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

REORGANIZATION OF THE WORKING CAPITAL FUND AND THE INTERIOR FRANCHISE FUND

ER-EV-PMB-0001-2009

June 2009

United States Department of the Interior
OFFICE OF INSPECTOR GENERAL
Washington, DC 20240

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Memorandum

To: Pamela K. Haze
Acting Assistant Secretary for Policy, Management and Budget

From: Mary L. Kendall
Acting Inspector General

Subject: Reorganization of the Working Capital Fund and the Interior Franchise Fund (Assignment No. ER-EV-PMB-0001-2009)

This memorandum transmits our report detailing the results of our evaluation of the Department of the Interior (DOI or Department) plan to expand the Interior Franchise Fund (IFF). DOI plans to move all National Business Center (NBC) services and associated revenue from the Working Capital Fund (WCF) to the IFF. We performed this evaluation to determine the legality of transferring all NBC services to the IFF and, if found to be legal, whether policies and procedures are in place that would ensure adequate accountability of the funds. We consider a review at this time to be prudent since previous Office of Inspector General (OIG) reviews have revealed problems with both the WCF and the IFF.

We found that DOI has the authority to transfer only those lines of business that customer agencies and offices can choose to use (non-mandatory) (see Public Law 104-208, div. A, tit. I, § 113, 110 Stat. 3009-181, 3009-200 (1996) (Interior Appropriations Act). Transferring mandatory services, such as payroll processing for DOI employees, would violate the Interior Appropriations Act's requirement that all IFF services be offered on a competitive basis. Further, we found that NBC has not established the operating and capital improvements reserves (reserve funds) in a manner appropriate under the Act. Specifically, NBC has failed to identify and document needed operating reserves. Until reserves are properly managed, we cannot recommend the transfer of any services to the IFF.

This report contains five recommendations. Our first two recommendations address issues that should be resolved before the transfer of any of the NBC lines of business from the WCF to the IFF. The final three recommendations should help NBC manage the IFF more effectively and address the issues raised in this report. Please let us know what actions the Department will take so we may track the status of their implementation. Please have a written response forwarded to this office within 30 days that identifies plans to address the findings and recommendations cited in this report.

Should you have any questions, please do not hesitate to contact me at 202–208–5745.

Why We Performed This Evaluation

We performed this evaluation to determine whether the Department's intent to reorganize the WCF and IFF is legally permissible and, if it is, whether existing policies and procedures would ensure adequate accountability under the proposed organizational structure. To do so, we evaluated the current organization of the WCF and IFF and their proposed reorganization. Our review also covered documentation of procedures and the status of past findings. See Appendix A for scope, methodology, and related reports.

Background on the Reorganization Plan

NBC provides a variety of administrative and financial services to DOI bureaus and offices and other federal agencies through two separate funds, the WCF and the IFF. The Department plans to transfer all NBC services, and related assets and liabilities, from the WCF to the IFF. DOI managers anticipate this reorganization would 1) increase retained reserves to fund additional Department-wide initiatives, 2) provide consistent financial and business management practices and oversight to ensure adequate accountability and reporting, and 3) maintain continued economies of scale for centralized services.

What We Learned

We found that the Interior Appropriations Act precludes the transfer of mandatory NBC services from the WCF to the IFF. Further, NBC has improperly managed the IFF by failing to establish an operating reserve separate from the capital improvements reserve. Specifically, NBC managers have not:

- ensured that IFF operations comply with internal policy of September 2, 2008, which requires separate reserves for day-to-day operations and a reserve for capital investments or

- documented reserve limit calculations, reviews, or approvals.

Working Capital Fund

The WCF finances activities on a ***reimbursable basis***, including centralized services provided by the Office of the Secretary and, currently, all NBC lines of business except acquisition and federal consulting services. WCF charges fees to offset operational expenses and recover costs, including two reserve accounts.

Interior Franchise Fund

DOI and other federal agencies use the IFF to obtain services on a ***competitive basis***, such as administrative and information technology support. Managers should charge fees that recover full operational expenses plus an amount necessary to maintain a reasonable operating reserve. In addition, the IFF is authorized to retain up to 4 percent of its total annual income in a capital improvements reserve.

Transfer of Mandatory Services Would Violate the Interior Appropriations Act

A legal obligation to provide services competitively is a central feature of any franchise fund. The competitive nature of such funds encourages the Government to operate in a more efficient, business-like manner. The Act expressly includes this criterion, requiring the IFF to offer services only on a "competitive basis."

Mandatory services for Department Offices and Bureaus are centrally billed through the WCF and include financial management, payroll processing, training, aviation, facilities and asset management and information technology services.

Data Source:
DOI FY 2009 Budget Justification

To promote a competitive environment and add further clarity to franchise fund requirements, the Office of Management and Budget and the Chief Financial Officers Council established 12 business operating principles at the request of the Congress (see Appendix B). The Government Accountability Office (GAO) described these principles as "criteria for operation" for franchise funds. Competition and voluntary exit are two of the principles. ***Competition*** is "the provision of services . . . on a fully competitive basis. The organization's operation should not be 'sheltered' or be a monopoly." ***Voluntary Exit*** means "customers should be able to 'exit' and go elsewhere for services after appropriate notification to the service provider and be permitted to choose other providers to obtain needed service." These two principles are consistent with the ordinary meaning of competition, which again, is specifically required by the Act.

Implementation of the DOI plan to transfer all NBC services from the WCF to the IFF would violate the Interior Appropriations Act requirement that all IFF services be offered on a competitive basis because some of the services are mandatory for customer agencies and offices. It would also violate two franchise fund business operating principles. Therefore, NBC mandatory services must remain in the WCF where no competition requirement exists.

NBC Managers Have Not Properly Managed Reserve Funds

The Act authorizes the Secretary to set a fee at a rate that returns in full all operating expenses, provides a reasonable operating reserve, and allows for a separate Department-wide capital improvements reserve that is limited to 4 percent of the total annual IFF income. The NBC September 2008 policy mirrors the Act. It establishes an operating reserve and limits the capital improvements reserve to 4 percent, although it fails to provide specific measures to monitor the amount of the capital improvements reserve. We found, however, that NBC managers do not distinguish between operating reserves and capital improvements even though their own policy requires the distinction. For example, all retained earnings are maintained in one reserve. This reserve is used for operating expenses, as well as Department-wide initiatives. Further, NBC managers do not document reserve limit calculations, reviews, or approvals. They may not be, therefore, in compliance with the Act.

Operating Reserves Versus Capital Improvements

The Interior Appropriations Act authorizes the Department to establish a reasonable IFF operating reserve separate from a capital improvements reserve. One way the Act differentiates between operating reserves and capital improvements is by the limits it establishes. An operating reserve must be "reasonable," while capital improvements reserves are limited to 4 percent of total IFF annual income.

Further, the September 2008 NBC policy states that the operating expenses and reserves take precedence over capital improvements. Fees charged to customers are to be used for operating expenses and a reasonable operating reserve. Only after these requirements are met should the IFF accumulate excess funds for capital improvements.

The IFF does not maintain separate operating and capital improvements reserves. Their failure to do so undermines the intent of the Act. NBC officials stated that the IFF uses only one reserve that is limited to 4 percent of total IFF annual income. If this reserve is bound by the 4 percent rule, NBC is treating it as a capital improvements reserve. Without a separate operating reserve, NBC cannot make good management decisions on behalf of the IFF. Further, it is impossible to know if the fees charged to customers are appropriate and sufficient. NBC managers, therefore, are not administering the IFF properly.

DOI Appropriations Act, 1997 establishing IFF

Such funds shall be paid . . . at rates which will return in full all expenses of operation, including accrued leave, depreciation of fund plant and equipment, amortization of automatic data processing (ADP) software and systems and an amount necessary to maintain a reasonable operating reserve . . . Provided further, That an amount not to exceed four percent of the total annual income to such fund may be retained in the fund . . . to be used for the acquisition of capital equipment, and for the improvement of Department financial management, ADP, and other support systems.

Documentation of Reserve Limit Calculations

During the audit of the fiscal year (FY) 2008 Departmental Offices' financial statements, DOI's independent auditors found more than 40 problems related to the operation of NBC and the IFF. All but one of these findings relate to IT security.

However, the one non-IT security finding, "Lack of documentation of review and approval of retained revenue," raises concerns regarding reserve accountability because expanding the services of the IFF would magnify the problem. NBC managers calculate the amount of income that the IFF can retain every year and compare the calculation to the amount kept in equity to ensure that the fund does not retain revenue in excess of 4 percent. However, NBC managers did not require documentation or review of the FY 2008 calculation and comparison. Without proper documentation, NBC cannot establish that the calculation was ever done, let alone ensure compliance with the Act. NBC disagreed with the finding and stated in response, "[t]he additional management controls would increase our costs and demonstrate limited return on investment." Such a reply suggests an emphasis on revenue to the detriment of reserve accountability.

CONCLUSION

The Interior Appropriations Act precludes the transfer of mandatory lines of business from the WCF to the IFF. In addition, IFF reserves have been and are being improperly managed.

RECOMMENDATIONS

By implementing the following recommendations, we believe DOI can address the problems identified in this report.

1. Identify the NBC mandatory service, or non-competitive, lines of business and ensure these lines of business remain in the WCF.

2. Delay the transfer of any of the NBC lines of business from the WCF to the IFF pending the implementation of an operating reserve and appropriate management controls over both reserve accounts.

3. Establish clearly defined "reasonable" limits for the IFF operating reserve.

4. Create an IFF operating reserve that reflects these "reasonable" limits.

5. Require process documentation for calculating reserve amounts to ensure revenue does not exceed the established limits for the operating and capital improvements reserves.

Appendix A — Scope, Methodology, and Select Reports on Revolving Fund Issues

Scope and Methodology

We performed our evaluation in accordance with the President's Council on Integrity and Efficiency "Quality Standards for Inspections." The evaluation focused on the current and proposed organizational structures of the WCF and the IFF; we reviewed the status of past findings and documentation of procedures. We believe that the work performed provides a reasonable basis for our conclusions and recommendations.

As part of our evaluation, we:

- obtained a general understanding of the WCF and IFF authorities, policies, and procedures;
- reviewed the FY 2009 Budget Justification;
- reviewed prior reports issued by DOI OIG and GAO;
- interviewed Department personnel; and
- reviewed accounting and financial information.

Select Reports

June 2008 — "Management Letter Concerning Issues Identified During the Audit of the Departmental Offices Financial Statements for Fiscal Years 2007 and 2006" (X-IN-OSS-0007-2008)

February 2008 — "Audit of FY2006 and FY2007 Department of Defense Purchases Made Through the Department of the Interior" (Y-IN-MOA-0001-2007)

March 2006 — "Fee-for-Service Organizations, Department of the Interior" (C-EV-MOA-0016-2005)

January 2005 — "High-Risk Series: An Update" (GAO-05-207)

APPENDIX B — 12 BUSINESS OPERATING PRINCIPLES

Operating Principle	OMB Description
Services	The enterprise should only provide common administrative support services.
Organization	The organization would have a clearly defined organizational structure including readily identifiable delineation of responsibilities and functions and separately identifiable units for the purpose of accumulating and reporting revenues and costs. The funds of the organization must be separate and identifiable and not commingled with another organization.
Competition	The provision of services should be on a fully competitive basis. The organization's operation should not be "sheltered" or be a monopoly.
Self-sustaining/ Full Cost Recovery	The operation should be self-sustaining. Fees will be established to recover the "full costs," as defined by standards issued in accordance with FASAB (the Federal Accounting Standards Advisory Board).
Performance Measures	The organization must have a comprehensive set of performance measures to assess each service that is being offered.
Benchmarks	Cost and performance benchmarks against other "competitors" are maintained and evaluated.
Adjustments to Business Dynamics	The ability to adjust capacity and resources up or down as business rises or falls, or as other conditions dictate, if necessary.
Surge Capacity	Resources to provide for "surge" capacity and peak business periods, capital investments, and new starts should be available.
Cessation of Activity	The organization should specify that prior to curtailing or eliminating a service, the provider will give notice within a reasonable and mutually agreed time frame so the customer may obtain services elsewhere. Notice will also be given within a reasonable and mutually agreeable timeframe to the provider when the customer elects to obtain services elsewhere.
Voluntary Exit	Customers should be able to "exit" and go elsewhere for services after appropriate notification to the service provider and be permitted to choose other providers to obtain needed service.
FTE Accountability	Full Time Equivalents (FTEs) would be accounted for in a manner consistent with the Federal Workforce Restructuring Act and OMB requirements, such as Circular A-11.
Initial Capitalization	Capitalization of franchises, administrative service, or other cross-servicing operations should include the appropriate FTE commensurate with the level of effort the operation has committed to perform.

Source: OMB and Chief Financial Officers Council

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