U.S. DEPARTMENT OF THE INTERIOR
OFFICE OF INSPECTOR GENERAL

EVALUATION REPORT

FEE-FOR-SERVICE ORGANIZATIONS

DEPARTMENT OF THE INTERIOR

U.S. Department of the Interior
NBC
National Business Center

GovWorks®
FEDERAL ACQUISITION CENTER
Government Working With Government

C-EV-MOA-0016-2005

MARCH 2006

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington D.C. 20240

MAR 3 1 2006

EVALUATION REPORT

Memorandum

To: P. Lynn Scarlett, Deputy Secretary
Department of the Interior

From: Earl E. Devaney
Inspector General

Earl E. Devaney

Subject: Fee-for-Service Organizations, Department of the Interior

INTRODUCTION

This report responds to your request to provide you with information that will assist in evaluating the benefits versus the risks of having fee-for-service organizations within the Department of the Interior (DOI or Department). Our evaluation objectives were to identify the fee-for-service organizations within the Department that provide services to other federal agencies and to identify the benefits associated with those activities. We limited our evaluation to those organizations that are self-sustaining, businesslike funds authorized to recover fees for services provided to others. Our report also reiterates some of the risks associated with these fee-for-service operations that have formerly been brought to management's attention as a result of previous and ongoing audits. Appendix 1 provides a full description of our evaluation objectives, scope, and methodology.

BACKGROUND

The Economy Act of 1932 (31 U.S.C. § 1535) authorizes agencies to furnish goods or services for other agencies when the ordering agency determines that this service is in the best interest of the U.S. Government. The ordering agency must also determine that ordering from another federal agency can be done more conveniently or cheaply than from a commercial enterprise. Under the Economy Act, the agency providing services must recover its full cost and is not allowed to make a profit or retain any excess funds derived from these services. DOI provides Economy Act services using its working capital funds and reimbursable agreements.

The Department's working capital fund (43 U.S.C. Chapter 31 §§ 1467, 1468) authorizes NBC to perform general administrative services for the Department and requires it to recover all costs. NBC is not allowed to make a profit or retain any excess funds derived from these services. NBC uses this authority and the Economy Act to perform services for other federal agencies.

The Government Management Reform Act of 1994 (31 U.S.C. § 501) authorized the creation of pilot franchise funds. Franchise funds were created so that common administrative services could be centralized within the U.S. Government and cost savings could be realized due to economies of scale, diminished overhead, and competition. Six federal departments were authorized to establish pilot franchise funds to provide services, such as procurement, personnel, and information technology services. Appendix 2 provides a list of the departments that operate franchise funds and describes their major business lines and customers.

The Interior Franchise Fund was established to implement the Government Management Reform Act. The Department's appropriation bill for FY1997 (Public Law 104-208, 110 STAT. § 113) authorized the Interior Franchise Fund to retain up to 4 percent of its total annual income for that year and each subsequent year. These retained funds can be used for acquisition of capital equipment and improvement and implementation of Departmental support systems.

RESULTS OF EVALUATION

Four DOI entities operate self-sustaining, businesslike fee-for-service organizations. They are the National Business Center (NBC); GovWorks; the Bureau of Reclamation's (BOR) Technical Service Center (TSC); and the U.S. Geological Survey's (USGS) working capital fund, which has six operating activities. These organizations provide administrative and technical services to both the Department and other federal agencies, and they reported combined revenues of approximately $3 billion in FY2005. We found that the Department also performed fee-for-service activities using reimbursable agreements under the authority of the Economy Act. We identified approximately 12,000 active reimbursable agreements with external entities, totaling approximately $1.3 billion.

We attempted to identify and quantify the benefits related to the Department's two major fee-for-service organizations, NBC and GovWorks. Managers of these organizations claimed monetary and nonmonetary benefits that include:

- Use of approximately $22 million in GovWorks retained income to fund Departmental initiatives.

- Reduction in the Department's administrative costs due to lower indirect costs and achievement of economies of scale.

- Development of procurement expertise to assist the Department in its procurements.

Except for the $22 million transferred from GovWorks to the Department to fund Department initiatives, management was unable to provide documentation to allow us to quantify and substantiate the monetary benefits associated with these fee-for-service organizations. Further, we could not determine that the nonmonetary benefits cited by management significantly affected the Department's operations.

Recent audits at the Department and other federal agencies have highlighted concerns with interagency procurement services. Specifically, DOI and other organizations providing these services have failed to follow procurement laws and regulations; which resulted in significant consequences for both the providers and recipients of those services. This problem came to light for DOI when it was discovered in FY2004 that NBC had inappropriately acquired interrogation services for the Department of Defense (DOD) using an information technology contract. Without the checks and balances provided by effective internal controls, the "risk taking" and "out-of-box" thinking advertised by NBC and encouraged by fee-for-service organizations could result in risks that may outweigh any benefits derived from these activities.

In the absence of significant, quantifiable benefits, it is questionable whether the overall benefits of these activities outweigh the risks brought to management's attention in the past as a result of previous and ongoing audits.

FEE-FOR-SERVICE ORGANIZATIONS

- **NBC** operates under DOI's working capital fund and provides a variety of administrative services under 11 major business lines. Because NBC performs services under the working capital fund authority and the Economy Act, it cannot earn income for the Department; it can only recover its costs for providing services. In FY2005, NBC reported $1.3 billion in fee-for-service operations, of which approximately $1 billion (77 percent) represented services to external agencies.

NBC'S MAJOR BUSINESS LINES

1. Financial and Business Management Systems and Services
2. Human Resource Systems and Services
3. Employee Services
4. Training Management Systems and Services
5. IT Systems Support and Services
6. Appraisal Services
7. Aviation Services
8. Acquisition Services
9. Property and Asset Management Services
10. Facilities Management Services
11. Business Services

- **GovWorks** is the only entity operating under the Interior Franchise Fund. It is an interagency acquisition center that provides procurement services to the Department and other federal agencies, including DOD and the Department of Homeland Security. As part of the Interior Franchise Fund, GovWorks is able to retain up to 4 percent of its total annual income each year to be used for acquisition of capital equipment and improvement and implementation of Departmental support systems. GovWorks states that it awarded approximately $1.4 billion in contracts in FY2005. Approximately $1.3 billion (93 percent) of these contracts were for other federal agencies.

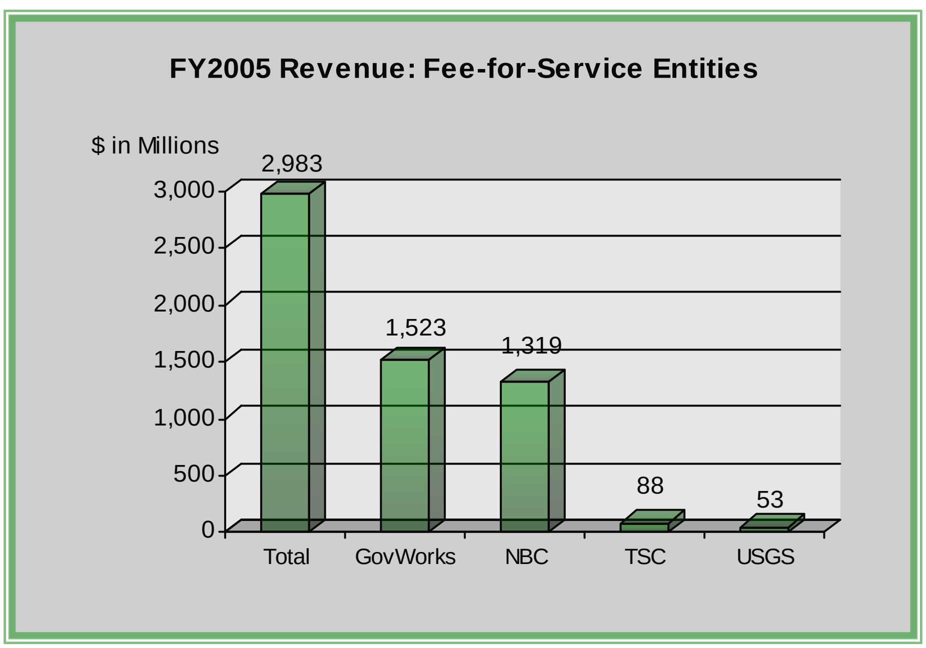
- **TSC** is a fee-for-service organization that operates under BOR's working capital fund on a cost reimbursement basis. TSC provides a variety of services in the areas of civil engineering, environmental resources, geotechnical services, infrastructure services, water resources, and client and technical support. In FY2005, TSC provided fee-for-service operations totaling $87.6 million, of which approximately $79.7 million (91 percent) represented services to the Department.

- **USGS** identified six fee-for-service activities that operated under its working capital fund in FY2005. These services are provided on a cost reimbursement basis. In FY2005, USGS provided fee-for-service operations totaling $52.5 million, of which $52 million (98.7 percent) represented services to the Department.

USGS' FEE-FOR-SERVICE ACTIVITIES

1. The National Water Quality Laboratory
2. The Hydrologic Instrumentation Facility
3. The Bureau of Laboratories
4. National Training Center
5. General Services Administration (GSA) Building Fund Delegation
6. Central and Western Bureau Drilling Units

The following chart depicts the total revenue for the four identified fee-for-service entities in the Department. Because NBC's and GovWorks' fee-for-service operations accounted for 99 percent of the Department's fee-for-service revenue in FY2005, we limited our identification of benefits to these two organizations.



BENEFITS

We requested that NBC and GovWorks provide us a list of the benefits of their fee-for-service activities. We also requested that they provide documentation to quantify and substantiate those benefits. In many cases, NBC and GovWorks identified benefits but were unable to quantify and substantiate the monetary values associated with those benefits. Below is our discussion of the benefits identified by management.

National Business Center

NBC performs services under authority of the Department's working capital fund and the Economy Act and cannot earn income for the Department; it can only recover its costs for providing services. NBC reported that its primary benefit to the Department is its ability to lower the cost of services provided. NBC claims that it lowers costs by reducing indirect costs associated with administrative services and by achieving economies of scale. Further, NBC stated that external customers have paid to implement new systems.

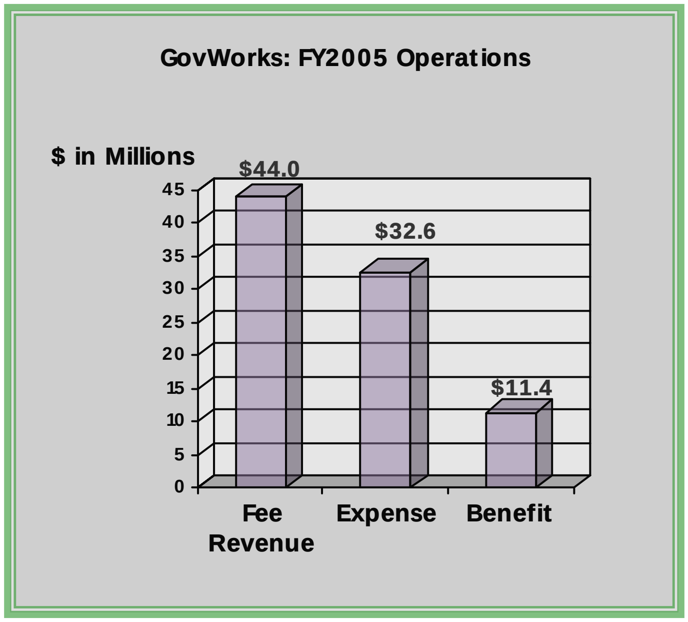
- ***Reduction in Indirect Costs:*** NBC managers stated that NBC provides direct savings to the Department by having other customers share indirect costs. NBC cited the E-Payroll Initiative as an example and estimated savings of approximately $1.2 million for DOI on the cost to provide payroll services for FY2006. While we agree that spreading indirect costs over a wider customer base may reduce the overall cost to the Department, NBC did not provide us with documentation supporting the estimated $1.2 million reduction in cost. We were unable to substantiate any other specific savings for payroll or any other of its business lines.

- ***Economies of Scale:*** NBC managers stated that servicing external clients also allows NBC to achieve economies of scale. For example, hosting multiple agencies results in reduction of mainframe computer costs. Again, NBC did not provide us documentation to substantiate this claim.

- ***Systems Implemented:*** NBC managers stated that external customers paid to implement the new E-Travel System in the Federal Financial System and to enhance the DOI procurement system. However, DOI chose not to implement these systems because DOI's new FBMS (Financial Business Management System) will provide these services. Although DOI may choose to use the E-Travel System or the procurement system enhancements in the future, it has not and does not currently receive any benefit from these systems.

GovWorks

- ***Retained Annual Income*:** The primary benefit that we identified is GovWorks ability to retain up to 4 percent of its annual income to fund Departmental initiatives. Each of the past 2 years, GovWorks made $11 million available to the Department from the income generated in those years. For example, in FY2005 GovWorks had approximately $44 million in service charge revenue and approximately $32.6 million in operating expenses. The $11.4 million net income represents a 35 percent "profit margin" for FY2005. DOI used the combined total of $22 million provided to the Department in FYs 2004-2005 to help fund the procurement of the FBMS and the Enterprise Services Network.



We interviewed officials at other departments with franchise funds to determine if they had made retained funds available for use by their host departments. Several officials told us that their agencies retain excess funds at the franchise fund level and use them only to improve the fund's systems and services. None of the officials stated that funds were retained and made available to their host departments. The following table describes how the other five franchise funds use retained funds:

Department	Description of the Use of Retained Funds
Commerce	Maintains its retained funds within the Office of Computer Services franchise fund and uses these funds for business operation and modernization.
Veterans Affairs	Uses its retained funds (or net position) as the operating reserves for its franchise fund. Veterans Affairs uses its retained funds to maintain its business lines without having to request advances from its customers.
Health and Human Services	Retains no annual income in its franchise fund. Health and Human Services does not have explicit authorization to retain annual income.
Environmental Protection Agency	Uses retained funds to purchase software licenses and to offset deficits from previous years.
Treasury	Retains funds to develop a reasonable operating reserve and improve the Fund's systems and services. The Department of Treasury's FY2004 Franchise Fund Accountability and Annual Report states "the operating reserve is critical to the health of the Fund enabling it to (i) weather downturns in business brought about by unforeseen circumstances, (ii) pay for system and process enhancements, and (iii) maintain an adequate cash flow."

- ***Professional Expertise with Acquisition Management*:** GovWorks officials stated that the Department benefits by having the professional expertise of its acquisition staff readily available. GovWorks claims that its acquisition staff gains experience servicing external agencies and then applies that expertise to Department acquisitions.

  We found that only a small portion of GovWorks' acquisition services are devoted to the Department. In FY2005, DOI contract awards represented only 7 percent of GovWorks total contract activity. Although the Department's portion of GovWorks operations is small, GovWorks officials have stated that they are the only acquisition activity within DOI with the resources and experience necessary to lead certain procurement efforts, for example, obtaining mission critical systems, such as FBMS. GovWorks stated that USGS commended its professionalism and leadership efforts in launching that organization's Geo-Spatial One-Stop project.

  We were unable to quantify or substantiate the extent of this benefit and whether or not the Department would have been able to acquire this expertise in the absence of GovWorks.

- ***Electronic Tracking Systems*:** GovWorks developed and paid for two electronic tracking systems. These included the Business Information Systems (BIS), a financial management tracking tool, and GovPay, an electronic invoicing system. According to GovWorks, all of its customers, including Department customers, benefit from the increased efficiency of these systems. For example, BIS allows the client to directly access all financial and project tracking information on a real-time basis. Likewise, GovPay allows all GovWorks customers to track the processing of its invoices electronically. Prior to the implementation of these systems, GovWorks and its clients spent countless hours trying to manually track financial and invoicing actions. GovWorks and the Department claim that FBMS, once fully implemented, will incorporate BIS and GovPay applications, which will also benefit the Department.

POTENTIAL BENEFITS

The Department is considering whether to move NBC's entire operation into the Interior Franchise Fund at a future date. If all NBC products and services were included under the Interior Franchise Fund, the Department could retain up to 4 percent of NBC's annual income generated from services provided to external agencies. NBC claimed that the benefits to the Department and NBC could be significant, based on DOI's current experience with GovWorks. For example, GovWorks has contributed $22 million to the FBMS and Enterprise Services Network projects from retained earnings that would otherwise have to have been funded by DOI bureaus or additional Congressional appropriations.

Currently, NBC bases its rates on recovering its costs. To generate the additional funds that would allow it to retain income for the Department's benefit, we believe that NBC would have to raise its rates. Such an increase could actually result in fewer customers and a reduction in expected benefit.

RISKS ASSOCIATED WITH FEE-FOR-SERVICE ORGANIZATIONS

Recent audits at the Department and other federal agencies have highlighted concerns with interagency procurement services. Specifically, DOI and other organizations that provided these services failed to follow procurement laws and regulations. In such cases, both the providers and recipients of those services suffered significant consequences.

In their desire to attract customers in a competitive environment, fee-for-service providers sometimes operate without effective internal controls. Without effective internal controls, the risks associated with these activities may far outweigh any benefits derived. Below we reiterate some of the risks that were previously brought to management's attention as a result of recent and ongoing audits.

DOI Violated Procurement Regulations for DOD Contracts

Problems related to DOI-provided acquisition services to DOD came to light in FY2004. It was disclosed by the General Services Administration (GSA) that NBC had inappropriately acquired interrogation services for DOD using an information technology contract. Subsequently, we conducted an audit of 12 procurements made by DOI for DOD valued at $81.1 million. Our July 2004 audit report "Review of 12 Procurements Placed Under General Services Administration Federal Supply Schedules 70 and 871 by the National Business Center" (Report No. W-EV-OSS-0075-2004) stated that NBC's contracting personnel had not followed regulations in procuring interrogation and other services for DOD. We found that 11 procurements were made outside the scope of work for the GSA schedules used. Several factors contributed to this issue:

- Lack of an effective system of policies, procedures, and process controls to ensure an equitable and competitive contracting environment that complies with acquisition laws and regulations and protects the public interest and resources.

- Lack of monitoring and oversight by NBC management.

- Lack of compliance with procurement regulations caused by the inherent conflict in a fee-for-service organization when procurement personnel in their eagerness to enhance organization revenues have found shortcuts to federal procurement procedures and procured services for clients whose own agencies might not have done so.

These findings were also identified by the Government Accountability Office (GAO) in its April 2005 report “Interagency Contracting: Problems with DOD’s and Interior’s Orders to Support Military Operations” (Report No. GAO-05-201).

In 2005, we and the DOD Office of Inspector General (DOD-OIG) began a statutorily mandated audit of DOD procurements performed by DOI’s fee-for-service organizations. In a February 2006 briefing to DOI management, the audit team expressed the following concerns about additional violations of procurement regulations:

NBC may have:

- Allowed program personnel to play an inappropriate role in the procurement process.
- Failed to follow Departmental policy before awarding sole-source contracts.
- Had ineffective control due to its local management philosophy and operating style, poor operating procedures, weak organizational structure, and lack of DOI oversight.

GovWorks may have:

- Used expired funds for contract actions.
- Inappropriately retained expired funds or funds for which a need no longer existed.
- Used funds for other than intended purposes.

In short, DOI-awarded contracts may not have been issued in accordance with federal regulations or in the best interest of the U.S. Government. These actions left DOI and DOD vulnerable to increased risk that fraud, waste, or abuse could occur and not be detected. These issues may also result in a disclaimer or qualified opinion for DOI’s FY2006 financial statements and a material restatement of DOI’s FY2005 financial statements. There is also a risk that the Department may have violated and may still be violating the Anti-Deficiency Act.

Similar Issues Found with General Services Administration’s Procurement Services

DOD-OIG’s July 2005 report “Acquisition: DOD purchases made through the General Services Administration” identified similar problems with GSA’s management of procurements. The report stated that:

- Expiring funds were being “parked” or “banked” at GSA for future purchases because the GSA fund was a no-year fund. This practice may have resulted in Anti-Deficiency Act violations.

- Purchases lacked acquisition planning to ensure that contracting through GSA was the best option for the U.S. Government.

- Inadequate interagency agreements outlining terms and conditions of purchase existed.

GSA's response to these problems may highlight practices that DOI should consider. GSA's Chief Financial Officer (CFO) told us that GSA had to take significant steps to change the culture within the organization to address these issues. GSA launched its "Get It Right" campaign to promote adherence to the procurement laws and regulations. To ensure success of its campaign, senior leadership met on a weekly basis to monitor progress.

The CFO told us that GSA's challenge is to get the message out to its employees that its "business is acquisitions" and it provides best value to its customers when it awards and manages contracts in accordance with laws and regulations. However, the CFO acknowledged that GSA will have difficulties with some customers who may not agree and still insist that GSA take shortcuts in the process. In fact, tightening its procedures and closely adhering to the procurement regulations have been contributory factors in GSA's decrease in business over the last year, according to the CFO.

GSA has seen a significant downturn in revenues over the past year as its customer base has decreased. Projected revenues for FY2006 are over $1 billion less than revenues generated for FY2005. This reduction has led to the need to reduce staffing, and GSA recently announced plans to offer cash buyouts and early retirement packages to over 400 employees. Other factors are also contributing to this decline. For example, GSA has identified that some of its customers are turning toward in-house procurement organizations rather than using GSA. Also, some business is being drawn away by increased competition with other providers such as GovWorks.

Increased Scrutiny on Interagency Procurement

Recently, there has been increased scrutiny of interagency service arrangements. For example:

- In November 2005, the Office of Management and Budget's (OMB) Office of Federal Procurement Policy announced an initiative on interagency contracting.
- In the Defense Authorization Act for FY2006, Congress imposed additional requirements on DOD to increase management controls over interagency contracting.
- The Acquisition Advisory Panel, established under the Services Acquisition Reform Act, concluded that OMB should review and refine governance processes to ensure overall effectiveness of interagency contracting.
- In FY2005, GAO made interagency contracting a high risk area.

In February 2006, OMB sent out a data call to all federal Chief Acquisition Officers to identify the scope of interagency contracting within the U.S. Government. In this memorandum, the Associate Administrator for OMB 's Office of Federal Procurement Policy stated, "Interagency contracting requires increased management attention to achieve the greatest value possible through these transactions." If DOI plans to continue its fee-for-service operations supporting other agencies, then it will need to increase senior management attention over how it delivers those services.

CONCLUSION

We have discussed the benefits and reiterated the risks involved in operating fee-for-service organizations. We hope the Department will use this information to evaluate the relative benefits and risks of having fee-for-service organizations. As part of such an evaluation, the Department should consider:

- Whether NBC and GovWorks are able to quantify and substantiate their claimed benefits.
- Whether the risks incurred for these activities are worth their potential benefits.
- What improvements in internal controls are required and what additional costs would be incurred.
- Whether the customer base is likely to decrease as the Department tightens controls and complies with procurement regulations.

Since this report does not contain any recommendations, a response is not required. However, we would appreciate being kept apprised of your evaluation and conclusions concerning fee-for-service organizations. Section 5(a) of the Inspector General Act (5 U.S.C. § App. 1) requires us to list this report in our semiannual report to Congress.

If you have any questions or comments regarding this report, please call me at 202-208-4252.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to identify the fee-for-service organizations within the Department that provide services to other federal agencies and to identify the benefits associated with those activities. For purposes of this evaluation, we defined fee-for-service activities as self-sustaining, businesslike funds, including working capital funds and the Interior Franchise Fund, where the bureau or office is authorized to recover fees for services provided to others. To accomplish our objectives, we requested the bureaus to provide us with revenues and expenditures for their fee-for-service operations. In addition, we requested bureaus to provide us with revenues and expenditures of reimbursable agreements with external organizations (entities outside of the Department). We did not include reimbursable agreements in our report because the services provided did not meet our definition of fee-for-service activities. Further, we narrowed our evaluation to only include the benefits related to NBC and GovWorks because these are the Department's principal self-sustaining, businesslike fee-for-service organizations.

We requested NBC and GovWorks to identify the benefits that DOI receives from its fee-for-service operations. We interviewed Department officials, as appropriate, and obtained available records supporting claimed benefits. We also interviewed officials and reviewed prior reports of the other five pilot franchise funds and obtained information on the services provided by their operations and revenues and expenditures of the funds for FY2005. Fieldwork for our evaluation was performed from July 22, 2005, to February 27, 2006.

Our evaluation was conducted in accordance with the January 2005, *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

FRANCHISE FUND ORGANIZATIONS BY DEPARTMENT FISCAL YEAR 2005

Department	Total Revenue	Funds Retained	Major Business Line	Major Customer
DOI	$1,523,000,000	$11,400,000	Acquisition Services	DOD
Commerce	$6,797,000	$178,000	Computer Services	Department of Homeland Security (DHS)
Veterans Affairs	$251,000,000	$4,128,000	Information Technology	Immigration Health Service, HHS
Health and Human Services (HHS)	$502,000,000	($16,000,000)	Federal Occupation Health	HHS components and many federal agencies and independent federal entities.
Environmental Protection Agency	$18,000,000	Unavailable in FY 2005	Data Processing	DHS
Treasury	$780,000,000	$12,000,000	Consolidated/ Integrated Admin. Management	DOD

Report Fraud, Waste, Abuse, and Mismanagement

Fraud, waste, and abuse in government concerns everyone: Office of Inspector General staff, Departmental employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and abuse related to Departmental or Insular Area programs and operations. You can report allegations to us in several ways.

By Mail:

U.S. Department of the Interior
Office of Inspector General
Mail Stop 5341 MIB
1849 C Street, NW
Washington, D.C. 20240

By Phone

24-Hour Toll Free	800-424-5081
Washington Metro Area	202-208-5300

By Fax

202-208-6081

By Internet

www.oig.doi.gov/hotline