 MINDY STAFF DIRECTOR

COMMITTEE ON SCIENCE AND TECHNOLOGY
U.S. HOUSE OF REPRESENTATIVES
 SUITE 2321 RAYBURN HOUSE OFFICE BUILDING
 WASHINGTON, D.C. 20515
 (202) 225-6371

September 22, 1982

Honorable Charles A. Bowsher
 Comptroller General
 General Accounting Office
 Washington, D.C. 20548

Dear Mr. Bowsher:

On August 23, 1982, the U.S. Department of Energy Office of Inspector General (IG) released the Report on Dollar Impact of Financial Management Decisions in the Uranium Enrichment Program (DOE/IG-0186). The IG recommended that the Assistant Secretary for Nuclear Energy (ASNE) consider: 1) using the current-value-of-funds rate rather than the average-marketable-securities rate in computing future schedule adjustment charges; and 2) reducing the 30-day customer payment period in future enrichment contracts.

The ASNE disagreed with both of the IG's recommendations. With regard to the first recommendation, he stated that the average-marketable-securities rate has consistently been used to represent the Government's cost of funds for all purposes of uranium enrichment operations. He also pointed out that the enrichment services contracts now require that the interest rate used on schedule adjustment charges be the same as that paid to customers on their advanced payments. He then concluded that the average-marketable-securities rate was the appropriate rate to use and should be continued.

The ASNE also contested the IG's recommendation that he consider reducing the 30-day payment period in future uranium enrichment contracts. He questioned the benefit to the Government since interest is now imputed on receivables and thus passed on to all customers. He also contended that such a change would have a negative impact on the enrichment enterprise's competitive position.

It appears from the brief analyses presented in the IG's report that implementation of the recommendations could result in substantial additions in Government revenues, and allow the uranium enrichment enterprise to operate in a more businesslike manner. Accordingly, I request that you analyze and evaluate the IG's recommendations, as well as the ASNE's responses to these recommendations, as render your opinion as to the validity of the competing claims.

Honorable Charles A. Bowsher
September 22, 1982
Page 2

If you have further questions concerning this request, please contact Dr. John V. Dugan, Jr., the Subcommittee Staff Director, at 225-2884, or Dr. Harlan Watson, Technical Consultant to the Subcommittee, at 225-3472.

Best regards.

Sincerely,



MARILYN L. BOUQUARD, Chairman
Subcommittee on Energy Research
and Production

MLB:Wjs



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

June 8, 1983

Dear Mr. Anderson:

On behalf of Secretary Regan, I am replying to your letter of May 20 requesting comments on your proposed report, "Evaluation of the Interest Rate for Computing Charges to Customers Deferring Deliveries of Uranium Enrichment Services and the Merits of Reducing the Customer Payment Period".

The draft report indicates that the Department of Energy provides uranium enrichment services for foreign and domestic nuclear powerplants, and is required by law to charge for these services amounts sufficient to recover all of the Government's costs within a reasonable period of time. DOE uses a 10-year period as the "reasonable period". DOE permits its customers to defer delivery of contracted enrichment services for specific periods of from one to five years. In calculating the charge for this deferral privilege ("schedule adjustment charge") DOE uses an interest rate which is, in effect, an average of the coupon rates of interest on all outstanding marketable Treasury securities. This same interest rate is also used for determining interest under other aspects of the program.

The proposed report indicates that the DOE Inspector General has recommended using the "current-value-of-funds" rate (the rate of interest that the Treasury earns on its deposits in commercial banks), rather than the coupon average, in computing future schedule adjustment charges. The draft report recommends use of a rate that reasonably reflects the current market yield on Treasury borrowings for a comparable period, rather than the coupon rate average now being used and the value-of-funds rate recommended by the Inspector General. We concur in this recommendation.

As a matter of longstanding policy, the Treasury Department has recommended the use of current market yields on outstanding United States obligations with maturities comparable to the period of investment as the best measure of the cost to the Federal Government of financing an activity. While the Treasury does not enter the market to borrow a specific amount of funds for the period required to finance the activity, Treasury is compelled to have a comparably greater amount of debt outstanding for that period. Thus, the most appropriate measure of the alternative cost involved in financing an activity by the Federal Government is the current market cost of Federal borrowing for a comparable maturity. The "yields-on-comparable-maturities" interest rate formula appears in scores of statutes governing Federal borrowing, lending, and investing activities, and it has been endorsed by OMB and GAO as the most equitable and effective way of approximating Treasury's current costs of borrowing in the market for comparable periods.

- 2 -

The average coupon rate formula currently being used produces a rate which is an arbitrary average of borrowing costs over the past three decades, and bears no relationship to current Treasury borrowing costs as measured by market yields on outstanding Treasury securities with remaining periods to maturity comparable to the period of investment.

The current-value-of-funds formula also produces a rate which bears no relationship to current market borrowing costs for maturities comparable to the period of investment. The value-of-funds rate is based on the average investment rate for Treasury tax and loan accounts, which is a measure of what Treasury earns on its deposits in financial institutions. This investment rate is, in turn, based on the cost of one source of funds to commercial banks, not on the cost of funds to the Government. The outstanding marketable public debt is approximately \$950 billion. The amount of funds in the tax and loan accounts at any one time, which may be only a few billion dollars, is determined by overall Treasury cash management decisions which are not related to the amount of revenues deferred under the DOE program. Thus, the effect of the existence of the deferred revenues is to increase the Government's borrowing requirements, and not to reduce the amount in the tax and loan accounts.

In conclusion, the Department supports the recommendation in the draft report that the "yields-on-comparable-maturities" interest rate formula be used in determining the schedule adjustment charges. We also recommend that consideration be given to using this formula in determining interest under all aspects of the DOE program.

The second issue discussed in the report, the customer payment period, is an agency determination, since the 30-day payment period already in existence is in accordance with the Treasury Financial Manual, I TFM 6-8020.10. As indicated in the report, this apparently is the industry standard. We have no further comments on this issue.

Sincerely,



C. Warren Carter
Acting Assistant Secretary
(Domestic Finance)

Mr. William J. Anderson
Director
General Government Division
General Accounting Office
Washington, D.C. 20548



Department of Energy
Washington, D.C. 20585

JUN 2 1983

Mr. J. Dexter Peach
Director, Resources, Community
and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

The Department of Energy (DOE) appreciates the opportunity to comment on the General Accounting Office (GAO) draft report entitled "Evaluation of the Interest Rate for Computing Charges to Customers Deferring Deliveries of Uranium Enrichment Services and the Merits of Reducing the Customer Payment Period." The report addresses two recommendations made by the DOE Inspector General (IG) on the uranium enrichment program.

GAO states on page 2 that choosing an appropriate interest rate for computing schedule adjustment charges (SAC) and establishing an appropriate customer payment period are largely judgmental matters subject to differing points of view. DOE agrees and believes that, although the conclusions reached by GAO are fair, the presentation of the varying viewpoints held by the IG and by the Office of Nuclear Energy (NE) could be presented with better balance.

GAO favors neither the current-value-of-funds interest rate recommended by the IG nor the average-marketable-securities interest rate used by NE but considers a third rate (current-market-yield) to be the most appropriate because this rate more closely approximates the cost of Treasury borrowings. Although the IG does not disagree with GAO's proposed rate, the IG believes that the reasons for their recommendation could be more clearly explained in GAO's final report. The Office of the Controller and NE continue to believe that the average-marketable-securities rate currently being used is the most appropriate rate when consideration is given to the long standing precedent established by the Department with its domestic and foreign customers. Furthermore, the rate has been accepted by all parties to be fair and equitable. NE also believes that adoption of the IG recommendation would not result in the long run in either a gain or a loss to the Government. Comments by both the IG and NE about the interest rate to be used are included as an enclosure to, and should be considered an integral part of, this letter. Since there is not yet an agreement within DOE about an official Departmental position, this issue may be considered as a matter for resolution by the Department of Energy Audit Review Council (DARC) in one of their upcoming meetings, although no official date has yet been set. The DARC is the official audit resolution group established as part of the Departmental audit review and followup system. Information supplied by the IG, NE and GAO will be considered by the DARC in their resolution process.

The second IG recommendation was for NE to consider reducing the 30 days from the date of invoice that customers are allowed to make payment. All parties seem to agree that the payment period should be reduced only after full consideration of the program's competitive position. As a practical matter, NE points out that nothing can be done under the existing contracts to reduce the payment period unless the customer agrees because the 30-day payment period is a provision of these contracts. Further, the current enrichment market is extremely price competitive today, and the DOE price is well above competitors' prices. In this environment, NE is not in a position to impose harsher financial terms to customers.

NE agrees with the IG's and GAO's position that diversity of supply was more important than price to foreign uranium enrichment customers (pages 14 and 15 of draft report) in the late 1970's, but they believe price has been the most important factor for the last several years. NE believes the GAO report references old data and is misleading as a result. Further, they do not believe that the 1974 India nuclear explosion was a major direct influence on the level of demand for uranium enrichment services [GAO Note 1.]

DOE hopes these comments are helpful to GAO in their preparation of the final report.

Sincerely,



Martha O. Hesse
Assistant Secretary
Management and Administration

Enclosure

[See GAO note, p. 24, app. IV.]

GAO Note 1: The draft report indicated that the 1974 India nuclear explosion was a factor which influenced the reduced level of demand for enriched uranium; reference to that explosion has been deleted from this report.

Enclosure
Page 1

COMMENTS ON GENERAL ACCOUNTING OFFICE DRAFT REPORT

Comments by the Inspector General

On page 8, the report states that the IG recommended a current interest rate because the rate used by the DOE was less than the Government's borrowing cost. The IG recommended a current rate not because it was more or less than the rate used, but because the current rate would more accurately discount the present value of the revenues deferred by SAC.

Also on page 8, the report states that the IG contended that the under-collection of revenues is borne by the Treasury rather than the enrichment program. On the contrary, the IG report states that the \$755 million will eventually be collected by the enrichment program through pricing. However, the Treasury will bear added interest costs on the deferred revenues during the period of collection. Based on the difference in interest rates at the time of the IG's audit between what the enrichment operation was charging and the current-market rate, the IG estimated those costs at \$270 million.

On page 2, and again on page 9, DOE officials are quoted to the effect that no matter which interest rate is used, no gain or loss will result to the Government. On page 3, GAO expresses agreement that, in the final analysis, adoption of the IG's recommendation would not result in either a gain or a loss to the Government. This leaves the impression that, therefore, it does not matter which rate is used. It should be pointed out in this context that the SAC was not designed to obtain revenues for the Government. In theory, there would have been no loss to the Government even if the charges had not been assessed at all. The purpose of the SAC, as noted on page 6, was to achieve equity among customers by ensuring that those delaying their deliveries paid the costs of the revenue deferrals, rather than passing them on to all customers equally through pricing. More generally, the whole draft treats the IG report as though gains or losses to the Treasury was the only issue. The IG believes DOE has an equally important obligation to see that its enrichment customers are equitably treated.

On page 9, after presenting the respective positions of the IG and NE, the draft quotes DOE program officials in what seems like a concluding paragraph. This is likely to lead the reader into thinking that GAO is endorsing these statements or that they constitute a summary of GAO's conclusions. The IG found the whole paragraph fallacious and believes it will confuse, rather than inform, the reader. The assertion is made that the average-marketable-securities rate and the current-market-yield rate should "average out over time," and that, even if they don't, the difference will be adjusted through the pricing formula. Since the two interest rates measure quite different things, there is no reason, except the most unlikely coincidence, that the rates will give the same result over any period of time. As to the pricing formula, it simply measures recorded costs against revenues to establish prices. Any differences in interest costs due to the use of inappropriate rates are, of course, not recorded, and so obviously will not be reflected in pricing.

Enclosure
Page 2

This fact also applies to the GAO conclusion expressed on pages 12 and 13. There, commenting on the IG contention that not all Treasury costs will be recovered, the draft states that GAO agrees with NE that the pricing formula is designed to recover costs and, assuming that an appropriate rate of interest is used to impute costs, it will recover costs. This might lead the reader to believe that GAO is refuting the IG's contention. That contention is, of course, based on the premise that the enrichment operation is not using an appropriate rate of interest to impute costs. Since GAO, as stated on page 4, did not examine the issue of appropriate interest rates for imputing costs, the IG thinks it might be better to exclude this paragraph from the report. It tends to confuse rather than inform.

On page 10, the draft presents a very convincing case that there is a broad consensus in the Government on the use of current interest rates as the most effective and equitable way to estimate Treasury borrowing costs. The message is somewhat blunted however, by the statement on page 2 that choosing appropriate rates is largely a judgmental matter subject to differing views. Also on page 10, the report draft states that DOE has a basis for using the average-marketable-securities rate to compute schedule adjustment charges, and then goes on for several pages to justify its use in pricing, but not for schedule adjustment charges. GAO's own well supported conclusion clearly is that the current-market-yield rate, and not the average-marketable-securities rate, is the appropriate one to use for computing schedule adjustment charges. The IG thinks it should be stated in the report with less equivocation.

Comments by the Office of Nuclear Energy

On page 11, GAO is apparently not concerned over consistently applying the use of the average-marketable-security rates given GAO's previous position that this rate reasonably reflects the Government's cost of investing in the program. A key feature in any financial practice is consistency. In 1972, the GAO approved use of the average-marketable-securities rate. Schedule adjustment charges (SAC) were not a factor in 1972, but were added with the adjustable fixed commitment contract in 1978. The conclusion at that time was that the outstanding marketable-securities rate was reasonably applicable to SAC, and its use would continue the advantage of consistency in calculating charges and credits involving interest, on a basis understood and perceived as being equitable by the customers.

The report fails to recognize that current contracts require that advance payment credits be accrued based on the same rate used for SAC. To base this rate, as GAO suggests, on maturities expiring in 1 to 5 years would be inconsistent with the time frame for advanced payment credits. DOE received about \$600 million in advanced payments in the mid-1970's. These payments are being credited with interest against deliveries from FY 1979 to about FY 1990. This time frame varies significantly from the 1 to 5 year period GAO recommends. Any attempt to set interest rates on SAC without considering the impact on advanced payments would result in inconsistencies both within the

financial system and within the terms of the enrichment contracts. While NE does not advocate an approach of choosing an interest rate tied to deferred deliveries or periods of outstanding advanced payments, the latter would be much more appropriate to use because of the magnitude of advanced payment credits (\$52 million in accrued interest in FY 1982) versus the almost absence of SAC (no charges have been assessed in FY 1983; only \$10.4 million were received in SAC out of \$2,063 million in total FY 1982 revenues; and none or very few are anticipated in the future).

The impact of SAC on the selling price and thus on DOE's customers is extremely small. For example, in the current selling price costs must change by \$220 million to change the price by \$1. Therefore, in FY 1982 the \$10.4 million in SAC only impacted the current price by less than \$0.05. The draft report argues that the current interest rate used for SAC may be inequitable to some customers. Adopting the GAO suggestions would change the \$0.05 charge by about \$0.01. In NE's opinion, neither charge represents an inequitable situation. In fact, in calculating actual SWU prices, NE takes the calculated results and rounds up to the nearest \$0.05.

GAO Note: Matters referred to in DOE's letter and enclosure are cross-referenced to locations in this report as follows:

<u>DOE page reference</u>	<u>Location in report</u>
p. 2	p. 3
pp. 14 and 15	p. 10 of app. I
p. 8	p. 4 of app. I
p. 9	p. 6 of app. I
p. 3	p. 2
pp. 12 and 13	p. 8 of app. I
p. 4	p. 4 of app. I
p. 10	p. 6 of app. I
p. 11	p. 6 of app. I

(305193)

26553
63

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, \$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE



THIRD CLASS